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FEDERAL REINSURANCE OF PRIVATE PENSION PLANS

1778-5

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-NINTH CONGRESS

SECOND SESSION

ON

S. 1575

A BILL TO ESTABLISH A SELF-SUPPORTING FEDERAL REINSURANCE PROGRAM TO PROTECT EMPLOYEES IN THE ENJOYMENT OF CERTAIN RIGHTS UNDER PRIVATE PENSION PLANS

AUGUST 15, 1966

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FEDERAL REINSURANCE OF PRIVATE PENSION PLANS

MONDAY, AUGUST 15, 1966

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:10 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Smathers, Anderson, Gore, McCarthy, Hartke, Williams, Carlson, and Curtis.

The CHAIRMAN. Today's hearing was called to receive testimony on S. 1575.

(The bill, S. 1575, follows:)

[S. 1575, 89th Cong., 1st sess.]

A BILL To establish a self-supporting Federal reinsurance program to protect employees in the enjoyment of certain rights under private pension plans

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Federal Reinsurance of Private Pension Plans Act".

DEFINITIONS

SEC. 2. As used in this Act—

(a) The term "pension fund" means a trust, pension plan, or other program under which an employer undertakes to provide, or assist in providing, retirement benefits for the exclusive benefit of his employees or their beneficiaries. Such term does not include any plan or program established by a self-employed individual for his own benefit or for the benefit of his survivors or established by one or more owner-employees exclusively for his or their benefit, or for the benefit of his or their survivors.

(b) The term "eligible pension fund" means a pension fund which meets the requirements set forth in section 401 of the Internal Revenue Code of 1954 with respect to qualified pension plans.

(c) (1) The term "insured pension fund" means an eligible pension fund which has been in operation for not less than three years and, for each of such years, has met the requirements set forth in subsection (b) and has been insured under the program established under this Act.

(2) Any addition to, or amendment of, an insured pension fund shall, if such addition or amendment involves a siginficant increase (as determined by the Secretary) in the unfunded liability of such pension fund, be regarded as a new and distinct pension fund which can become an "insured pension fund" only upon compliance with the provisions of paragraph (1) of this subsection.

ESTABLISHMENT OF INSURANCE PROGRAM

SEC. 3. There is hereby established in the Department of Health, Education, and Welfare a program to be known as the Federal insurance program for private

pension plans (hereinafter referred to as the "program"). The program shall be administered by, or under the direction and control of, the Secretary.

CONTINGENCIES INSURED AGAINST UNDER PROGRAM

SEC. 4. (a) The program shall insure (to the extent provided in subsection (b)) beneficiaries of an insured pension fund against loss of benefits to which they are entitled under such pension fund arising from—

(1) failure of the amounts contributed to such fund to provide benefits anticipated at the time such fund was established, if such failure is attributable to cessation of one or more of the operations carried on by him in one or more facilities of such employer; or

(2) losses realized upon the sale of investments of such fund if the sale is required to provide benefits payable by such fund.

(b) The rights of beneficiaries of an insured pension fund shall only be insured under the program to the extent that such rights do not exceed—

(1) in the case of a right to a monthly retirement or disability benefit for the employee himself, the lesser of 50 per centum of his average monthly wage in the five-year period for which his earnings were the greatest, or $500 per month;

(2) in the case of a right on the part of one or more dependents, or members of the family, of the employee, or in the case of a right to a lump-sum survivor benefit on account of the death of an employee, an amount found by the Secretary to be reasonably related to the amount determined under subparagraph (1).

In the case of a periodic benefit which is paid on other than a monthly basis, the monthly equivalent of such benefit shall be regarded as the amount of the monthly benefit for purposes of clauses (1) and (2) of the preceding sentence.

(c) If an eligible pension fund has not been insured under the program for each of at least the three years preceding the time when there occurs the contingency insured against, the rights of beneficiaries shall not be insured and in lieu thereof the contributions made on behalf of such pension fund during such period shall be returned to the pension fund.

PREMIUM FOR PARTICIPATION IN PROGRAM

SEC. 5. (a) Each eligible pension fund may, upon application therefor, obtain insurance under the program upon payment of such annual premium as may be established by the Secretary. The Secretary shall establish separate premium rates for insurance against each of the contingencies described in section 4(a)(1) and section 4(a)(2). In establishing such premium rates for insurance against the contingency described in section 4(a)(2), the Secretary shall provide that the rate shall vary, to whatever extent is appropriate, for different classes of investments. Premium rates established under this section shall be uniform for all pension funds insured by the program and shall be applied to the amount of the unfunded obligations and assets or class of assets, respectively, of each insured pension fund. The premium rates may be changed from year to year by the Secretary, when the Secretary determines changes to be necessary or desirable to give effect to the purposes of this Act; but in no event shall the premium rate established for the contingency described in section 4(a)(1) exceed 1 per centum for each dollar of unfunded obligations, nor shall the aggregate premium payable by any insured pension fund for the contingency described in section 4(a)(2) exceed one-quarter of 1 per centum of the assets of such fund.

(b) The Secretary, in determining premium rates, and in establishing formulas for determining unfunded obligations and assets of pension funds, shall consult with, and be guided by the advice of, the Advisory Council (established by section 8).

(c) If the Secretary (after consulting with the Advisory Council) determines that, because of the limitation on rate of premium established under subsection (a) or for other reasons, it is not feasible to insure against loss of rights of all beneficiaries of insured pension funds, then the Secretary shall insure the rights of beneficiaries in accordance with the following order of priorities—

First: individuals who, at the time when there occurs the contingency insured against, are receiving benefits under the pension fund, and individuals who have attained normal retirement age or if no normal retirement age is fixed have reached the age when an unreduced old-age benefit is

payable under title II of the Social Security Act, as amended, and who are eligible, upon retirement, for retirement benefits under the pension fund;

Second: individuals who, at such time, have attained the age for early retirement and who are entitled, upon early retirement, to early retirement benefits under the pension fund; or, if the pension fund plan does not provide for early retirement, individuals who, at such time, have attained age sixty and who, under such pension fund, are eligible for benefits upon retirement;

Third: individuals who, at such time, have attained age forty-five;

Fourth: individuals who, at such time, have attained age forty; and

Fifth: in addition to individuals described in the above priorities, such other individuals as the Secretary, after consulting with the Advisory Council, shall prescribe.

(d) Participation in the program by a pension fund shall be terminated by the Secretary upon failure, after such reasonable period as the Secretary shall prescribe, of such pension fund to make payment of premiums due for participation in the program. Participation by any pension fund in the program may be terminated by such fund at any time by giving not less than sixty days' notice of termination to the Secretary.

REVOLVING FUND

SEC. 6. (a) In carrying out his duties under this Act, the Secretary shall establish a revolving fund into which all amounts paid into the program as premiums shall be deposited and from which all liabilities incurred under the program shall be paid.

(b) The Secretary is authorized to borrow from the Treasury such amounts as may be necessary, for deposit into the revolving fund, to meet the liabilities of the program. Moneys borrowed from the Treasury shall bear a rate of interest determined by the Secretary of the Treasury to be equal to the average rate on outstanding marketable obligations of the United States as of the period such moneys are borrowed. Such moneys shall be repaid by the Secretary from premiums paid into the revolving fund.

(c) Moneys in the revolving fund not required for current operations shall be invested in obligations of, or guaranteed as to principal and interest by, the United States.

AMENDMENT TO INTERNAL REVENUE CODE

SEC. 7. (a) Section 401(a) of the Internal Revenue Code of 1954 (relating to definition of qualified pension and other similar plans) is amended by adding at the end thereof the following new paragraph:

"(11) Notwithstanding the preceding provisions of this subsection, no pension fund which, for any taxable year is insurable under the Federal Reinsurance of Private Pension Plans Act, shall be a qualified pension plan under this section if such fund is not insured for such year under the program established under such Act."

(b) Section 404(a)(2) of such Code (relating to deductibility of contributions to employees' annuities) is amended by striking out "section 401(a) (9) and (10)" and inserting in lieu thereof "section 401(a) (9), (10), and (11)".

(c) The amendments made by this section shall be effective with respect to taxable years which begin not less than six months after the date of enactment of this Act.

ADVISORY COUNCIL

SEC. 8. (a) There is hereby created a Federal Advisory Council for Insurance of Employees' Pension Funds (hereinafter referred to as the "Advisory Council"), which shall consist of nine members, to be appointed by the President, by and with the advice and consent of the Senate. he President shall select, for appointment to the Council, individuals who are, by reason of training or experience, or both, familiar with and competent to deal with, problems involving employees' pension funds and problems relating to the insurance of such funds. Members of the Council shall be appointed for a term of two years.

(b) Members shall be compensated at the rate of $100 per day for each day they are engaged in the duties of the Advisory Council and shall be entitled to reimbursement for traveling expenses incurred in attendance at meetings of the Council. The Advisory Council shall meet at Washington, District of

Columbia, upon call of the Secretary who shall serve as Chairman of the Council. Meetings shall be called by such Chairman not less often than twice each year.

(c) It shall be the duty of the Advisory Council to consult with and advise the Secretary with respect to the administration of this Act.

(Departmental comments on S. 1575 follow:)

BUREAU OF THE BUDGET,
August 12, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, New Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request of March 29, 1965, for the views of the Bureau of the Budget on S. 1575, a bill "To establish a self-supporting Federal reinsurance program to protect employees in the enjoyment of certain rights under private pension plans."

The report of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs issued January 15, 1965, made it clear that the public interest in private pension plans is great because of their role in providing economic security to millions of Americans and because of their impact on labor mobility and manpower policy.

The President's Committee, which included representatives from the Bureau of the Budget, identified as in need of attention and improvement the areas of safeguarding and funding of benefits, vesting benefits, and transferring benefits. Among these areas the Committee discussed several possible types of insurance and specifically noted (pp. 57–58) the problems which arise when terminated pension plans leave workers unprotected.

S. 1575 would establish a system of insurance for pension plans as a condition for continued favorable tax treatment. The beneficiaries of a pension plan would be insured against loss of benefits caused by cessation of some of the operations of the employers, and losses incurred upon the sale of pension fund investments.

The annual premium rates for the above contingencies would be limited to maximums of 1% and ¼ of 1% respectively. If the premiums were inadequate to cover losses, then the benefits would be limited to various priority groups and the Secretary of Health, Education, and Welfare could also borrow from the Treasury to meet these liabilities.

The development of an insurance approach to pool risks among all pension plans would appear to merit exploration as part of the broader effort to strengthen the protection afforded by pensions. However, S. 1575 raises a number of problems or questions for which there do not appear to be available at present adequate answers or solutions. Among these are the following:

1. What risks are appropriate to cover through insurance and which ones are intended to be insured under the present bill? The bill conceivably would require the Government to pay losses incurred because of poor management, changes in corporate structure, etc.

2. Should not premiums be structured by different degrees of risk? The bill prevents adjusting the premium rate, except below 1%. Thus, the premium provisions do not provide an incentive for plan managers to correct situations which would result in defaults.

3. Would limiting the premium to only 1% lead companies with better funded plans to reduce their contributions to them and thus reduce the level of their funding? This could happen because the reinsurance at a low premium rate would remove the pressure to build up reserves against future liabilities in pension funds. Protected by reinsurance at a low rate, these funds might be invested in other ways.

4. What alternative solutions, such as standards for funding, for discharge of fiduciary obligations or for investment of funds might accomplish some of the same objectives?

5. Is it not unusual to design a reinsurance system and fund which apparently contemplates the failure to cover the system's liabilities? Might not the inclusion of borrowing authority from the Treasury lead to demands for outright subsidy of the pension plans?

Many of the problems in the private pension field, especially the question of insurance, are difficult of solution, because of the dearth of statistical information on pension programs. Nor are the data available to provide a basis for

setting premiums accurately. There are thus not available at this time the basic data necessary to properly evaluate reinsurance proposals. The executive branch is now working to fill some of these gaps.

The Bureau of the Budget believes that exploration of insurance protection for private pensions is desirable. However, for the reasons indicated above, we recommend that action on S. 1575 be deferred until the necessary information can be developed and evaluation of related alternatives completed.

Sincerely yours,

WILFRED H. ROMMEL,
Assistant Director for Legislative Reference.

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE,
August 17, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: This letter is in response to your request of April 12, 1966, for a report on S. 1575—"To establish a self-supporting Federal reinsurance program to protect employees in the enjoyment of certain rights under private pension plans."

Under this bill, in order to receive continued favorable tax treatment a qualified pension plan would be required to pay reinsurance premiums. The beneficiaries of such a pension plan would, after three years, be insured up to a specified limit against loss of pension benefits to which they are entitled, if such losses are attributable to insufficient plan resources resulting from either of the following two contingencies:

A. Cessation of one or more of the operations in one or more facilities of the employer.

B. Losses incurred upon the sale of pension fund investments if the sale is required to provide benefits payable.

Annual premium rates could not exceed one percent of an "insured pension fund's" unfunded obligations for contingency (A), and could not exceed one-fourth of one percent of a pension fund's assets for contingency (B). If the premiums are inadequate to pay all losses, then the insurance would be limited to beneficiaries in the upper priority groups established by the bill.

The reinsurance program would be administered by, or under the direction and control of, the Secretary of Health, Education, and Welfare. The Secretary, along with an Advisory Council (appointed by the President), would be specifically responsible for (1) establishing formulas for determining unfunded obligations and assets of private pension funds; (2) establishing separate premium rates for each contingency insured against; and (3) establishing a revolving fund into which all premium income will be paid and from which benefit disbursements will be made.

Notification of persons eligible for reinsurance benefits would presumably be accomplished through coordination of the program with social security records, although the bill is not explicit on this point.

While it is generally agreed that the intent of the proposed bill has considerable merit, a number of technical uncertainties concerning specific provisions of the bill remain unresolved. Moreover, in its present form the bill contains a number of shortcomings, especially with regard to controls, the calculation and assessment of premium rates, and the indefinite nature of the protection provided. Any workable insurance system must contain provisions that precisely define the risk or risks covered, the financing arrangements and their relationship to the protection provided, and the controls necessary to provide safeguards against imprudent operation and manipulation.

We would suggest that the following questions raised by the bill be given further study:

(1) *To what extent are the types of risks covered in the bill insurable?* With respect to contingency (A), since the operations of a business can cease for a variety of reasons, it may be desirable to differentiate among the causes of termination. For example, the risks covered by the bill, as now written, include events that may be subject to control by the employer, such as sales or mergers. The risk covered by contingency (B) involves a high degree of individual selection—that involved in choice of investments and timing of liquidation. Even if such

a risk is considered insurable, it is possible to provide such insurance without imposing investment and funding standards additional to those very limited standards now imposed? Further, what would be the effects of more stringent standards on the future development of private pension plans?

(2) *Is it feasible to calculate premiums under the formulas used in the bill?* With respect to contingency (A), the bill uses as a basis for calculating premiums the unfunded liability. Generally, the size of an unfunded liability can vary according to the actuarial funding formulas and the actuarial assumptions employed in calculating it. It is questionable whether the unfunded liability, by itself, is a reasonable and feasible basis for calculating premiums since there are many variables that influence the risk of business failure. With respect to contingency (B), the bill provides for calculation of premium rates in relation to a pension fund's assets. The latter, however, vary according to the quality of the portfolio and the amount of equities owned. It would be very difficult to calculate a premium that would accurately reflect the soundness of different types of investment.

(3) *What alternative solutions are there to the problem of pension fund losses, particularly losses due to the risk of business failure?* For example, what are the possibilities of some kind of pooling of the risk, perhaps on an assessment basis, either in conjunction with reinsurance or other methods?

Questions of this nature will be discussed in a series of meetings that the Executive Branch through an interagency task force on private pension plans is holding this summer and fall with nongovernment technicians. At these meetings, a number of closely-related public policy issues, such as those dealing with vesting and funding standards, will be discussed. These issues should be considered concurrently with the question of reinsurance.

We think that it would also be useful to have additional information, now being collected, on such matters as the experience of terminated plans and the extent to which plans are funded, before action is taken on S. 1575.

We, therefore, recommend deferral of action on S. 1575 until there has been an opportunity to analyze the results of these discussions and studies.

We are advised by the Bureau of the Budget that there is no objection to the presentation of this report from the standpoint of the Administration's program.

Sincerely,

WILBUR J. COHEN,
Under Secretary.

U.S. DEPARTMENT OF LABOR,
Washington, August 4, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for a report on S. 1575, the "Federal Reinsurance of Private Pension Plans Act."

Millions of workers and their dependents now rely on private pension plans to help meet the financial needs of their later years. Unfortunately, each year a number of these plans are unable to meet their obligations. S. 1575 reflects a constructive attempt to provide limited protections for the beneficiaries of certain pension funds through a system of reinsurance. There may be other approaches. This bill provides your Committee with a useful opportunity to consider the problem areas and the means for arriving at a solution.

The Department of Labor strongly supports the efforts being made by your Committee to deal with the many difficulties in this area. As you know, the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs has also been considering reinsurance and other proposals looking towards the improvement of private pension plans. In its 1965 report, the Committee suggested that further study be given to various aspects of reinsurance proposals.

Among those matters which should be considered are: (1) reasons for termination of plans (2) types of risks to be covered under a reinsurance program (3) equitable methods of calculating premiums to insure such risks (4) possible funding and investment standards which should be applicable to covered plans in order to assure a minimum of risk to the integrity of reinsurance programs (5) other means besides reinsurance to protect pension plan beneficiaries.

Studies are already under way in some of these areas. The Department of Labor's Bureau of Labor Statistics and the Internal Revenue Service are now

conducting a study of the reasons for the termination of pension plans and the number of plan participants involved in such terminations. In addition, an interagency task force is in the process of meeting with representatives of various groups outside the Government to examine a broad range of problems related to the sound administration of private pension plans, including the matter of reinsurance. Other studies will be necessary.

This Department believes that the development of adequate legislation assuring protections to the beneficiaries of private pension plans is essential. We will provide the fullest degree of cooperation and assistance to your Committee in working out some of the difficulties in this area.

The Bureau of the Budget advises that there is no objection from the standpoint of the Administration's program to the submission of this report.

Sincerely,

W. WILLARD WIRTZ,
Secretary of Labor.

TREASURY DEPARTMENT,
Washington, D.C., August 12, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for the views of the Treasury Department on S. 1575, "A BILL To establish a self-supporting Federal reinsurance program to protect employees in the enjoyment of certain rights under private pension plans."

Generally speaking, the bill would establish an insurance program to protect beneficiaries of private pension plans against certain types of risks. Administered by the Department of Health, Education, and Welfare, the program is to be financed by contributions by the member pension plans. The premium rates are (subject to specified maximum limits) to be set by the Secretary of the Department of Health, Education, and Welfare with the advice of an advisory council to be established under provisions of the bill. The program is to insure the beneficiaries of pension plans against loss of plan benefits arising from: (1) failure of the amounts contributed to the plan to provide anticipated benefits due to the cessation of one or more of the operations in one or more facilities of the employer; or (2) losses realized upon the sale of investments if the sale is required to provide benefits payable by the plan.

The bill provides that benefits will be insured only to the extent of the lesser of $500 per month or 50 percent of the beneficiary's average monthly wage in the five-year period for which his earnings were the greatest. In the event that the fund's resources are not sufficient to meet all claims against it, the resources available are to be applied to the discharge of obligations in accordance with a schedule of priorities set out in the bill, based chiefly on the age of the beneficiaries.

To encourage participation in the insurance program, the bill would deny tax qualification under section 401 of the Internal Revenue Code to any pension plan which is not insured under the program.

The Treasury Department supports the objective of S. 1575. It agrees with the conclusion in the Report of the President's Committee on Corporate Pension Funds that:

"The value of private pension plans as a socially desirable supplement to the public retirement system depends on the degree to which accumulated funds are sufficient to pay the pension benefits of workers as they reach retirement. This is a matter of utmost public importance."

A program which would assure employees of receiving their accrued benefits on the termination of a pension plan would, in the opinion of this Department, be a meaningful step in strengthening the private retirement system in this regard. To this end, the President's Committee recommended, and this Department agrees, that serious study be given to consider whether a system of insurance would accomplish this objective. If so, the Treasury Department believes that conditioning a plan's tax qualification on its participation in such an insurance program is an appropriate method for encouraging plans to adopt the program.

On the other hand, as the Report of the President's Committee recognizes, the development of such an insurance program raises a number of difficult questions. Since many of these questions are not within the particular competence

of the Treasury Department, we are not in a position to make a judgment as to whether the program contained in S. 1575 is an appropriate solution.

The Treasury Department does believe, however, that there are certain guidelines which should be followed in developing any insurance program of the type envisioned by the bill. First, we believe that such an insurance program cannot be considered independently of the question of what funding standards should be applied to private retirement plans. In this regard, the Report of the President's Committee contains a series of recommendations for improving the funding of private retirement plans as well as for verifying that the funding standards are, in fact, met. An insurance program without adequate funding requirements could well operate to encourage employers to rely on the insurance rather than on prudent funding, especially if the insurance premiums were significantly less than the costs of adequate funding. If reliance on the insurance were to become a widespread practice, the whole program could well become self-defeating.

Moreover, it is essential that the type of risks to be covered by the insurance be carefully defined in order to prevent the possibility of corporate maneuvering to shift plan liabilities to the insurance program. In addition, we note that the Departments of Labor and Health, Education and Welfare have raised a number of other issues including questions regarding investment standards; the determination of insurable risks; and the adequacy and method of calculation of the insurance premiums, including the problem of rating various types of risk.

The Treasury Department would be happy to cooperate in the study of an insurance system as well as in the development of sound funding standards for private retirement plans. In this regard, the Internal Revenue Service is presently participating with the Department of Labor in compiling information on the reasons for plan terminations and the number of plan participants who lose benefits by virtue of terminations. Moreover, the Treasury Department is represented on an interagency task force which has scheduled meetings with a number of interested private groups to discuss some of the proposals included in the Report of the President's Committee. One of the topics on the agenda for these meetings is the matter of insuring employees against loss of benefits on termination of the plan.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the Administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

The CHAIRMAN. This bill would establish an insurance program to protect workers covered by private pension plans from loss of their pension rights where an employer terminates a business or where the pension plan investments turn bad.

We have all heard of the tragic events in South Bend, Ind., when the Studebaker plant closed and its pension plan terminated. Assets in the pension fund were sufficient to provide only a fraction of the auto workers involved with the pension rights they had earned. Many of the former workers received nothing.

Less spectacular but perhaps equally distressing to the affected workers has been the termination of nearly 7,000 pension plans in the last 12 years.

These pension plan shutdowns raise serious questions regarding vesting of pension rights and adequacy of their funding. S. 1575 does not get at these issues directly, but it does present a possible approach, which it is appropriate to explore, to assure that workers actually get the pension benefits they earn.

We are fortunate to have as our first witness the Secretary of Labor, the Honorable W. Willard Wirtz. We know of the many hours you have worked to help end the airline strike now entering its 39th day, Mr. Wirtz, and we appreciate that your taking time from that serious business indicates the importance you attach to the issue before the committee. Now I suggest that you proceed in your own fashion.

STATEMENT OF HON. W. WILLARD WIRTZ, SECRETARY OF LABOR ACCOMPANIED BY MISS EDITH COOK, ASSOCIATE SOLICITOR; PETER HENLE, DIRECTOR OF SPECIAL PROJECTS, BUREAU OF LABOR STATISTICS; DONALD LANDAY, CHIEF, EMPLOYEE BENEFITS BRANCH, BUREAU OF LABOR STATISTICS; AND JACK BALLARD, ASSISTANT DIRECTOR FOR REPORTS AND ANALYSIS, OFFICE OF LABOR-MANAGEMENT AND WELFARE-PENSION REPORTS

Secretary WIRTZ. I will proceed to tell you that agreement was reached at 6:20 this morning.

The CHAIRMAN. The strike is still not terminated, though, is it?

Secretary WIRTZ. Thank you, Mr. Chairman, members of the committee. There are with me this morning Miss Edith Cook, our Associate Solicitor; Peter Henle, Director of Special Projects of the Bureau of Labor Statistics; Mr. Donald Landay, Chief of Employee Benefits Branch, Bureau of Labor Statistics; and Mr. Jack Ballard, Assistant Director of Reports and Analysis, Office of Labor-Management and Welfare-Pension Reports.

I have, Mr. Chairman, a statement which has been filed with the committee. It is my usual practice only to try to summarize it for you. I am frank to say my head is tireder than my mouth right now and I suspect I will be better off if I just read through this if that is all right with the committee.

The CHAIRMAN. All right.

Secretary WIRTZ. We are at the start, as the President has said, of "a great new era for older Americans," when we are beginning to recognize "the right to an adequate income," "the right to a decent home," and "the right to a meaningful retirement." The private pension system is a vital element in the achievement of these rights.

This is a matter of personal financial security for millions of individuals. Annual benefit payments from these plans now total some 3 billion—to almost 3 million beneficiaries. By 1980, coverage of these plans is expected to increase from the approximately 25 million employees now covered to about 42 million. Over the same period, the present $85 billion held in these funds will probably grow to $225 billion. Mr. Chairman, members of the committee, we have gotten used to figures so large that their impact is sometimes lost on us. I can only point out that these are figures of magnitude which in my judgment warrant the country's most serious attention to this problem.

These facts make it plain that the Nation, as a whole, has a major stake in the private retirement system. Although no public funds are utilized directly to finance private pensions, practically all private plans have met the qualifications for special income tax treatment. As a result, a given pension system can be financed by a 30-percent-lower rate of contributions. The burden of these tax reductions is, of course, shifted to other taxpayers. Private retirement plans, moreover, represent a force of substantial magnitude in the financing of the economy, the mobility of labor, and the later lives of the plan participants.

These important considerations require a continuing public concern with the operations of private pension plans. Congress has already demonstrated this concern in enacting various provisions of the Tax

Code, the Labor Management Relations Act, the Securities Exchange Act, and the Welfare and Pension Plans Disclosure Act.

More recently, the public stake in the private pension plan system was emphasized when the President established in March 1962 a Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. I have had the privilege of serving as Chairman of this interagency Committee which looked into a broad range of problems relating to private welfare and pension plans. In its January 1965 report, the Committee recommended a number of measures to strengthen the private pension system. I should like to interrupt, Mr. Chairman and members of the committee, to pay my respects to that Committee with which it was my pleasure to work. It is a Committee which has taken its assignments more seriously than any other which it has been my privilege to work with while I have been in the Government. It reached unanimous conclusions on every single point. It favored, for example, strengthening the minimum standard for funding and introducing a standard for vesting. It went on to suggest that a system of insurance to protect beneficiaries in the event of plan termination was "worthy of serious study." That appears at page 58 of that report which I should like to offer as part of the record before this committee, identifying it as "Public Policy and Private Pension Programs," a report to the President on private employee retirement plans by the President's Committee, for such disposition as the committee may care to make of it.

(The report, "Public Policy and Private Pension Programs," was filed with the committee.)

This hearing is concerned with a specific proposal to enact such a system of insurance. It is aimed at providing protection for beneficiaries in the event the pension plan is terminated without sufficient funds to meet accumulated pension obligations. To the breadwinner who has planned his retirement in the expectation of regular pension payments, the failure to fulfill these payments is obviously a crushing blow to his hopes, his plans, and his aspirations. I would like to commend this committee for these hearings, for inquiring into a matter which is at once highly complex and highly charged with the public interest.

It is clear that many plans do not now afford beneficiaries adequate protection against the loss of their accrued benefits. Employers customarily reserve the right to discontinue contributions at any time and do not assume contractual liability for any deficiency if the assets in the fund are not adequate to pay the benefits under the plan. If the plan is terminated for any reason, the employer has no further obligation to contribute to the fund.

Union agreements may somewhat minimize these risks. Multiemployer agreements, for example, typically provide for a fixed rate of contributions, such as 10 cents an hour or 3 percent of payroll. Single employer plans, on the other hand, may require that a specified funding plan be followed to provide certain benefits—normal cost plus amortization of past service costs over 30 years just as an example. Yet in all these instances, the employer's obligation ceases when and if the plan should terminate.

Let me illustrate the problem by referring to the experience of the pension plans of a few prominent concerns. In general, these plans were operated in the same prudent manner as those of other highly

respected corporations. Yet, in each case the plan termination left many employees without the retirement protection on which they had been relying. You have already referred, Mr. Chairman, to what is the classic example, the 1964 closing of the South Bend, Ind., plant of the Studebaker Corp. In this instance, the available assets were adequate to assure all eligible participants of full pension payments. However, these payments so depleted the fund's assets that employees with vested rights—those between ages 40 and 60 and with 10 years of service—received lump sum payments that were equal to only 15 percent of their accrued benefits. No payments were made to the remaining participants.

A similar situation occurred when the Packard Motor Co. shut down its Detroit plant in 1955–56 and terminated its plan in 1958. The Steelworkers union has listed 30 plans that have terminated owing to plant closings in the past half-dozen years. They include such plants as Superior Steel in Pittsburg and Atkins Saw in Indianapolis.

To help meet the problem of plan failures owing to bankruptcy, the Department of Labor has, for a number of years, actively supported legislation which would treat payments due to funds or plans as wages for the purpose of the Bankruptcy Act. Such treatment would entitle these obligations to a limited priority under that act. While legislation of this type might be helpful, it is obviously an answer to only a very small part of the problem. The law could be brought to bear only if the employer had an outstanding legal obligation to the fund. Little benefit would be derived if the employer's assets were insufficient to meet even its priority debts. And, in almost all terminations, the problem is not that employers are delinquent in their payments to the fund but rather that the fund's assets, including any such delinquencies, are not sufficient to pay the accumulated pension obligations.

The Welfare and Pension Plans Disclosure Act, which the Department of Labor administers, is of limited usefulness, too, in this area. As important as this law is, it affords little or no protection against failures due to discontinuance of operations by an employer, poor business judgment, decline in value of fund assets, or other such causes. The act specifically denies the Secretary of Labor any authority "to regulate, or interfere in the management of, any employee welfare or pension benefit plans," except for the limited purpose of inquiry into investments and actuarial assumptions, under special procedures and on presumption that the act has been violated.

The legislation which you are considering today, S. 1575, is a serious, constructive attempt to deal with these difficulties and to provide beneficiaries of private pension plans with limited protection through a Federal reinsurance program. For this and other reasons already stated, I wholeheartedly endorse the purposes and objectives of this bill.

In considering this proposal, it is important to keep in mind that there are often no perfect solutions to difficult problems. Until others come up with better answers, this bill, honestly put as it is, is as much entitled to the field of our consideration as any other proposal aimed at correcting these obvious ills.

In discussing this issue, it is important for the committee to keep in mind that this proposal is aimed at providing an important aspect of

protection to plan participants; namely, protection in the event of the plan's termination. There are, however, additional public policy issues closely related to this problem. Among these are possible discrimination in coverage of the plan, protection against a plan's failure to provide benefits for lack of vesting, inadequate funding, and possible abuse of fiduciary responsibility in the management of pension funds. The present proposal, therefore, must be viewed as one possible step toward providing additional protection for plan participants, but it is by no means the only step which should be considered.

The difficulties in the path of developing a feasible system of insurance for private pension plans are many. The bill before you makes an admirable attempt to meet a number of these problem areas. Yet its provisions do raise some complex issues which require further study and discussion. I would like to refer to a few.

Perhaps the most important problem area involves the question of standards. If the Federal Government were to take upon itself the obligation of insuring private pension funds, compliance with certain minimum operating standards would appear to be required. Without standards to assure adequate funding, prudent investment practices, and competent, honest management of these plans, a reinsurance program could have the effect of subsidizing imprudent procedures and inadequate funding.

It is important to recall that other, somewhat analogous, Federal insurance programs embody necessary controls or standards. The Federal Housing Administration, for example, does not insure mortgages unless both the borrower and the property meet certain minimum standards. Similarly, the Federal Deposit Insurance Corporation and the Savings and Loan Insurance Corporation have standards that loans and investments must meet in order that banks and savings and loan associations may continue the insurance of their deposits.

Another question concerns the appropriate rate structure. The proposed legislation covers losses attributable to cessation of either part or all of an employer's operations and losses which occur when investments must be sold to pay benefits. There is little information available indicating how the risk of loss varies for these perils among types of employers and types of plans. It seems desirable that any rate structure reflect these differences in risk.

Other questions arise with respect to S. 1575. For example, it provides for termination of insurance protection whenever a plan or its operation fails to comply with basic requirements of the insurance system. The consequences of any such termination of insurance protection would, of course, fall most heavily upon the beneficiaries. Other methods of enforcing compliance should be seriously considered.

These are some of the problem areas which would appear to require additional study. In some areas, a start toward such study is being made. The Department of Labor, in cooperation with the Internal Revenue Service, has undertaken a special study of plan terminations aimed at identifying more closely the reasons for termination and their prevalence. I can give you, if you are interested, Mr. Chairman and members of the committee, just some of the prime indications of the study as it has already been undertaken but they will perhaps be very preliminary and inconclusive. An interagency task

force is currently exploring problems affecting private pension plans. This group has planned a series of meetings with various groups outside of Government, including representatives of business, labor, and interested professional groups, to discuss a full range of problems, including reinsurance proposals.

Let me emphasize that these efforts currently underway can only serve as a starting point. By themselves, they cannot provide sufficient information to formulate an effective reinsurance program. Further studies will undoubtedly be necessary. The Department of Labor intends to pursue these efforts with all due dispatch and to the limit of its available resources. We will work in collaboration with other Federal agencies concerned—especially the Treasury Department—and will provide the fullest cooperation to your committee in the development of legislative proposals.

Our efforts will be strengthened by the concern this committee is displaying by holding these hearings. We recognize full well the key role which the private pension system is playing in assuring retirement security to millions of employees. In general, this system has operated effectively, efficiently, and honestly. However, its continued success must not be jeopardized by certain weaknesses which not only may lead to the loss of retirement protection for many individuals, but also may undermine the public's confidence in the promise of the private pension system.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Secretary. As I understand it, at present you are not in a position to recommend just precisely how such a reinsurance program should work.

Secretary WIRTZ. That is correct, Mr. Chairman.

The CHAIRMAN. There are two objectives of the pension plans. One of them is to assure additional security for employees and the other to try to assure for management a stable labor force. Insofar as the first objective is concerned, we could very well ask that there be some type of requirement or some type reinsurance program to protect them against closing of a plant, could we not?

Secretary WIRTZ. That is correct.

The CHAIRMAN. Now, with regard to the second objective, it is more difficult, it would seem to me, and I imagine you would agree, to insist that that plan be worked out so a man retains his rights even though he does go to a different corporation and work somewhere else.

Secretary WIRTZ. Yes. That is a very involved point of economic and social interest, both. There is on the one hand the interest to which you refer, in retaining employees. There is on the other hand the very general interest today in trying to take full account of the increased mobility of labor which is required in an economy that is moving as fast as ours is today. Each day there are, we do not know exactly, some 25,000 to 50,000 new hires and shifts of people from one place to another. When you come to consider the vesting provisions of these pension systems, you would run very squarely into that problem or that consideration, the mobility of labor.

The CHAIRMAN. In view of the fact that we give these pension plans a very special tax advantage, we do have something of a moral right to require that they meet certain standards. I take it you do feel

that something should be done but you are not ready to recommend precisely what it ought to be.

Secretary WIRTZ. Yes. That is right. I think it would be helpful, Mr. Chairman, if I suggest that part of the difficulty we have run into in bringing this whole problem forward is reflected in your reference to the "tax advantage" and the morals of this situation and if I may respectfully suggest, our own use of those terms has gotten us into trouble. There is a resentment I should like to try to remove from this picture which has arisen from talking about "tax advantages" which the plans have.

You have spoken my view entirely. I think there are certain elements of tax advantage in the situation. I do suggest, however, that we have more recently been trying to divorce this pension problem from considerations of "tax advantages."

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Secretary, as I understand it, you are not endorsing the bill before us for enactment at this time but more or less endorsing the fact that this area needs a study by the committees and by the Department; is that correct?

Secretary WIRTZ. Yes, and inasmuch as this is the most specific proposal that has been brought forward, it would seem to me entitled to consideration as a concrete illustration of the possibilities that have otherwise been left very general.

You are correct in your statement that I am not in a position to endorse it as such, but neither do I mean to shove it aside as a matter simply to await further study, although essentially that is what my final position comes down to.

Senator WILLIAMS. In your studies has there been any estimate as to the actuarial deficiencies of the private pension plans?

Secretary WIRTZ. That is exactly the kind of thing, Senator Williams, that presents the largest problem. My answer is that we have not even yet really nibbled at that. The actuarial elements in this situation are exceedingly complex. So far we have been able to identify, for example, only the number of plans which have been terminated in the last 12 years, 1954 to 1965 inclusive. We know the number of plans, about the number of workers. We know the distribution of plans by the number of employees affected, and that is about all.

Senator WILLIAMS. I agree with you that this area needs study but before we can approach it intelligently, we would almost have to have such an estimate in order to evaluate the premium rates to be charged, and so forth, would we not?

Secretary WIRTZ. Before we concluded we would have to have that. I think that is a necessary part of our approach to the problem.

Senator WILLIAMS. Is there any study being made by the Labor or Treasury Departments that could help us determine the amount of actuarial deficiencies of these plans?

Secretary WIRTZ. Those facts and factors will become identifiable in the course of studies presently underway or planned.

Senator WILLIAMS. The point of the vested rights of the employees is a problem that is confronting many employees. Some of them feel that they are unfairly locked in, that they cannot change employment.

Of course, the argument management gives is that if it is vested many of our private pension plans would become actuarially deficient, is that true?

Secretary WIRTZ. That problem is involved.

Senator WILLIAMS. So it is just not a simple answer to say give them vested rights unless we can take care of that actuarial deficiency that would result therefrom.

Secretary WIRTZ. I think these plans should all be on an actuarially sound basis.

Senator WILLIAMS. Have there been any estimates or are you trying to determine how much deficiency would be created over and above the existing deficiencies if vesting requirements were enacted?

Secretary WIRTZ. I will be glad to try and find out how much of an answer we have to it. I should want to proceed, however, by identifying the fact that the bill before us does not involve primarily the point of vesting but, rather, the protection of funds. I will inquire of Mr. Henle, if we have the information you requested.

Mr. HENLE. Senator, when the Committee to which Secretary Wirtz referred was conducting its investigations a year or two ago, there were some preliminary discussions with actuaries about the cost of adding a vesting requirement to a normal pension plan, and the estimates that we received at that time ranged around 5 percent. You realize, of course, that for any given plan the increase in cost would vary with the age and sex of the employees concerned and how much prior service they had and various other factors.

Secretary WIRTZ. Does that mean, then, that the answer to Senator Williams' question as to the increased deficiencies which would result from vesting would be approximately 5 percent on the basis of this preliminary evidence?

Mr. HENLE. Yes. Of course, the effect on any particular plan's liabilities would depend on the provisions of that particular plan and the characteristics of the group, such as its rate of turnover.

Senator WILLIAMS. Any information which you may have in that connection which you could supply for the record at that point would be appreciated. Personally I would be surprised at a 5-percent figure.

Secretary WIRTZ. We will make a special effort to bring together any information bearing on that point.

(Secretary Wirtz subsequently supplied the following information:)

The cost of vesting depends on many critical factors, such as the requirements for vesting, the proportion of participants leaving the plan at various ages, and the method of funding. Accordingly, it is feasible to estimate costs only under a limited range of conditions that might be encountered in practice.

The cost of vesting was examined by the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. Its report to the President states:

Representative costs have been estimated by government actuaries under a variety of assumptions, including high, low, and moderate turnover for employee groups with high, low, and medium age distributions. It is believed that all but a small percentage of plans would fall within the scope of these assumptions. These estimates indicate that deferred *full* vesting after 20 years of service (including premembership service) would seldom add more than 6 percent to the cost of providing normal retirement benefits at age 65, and that the Committee's recommendations, including graduated vesting between 15 and 20 years of service, would seldom add more than 8 percent. . . . The added

cost would be quite modest; that is, under 5 percent for a large majority of pension plans.

This analysis was based upon computations by Government actuaries. To illustrate the cost of vesting, the added costs of deferred full vesting under four service requirements and three assumptions regarding turnover is given below:

Percent increase in cost attributable to vesting[1]

Service requirement	Assumed turnover		
	High—5 percent per year	Moderate—4 percent per year	Low—3 percent per year
Immediate vesting	23	18	9
10 years	12	11	7
15 years	8	6	3
20 years	5	2	1

[1] For group with a "medium" age distribution, with a normal retirement age of 65 years.

Senator WILLIAMS. How would this bill deal with bankruptcies—where the company went bankrupt and its pension plan was not actuarially sound? Would this insurance underwrite all of that?

Secretary WIRTZ. The bill limits the extent of the coverage. S. 1575 on page 3, limits coverage in this language:

in the case of a right to a monthly retirement or disability benefit for the employee himself, the lesser of 50 per centum of his average monthly wage in the five-year period for which his earnings were the greatest, or $500 per month.

Taking into account that limitation, the answer to your question would be yes, this would provide for reinsurance or for insurance in that situation.

Senator WILLIAMS. And again no estimate as to the cost of that factor has been made, is that correct?

Secretary WIRTZ. That is correct.

Senator WILLIAMS. Now, I noticed on page 3, part one, 4(a) deals with the rights to cancel the insurance under certain circumstances. Now, the cancellation of this insurance—once it started, and employees felt they had a pension plan which had been reinsured—would leave all of those employees out on a limb, would it not?

Secretary WIRTZ. We do make a point in our presentation that one of the items to which we would feel further attention should be given would be the method of enforcing this and just as your question suggests, would share the feeling that cancellation is a poor sanction in a situation of this kind.

Now, as the bill is drafted and that cancellation provision, would it be prospective or retroactive, or would it be effective to cancel everything as of the moment? I cannot answer that question. I will have to inquire as to the application of the bill in that connection.

Senator WILLIAMS. I just question whether you can insure a fund and then cancel it retroactively. In private insurance we do not allow it, you know.

Secretary WIRTZ. I will be glad to add to the record a considered answer to that question. I would not offhand know whether once there was insurance, where there was coverage, there could subsequently be cancellation.

(Pursuant to the above discussion the following information was submitted:)

A considered answer concerning the application of the cancellation provision of S. 1575 would require a specific legal interpretation. It appears that the protection of the system would terminate at the time participation by a fund is canceled. (See p. 7, sec. 5(d), of the bill.) The system would accordingly cover any insurable losses actually realized prior to the time of cancellation. The burden of losses realized after that time would fall on the contributors to the fund, its participants, or both.

Senator WILLIAMS. Have any estimates been made as to the number of wage earners in America that are covered by private pension plans?

Secretary WIRTZ. Yes. The opening part of my statement uses a figure of approximately 25 million employees now covered with the prospect that that number will increase very substantially in the future, rising to about 42 million by 1980.

Senator WILLIAMS. Has there been any comparison made in your studies as to the actuarial deficiency of private pension plans as compared to the actuarial deficiency of the Federal pension plans? Are they somewhat related or is one greater or lesser?

Secretary WIRTZ. Would our answer or HEW's answer be firmer on that? You have coming before you Mr. Ball from HEW and our confidence in his answer to your question would be larger than our confidence in our own.

Senator WILLIAMS. I was speaking primarily of the civil service retirement fund at the moment. Has there been any comparison as to the actuarial deficiency of that fund as related to private pension plans percentagewise?

Secretary WIRTZ. So far as we know there has not been such a comparison and I will again inquire as to whether there is a fuller answer to that question. I think there is not, Senator.

(The Secretary subsequently informed the committee that, since information on the magnitude of existing actuarial deficiencies in private pension plans is not available, no such comparison can be made.)

Senator WILLIAMS. The reason that I ask that, I thought that would give us a springboard to get an estimate. We are advised by the Retirement Division that there is about a $40 billion actuarial deficiency in the retirement fund for the 2½ million Federal employees. If we extend the insurance for 25 million employees on the outside I wonder how it would compare. I was wondering just what size the problem is that we are being asked to approach. I realize there is a problem. It sounds nice to say we can insure it but we have got to get into these figures if we are going to approach it to see whether or not we can really insure it.

Secretary WIRTZ. Yes, sir.

Senator WILLIAMS. And whether or not we have enough money to back it. I understand there has been no estimate made as to the dollar amount involved in insuring these deficiencies, is that correct?

Secretary WIRTZ. We have not the information presently to cost out the expense which would be involved.

Senator WILLIAMS. Then I understand that your recommendation is that such information be obtained prior to proceeding in this direction to the final——

Secretary WIRTZ. If I could just say prior to concluding, it seems to me there must be that information.

Senator WILLIAMS. I agree the study should be made and these answers obtained and that is what we are going to do. Thank you.

The CHAIRMAN. Senator Anderson?

Senator ANDERSON. On page 4, section 5, of the bill "each eligible pension fund may, upon application therefor, obtain insurance under the program upon payment of such annual premium as may be established."

Does that mean a merit rating for each business?

Secretary WIRTZ. A merit rating for each business?

Senator ANDERSON. Yes.

Secretary WIRTZ. No. I do not think so.

Senator ANDERSON. In writing up pension plans, they take some recognition of the type of business you are in.

Secretary WIRTZ. Yes.

Senator ANDERSON. Some of those plans are hazardous and therefore the rate is higher.

Secretary WIRTZ. I see. Well, the authority given to the next two sentences would seem to me to suggest that the Secretary of HEW could, under S. 1575, take that consideration into account. I do not see anything here to preclude that. It leaves considerable discretion for establishing separate premium rates. My offhand answer would be that it does not require that, but would permit it in the determination of the Secretary.

Senator ANDERSON. Well, you see two types of business occupying side by side. One of them has a very good employment record, one has a very bad one. They ought to be based on that fact.

Secretary WIRTZ. I would have to consider, Senator Anderson, the effect of the subsequent sentence, "premium rates established under this section shall be uniform for all pension funds insured by the program and shall be applied to the amount of the unfunded obligations and assets or class of assets, respectively, of each insured pension fund."

With that much reading I am inclined to question my previous answer that there would be that degree of discretion. We feel that your question warrants further consideration on our part.

Senator ANDERSON. I would think it would almost have to require a merit rating, because, if you take a fire insurance policy on a cotton gin, its rate is about 20 times more than it might be on a dwelling. You take the hazards into consideration.

Secretary WIRTZ. The principle is a completely sound one—one that should be considered before final drafting of the act.

Senator ANDERSON. Is it not a fact that the Internal Revenue Service would not let you charge off what it regards as too much?

Secretary WIRTZ. I would know that as a matter of general information, but would again rely on their subsequent testimony here for a more precise answer.

Senator ANDERSON. A year or so ago, I went through a couple of pension plans for companies in which I was interested, and I found out the Internal Revenue Service had quite a bit to say about it, and the expert from the Dallas office of the actuarial firm based his whole argument on how much you could take away and how much you could not. If you do not have a merit rating, how can you tell?

Secretary WIRTZ. My only personal response is that the idea of the merit rating ought to be taken into account.

Senator ANDERSON. The tax advantages could be substantial or not very substantial at all, could they not, depending on how much was being paid?

Secretary WIRTZ. You know, Senator, I am really out of my depth when it comes to an identification of the validity of the merit-rating principle in a plan of this kind. I will best inform you by pleading almost ignorance to that subject.

Senator ANDERSON. I think it could be shown that the Internal Revenue Service allows you to make certain deductions, but, after 3 or 4 years, if your plan is going well, they then insist upon these being reduced. I am not sure of this, but I think Sears has an elaborate pension plan and may be the principal stockholder in the company. Under those circumstances the rate might be wholly different from that of some company that was manufacturing automobiles and was very close to the line of financial solvency.

Secretary WIRTZ. I say again my own offhand reaction parallels yours completely. I am just not sure of mine.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Secretary, just this. This is a field I think we should have some concern about and take an interest in but, in view of the questions of the Senator from Delaware and the Senator from New Mexico, I think it will require additional study. I will appreciate any information you can supply for the record.

Secretary WIRTZ. All right.

The CHAIRMAN. Senator Gore?

Senator GORE. No questions.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. Mr. Secretary, I do not think there is any question about the need for action now, for doing something. Between 1956 and 1962 it is estimated at least 1,800 qualified pension plans have been terminated. Now, for these people this is a serious thing. This may be as serious to them on an individual level as almost anything that has happened to them in their lives.

Senator GORE. How many did you say?

Senator HARTKE. 1,800.

Senator GORE. Involving how many individuals?

Senator HARTKE. We do not know.

Secretary WIRTZ. I do have, if it will be helpful, preliminary figures for the period 1954 to 1965. Our study shows the termination of 4,243 pension plans involving 183,699 workers. We have a breakdown of the size of the plans but what these figures lack is an identification of the reasons and also of whether the benefits were lost, so that we are at a point now of moving into that. So this is the number of terminations and the number of workers affected, but does not include identification of whether they lost their benefits.

Senator GORE. Would the Senator yield?

Senator HARTKE. Yes.

Senator GORE. That is very helpful as an order of magnitude of this problem. Would it be the proper function of the Department of Labor to ascertain the unknown facts here?

Secretary WIRTZ. We are working on that right now. We have instituted that study working with the Treasury on it.

Senator GORE. I apologize. I yielded in order that the author of the bill might have——

Senator HARTKE. You go right ahead.

Senator GORE (continuing). Have the priority and then I asked him to yield. I do have one other question here and then I will not ask the Senator to yield further.

It seems to me that to qualify for reinsurance, there should be some standards as to the quality of the pension plan. Just as Senator Anderson recently had a personal experience, I had one. An employee had been working for the same company continuously except for about 2 weeks for some 15 years. Yet he found the fine print completely disqualified him because that 2-week interruption of his employment left him completely out in the cold. And this is true in, I am told, a surprising number of pension plans.

So along with this study that the Department is making, and one which I think the staff of this committee could well and fruitfully explore, I wish that you would inquire into the quality and the stipulations, the details of various pension plans.

Secretary WIRTZ. We are doing so, Senator.

Senator GORE. Thank you.

Secretary WIRTZ. And do subscribe completely as suggested in my opening statement to the suggestion that a complete coverage of this matter must include standards.

Senator GORE. Thank you, Senator.

Senator HARTKE. Mr. Secretary, I am delighted that you have done as much work in this field as has been done up to this date. It is at least a beginning, and I think that the task force has done a wonderful job in accelerating some of the factors which are necessary for some approach to a very serious problem.

I might point out, just to indicate the area of magnitude which you brought out in your opening statement, that by 1980 there will probably be more money involved in the pension funds than is involved in the total assets of the life insurance industry today. So we are talking about something which is quite large and something which I at least think really deserves a little bit more than a casual study at the moment. And this is one of the reasons why, when I introduced this bill, instead of just asking for a study, I put forth a definite plan of operation so people could have something upon which they could start a dissection and then operational surgery, putting it back together.

I am not claiming that this bill is a perfect answer, and I think both of us would agree that there are a lot of problems which are to be solved. But the mere fact that there are so many problems in this field does not mean that we are going to have to wait until we have a crisis of serious proportions before we start coming up with something constructive in this field. Would you not agree with that?

Secretary WIRTZ. I surely do.

Senator HARTKE. Now, in Canada they do have a system which is contributory in nature, in two of the Provinces as I understand it, over and above the social security system. Of course, most of the attempts by negotiations here on the part of the workers are probably for a noncontributory system but anyway, there is a variety of systems which can be worked out. But in this field, do you feel that generally

speaking, the pension plan itself is really a payment in lieu of wages? It is an item at at the collective bargaining table.

Secretary WIRTZ. Yes. There are various implications that could be read into any answer to that question all the way from tax implications, bargaining implications, and so forth. This is the only reason for my hesitancy in answering it flatly. In general, the answer seems to me to be affirmative. I think the point which your question suggests is that great importance attaches to these benefits and on that there could be no question in my mind at all.

Senator HARTKE. We can agree at least that it is an item at the collective bargaining table.

Secretary WIRTZ. Sure.

Senator HARTKE. And it is an item which is considered in the total wrap-up of the package just as you have been through now. I do not know whether it was involved in the airline strike. Frankly, I am not interested—not that I am not interested, but I just do not want to discuss it.

Secretary WIRTZ. It was, at the start of the negotiations. It was not, at the conclusion.

Senator HARTKE. I do not want to do anything to interfere with that operation at this time.

Secretary WIRTZ. Amen.

Senator HARTKE. But there are a lot of workers, just as the Senator from Tennessee has indicated, who find themselves in this position, that they work for years and then suddenly they find that they have no pension through one cause or another, is that not true?

Secretary WIRTZ. Yes, sir.

Senator HARTKE. Do you have any estimate at all as to the percentage of the workers who are in pension plans who never received any benefits whatsoever?

Secretary WIRTZ. We do not have that information. I do not believe, even in a preliminary way. We are hoping to move right into that area now.

Senator HARTKE. The estimates which I have, indicate that probably in the neighborhood of about 40 percent received benefits, cash benefits, out of their pension plans and not more than 50 percent. Now, this is an element which probably is subject to a lot of different factors, but the point remains, if pension plans are intended to cover a hundred percent of the employees, the fact that about half of them never receive their benefits certainly indicate that there is a more serious problem here than merely just the termination of the plans, is that not true?

Secretary WIRTZ. Yes, sir.

Senator HARTKE. The tax benefit—do you know the amount involved?

Secretary WIRTZ. May I add one point before you leave that question? My answer that we have no information was said for purposes of general consideration. Your suggestion is in the right range so far as we presently know and is a reliable indication of the scope of the problem.

Senator HARTKE. Now, as far as employees are concerned, many of them really feel they have a pension plan system. They consider that as an item when they go to work and in considering whether they will

stay on a job. But in reality, they may never have the opportunity to cash in on this element of their pay check.

Secretary WIRTZ. Yes, sir.

Senator HARTKE. I mean in broad general terms.

Secretary WIRTZ. That is right.

Senator HARTKE. I do not want to get into the legal technicalities.

Secretary WIRTZ. That is my understanding of what you said.

Senator HARTKE. Also, is there not quite a problem involved in the treatment of pension plans when you have mergers and consolidations?

Secretary WIRTZ. Yes, sir; and some of the present termination figures may be merger figures so far as we know.

Senator HARTKE. All right. Now, this is another problem which presents itself to American society. Take a young man; this refers to those who are taken up with the idea of a voluntary social security system. A young man does not place the same type of importance on his pension plan as does a person, say, who has reached that wonderful age of 47 as the Senior Senator from Indiana has, right?

Secretary WIRTZ. You mean is that right about your age? [Laughter.]

Senator HARTKE. Let me rephrase it.

Secretary WIRTZ. I agree it is more important with every passing year to everyone.

Senator HARTKE. To the older worker the value of the pension plan becomes much more important as the years go by, and yet there is no real consideration of this taken into the account in the pension plans generally, is there?

Secretary WIRTZ. I agree as a point of fact. I am not sure as to whether there is any reflection of that in pension plan practice. I did not get the last part of your question.

Senator HARTKE. In other words, what I am saying here, for the young man who goes into a pension plan, and due to the fine type, the small print, and after he works in a place for 3 years, and he is maybe 24 years of age, the fact that he loses his pension plan does not become an item of great significance to him, is that right?

Secretary WIRTZ. That is correct.

Senator HARTKE. And yet the same general rules apply to most pension plans for the person who starts work in a plant at the age of 21 as contrasted with a person who starts working in a plant at age 45.

Secretary WIRTZ. I think they generally would.

Senator HARTKE. Another thing which also complicates our society for the older worker is that his opportunity for mobility is cut down in view of the fact that many companies say, "I am sorry, we cannot consider you, you are over 40, and our pension plan just will not permit us to take you on the payroll." Is that not true?

Secretary WIRTZ. Yes, sir.

Senator HARTKE. So to that extent it creates more serious problems for older people and also cuts down on the mobility of the labor force which we generally consider an item of great importance in the United States.

Secretary WIRTZ. That is correct.

Senator HARTKE. On the other side of that picture, let us look at the man who would like to leave his job. I am not saying this to en-

courage people to leave their jobs, but certainly in this society we do not want our people to be restricted. You take the man who works in a place, and he says, "I cannot leave my job. I have too much invested in my pension plan." Is that not a problem also?

Secretary WIRTZ. Yes. Most unfortunately.

Senator HARTKE. And this is——

Senator GORE. Did you say most unfortunately?

Secretary WIRTZ. Most.

Senator GORE. That is almost economic peonage.

Secretary WIRTZ. It is a very real factor as the Senator from Indiana suggests. It has a number of unfortunate implications, including an attempt to preserve that job.

Senator GORE. Will the Senator yield further? So if we provide some reinsurance buttress for the pension plan, without freeing the employee from his indenture, then we will be but further pyramiding this restriction upon the fluidity of the American economy.

Secretary WIRTZ. In my judgment that is correct. The task force to which we are referring attaches almost equal importance to vesting which is the point involved here, and to funding, which is the point involved in S. 1575.

Senator GORE. All of which seems to indicate that the Senator from Indiana has opened a very large but a very important and urgent subject.

Secretary WIRTZ. It could not be exaggerated in its importance.

Senator WILLIAMS. If the Senator will yield, that was the basis of the question which I raised because that is an important point with many employees and that was the basis of the question as to the extent of the unfunded liability that would be created in these various pension plans if we were to require vested rights for an employee. I think it is a problem that should be studied but you cannot study it without relating it as to what it is going to take to do it, and I understand the Secretary is going to furnish us some information in that connection. (See p. 15.)

Senator HARTKE. Let me say I do not think, and I say this to my good friend, the Senator from Delaware, I do not think it is the responsibility, generally speaking, of the Secretary or the Department of Labor to assume all this responsibility in their own field. I think as a legislative body we have a certain amount of responsibility, and for those who have constantly advocated that the legislature do its fair share, all I want to do is to try to get the Congress to start doing its fair share of the work.

Senator WILLIAMS. I was not putting the burden on the Secretary. I was merely suggesting that any information he could develop in that connection he should make available and he already indicated he is studying it. It is information we would have to have and I think it is information which would take more than the capabilities of this committee to develop. I think it would take even more than the Secretary to do it. In fact, I am not sure that the Treasury Department would not have more information on that line than any of us but it is information which we will need. It is a problem in which there is much interest, and I am interested, but you cannot solve the problem until you know what it is.

Senator HARTKE. Let me say this to the Secretary. Generally speaking, we are dealing with three problems: vesting, funding, and portability. These are the primary elements which are creating the problem.

Secretary WIRTZ. That is right.

Senator HARTKE. Now, there is one other basic economic factor which is serious today, and that is the fact that most of these pension funds have been created and operate in a period of relative economic expansion, or, to put it in ordinary terms, good times. There has been an increase in the amount of the funds, an increase which has gone along with these good times and which does not necessarily mean good fund management, is that not true?

Secretary WIRTZ. I would think there would be an increased possibility of that in an expanding period.

Senator HARTKE. Now, if we have a serious economic decline, which no one wants but which all of us are always cognizant can happen, if we have a serious recession, you might see a new element in this recession, in the pension fund field, which could create even additional hardships for employees, which heretofore have never been known before in periods of recession, is that not true?

Secretary WIRTZ. Well, I would answer yes, but would have the feeling that the problems which we both have in mind will be so real in either an expansion period or a depression or a recession period that it is hard to make a comparison. Expansion will mean a very fast turnover. One element of the expanding economy is a very fast movement from one kind of operation to another. That could very well have a larger effect on terminations even than a slowing up.

Senator HARTKE. Let me say to the Secretary that I want to thank you for your testimony today, and I am delighted that you have at least done as much as you have. I am thankful that you have endorsed the principles of my bill, but I do not consider this bill to be the perfect answer. At least, I think it is a beginning, and I am hopeful that we can move more rapidly than sometimes all of us have a tendency to move.

Secretary WIRTZ. What you say, and the way you say it, brings to mind, Mr. Chairman, if it is all right, a story. Not to belittle the bill at all, but you put it in almost the same form as the boy who came home from school, third grade, holding up a book he had won as a prize. His mother asked him what he got it for. Well, he got it for giving the best answer to a question. She said, "What was the question?" He said, "The question was how many legs has an ostrich." His mother said, "What did you say?" "I said three." She said. "How did you win the prize?" He said, "Everybody else came up with four."

It comes closer than anything else I have seen. We may have reservations about it. That does not mean in any sense that we would minimize the support for the contribution that it makes.

Senator ANDERSON. I do think you might mention the fact that pension plans do have a stabilizing influence on employment.

Secretary WIRTZ. Yes, sir.

Senator ANDERSON. And that is a very important part of it.

Senator GORE. Sometimes too much of a stabilizing influence.

Secretary WIRTZ. That is correct, but it sometimes will have the effect of keeping the individual in the position, hanging on to it when he does not want it, keeping him from going some place else very possibly that needs him more. At a time when we are approaching the full use of our manpower capacity, it is awfully important that we do not have the brakes on.

Senator GORE. At other places where their labor would be more fruitful, they would be happier, and enjoy a better salary.

Secretary WIRTZ. That is right, and yet they stay and hold on for the very understandable reason that that pension means a great deal to them.

Senator GORE. Well, we want it to mean a great deal.

Secretary WIRTZ. That is right.

Senator GORE. But there ought to be some vesting of the rights as a man goes along.

Secretary WIRTZ. That is right. We just attach infinite importance to both protection and the vesting point.

Senator GORE. And particularly should this be true when the pension is made possible by very generous tax benefits from the Treasury of the United States.

Secretary WIRTZ. I think that is a fair statement, yes.

Senator ANDERSON. Mr. Secretary, is it your experience that most of the modern plans do carry some vesting?

Secretary WIRTZ. That is an extremely complicated question to answer. Going into it in the task force and in considering it in the President's Labor-Management Policy Committee as we did, we found such a variety of answers to that. If the question is whether they include some degree of vesting, the answer is that most plans do, but I can tell you that the meaningful answer to that question in terms of suggesting the dimensions of the remaining problem is no. Putting it the other way around, there are a great many plans which include no adequate vesting or funding.

Now, with respect to the question of how many include vesting—do you have an indication of that?

Mr. HENLE. Two-thirds.

Secretary WIRTZ. Up to two-thirds of the plans I am advised have some kind of vesting. If you take a harder standard of what is fair vesting, even that proportion goes down sharply.

Senator ANDERSON. That is a substantial figure, is it not?

Secretary WIRTZ. It is enough to confirm by experience the validity of the practice. It is enough to indicate the possibility of covering the remainder of the problem. It still leaves a very large problem.

Senator SMATHERS (presiding). Any other questions? Thank you very much.

Secretary WIRTZ. Thank you, Mr. Chairman and members.

Senator SMATHERS. Our next witness will be Mr. Robert M. Ball, Commissioner of Social Security, accompanied by Mr. Roberts Myers, Chief Actuary.

All right, sir, we are always happy to have you, Mr. Ball.

STATEMENT OF ROBERT M. BALL, COMMISSIONER OF SOCIAL SECURITY, ACCOMPANIED BY ROBERT J. MYERS, CHIEF ACTUARY OF THE SOCIAL SECURITY ADMINISTRATION, AND MRS. IDA C. MERRIAM, ASSISTANT COMMISSIONER FOR RESEARCH AND STATISTICS

Mr. BALL. Thank you very much.

Senator SMATHERS. You may proceed, please.

Mr. BALL. I have with me Mr. Robert J. Myers, Chief Actuary of the Social Security Administration, and Mrs. Ida C. Merriam, Assistant Commissioner for Research and Statistics.

I appreciate this opportunity to discuss with you the provisions of S. 1575, the Federal Reinsurance of Private Pensions Act. Secretary Wirtz has already presented the administration's views on this bill. My purpose is merely to supplement those views from the standpoint of the Department of Health, Education, and Welfare, which would administer the new program that the bill would establish.

Private pension plans are a major element in the Nation's total retirement security program. They now cover about 25 million workers, pay $2¾ billion a year in benefits, and pay monthly benefits to 2.5 million beneficiaries. The President's Committee on Corporate Pension Funds and Others Private Retirement and Welfare Programs has estimated that by 1980, private plans would cover some 42 million workers and that then there would be about 6½ million beneficiaries. A large part of the labor force, then, is relying on the protection provided by private plans to supplement the basic protection that is provided by the social security program. Each year, though, a small number of plans are unable to pay the promised benefits for such reasons as the company stopping operations and the plan having insufficient assets to pay the benefits that have accrued to date—particularly those payable in the future to persons near retirement age. S. 1575 is an effort to provide some degree of protection for employees who would otherwise lose their benefit rights for these reasons.

The Department of Health, Education, and Welfare believes that the objective of this bill—to afford people more assurance that promised pensions will be paid—is a highly desirable one. However, as Secretary Wirtz has brought out, the bill raises a number of questions that require further study. For example, there is the question of whether it is feasible to include under a reinsurance program all of the risks that would be covered by the present bill. The operations of a business can stop for a variety of reasons, including events that may be subject to control by the employer, such as a sale or merger of the company. The fact that in some instances termination can be controlled by the employer raises a question of whether the risk of termination can be insured against unless the insured risk is limited to those terminations beyond the employer's control.

Another type of question that requires study—this too mentioned by Secretary Wirtz—has to do with what minimum operating standards should be required for participation in the reinsurance program. Criteria must be formulated to determine eligibility for participation so as to protect the reinsurance fund against being used as a means of subsidizing imprudent investment practices and inadequate funding by the pension plans covered.

The President's Committee on Corporate Pension Funds, in considering the problem of insuring benefit rights in the event of a plan's termination, recognized that there are a number of difficult questions involved, including, in addition to the question of whether termination of a business is an insurable risk, the questions of what types of terminations, bankruptcy, merger, and closing down of certain operations, for example, could be insured against and what experience there is on which to base the premiums. As Secretary Wirtz has mentioned, a number of studies are now underway. Hopefully, answers to some of these questions will come out of these studies. It would seem wise to await the outcome of the studies now in progress before taking legislative action in this important and difficult area.

Senator SMATHERS. Senator Anderson, do you have any questions?

Senator ANDERSON. Well, I wonder, are there companies that do this reinsurance work already in existence?

Mr. BALL. Senator, I do not know of any plans for reinsurance of pension plans as such.

Senator ANDERSON. Well, if a large life insurance company——

Mr. BALL. Yes. There is reinsurance of life insurance, Senator, but I know of none in the pension area. I understand in the life insurance area they do not even cover the individual annuity business but only death claims.

Senator ANDERSON. Why then a proposal to set up a Government agency to handle this, when it might be pretty well handled by the insurance companies right now——

Mr. BALL. The insurance companies, as I suggest, are not really in the business of insuring pension plans as a whole, partly I presume for the same reasons that we find some difficulty with a definition of risk that could be insured, and difficulty with the setting of premiums. That is, to my knowledge no private company has yet moved into this area of reinsurance of pension rights.

Senator ANDERSON. Could you not very quickly find out what is being done by an examination of a number of large companies, get a cross section of industry that way? Would it be a great problem to find out what the motor companies have done in this field?

Mr. BALL. Senator, we do have a study in process that I think is right on the point of this bill and I believe would be of real interest to the committee. We have undertaken, through a grant, to back a study by the Wharton School of Finance. The object of this study is to determine the extent to which a reperesentative sample of private pension plans would be able to meet their cumulative benefit obligations in the event that the plan should terminate as of a current date. In other words, this would be the first time—when this study was completed—that we would really know the capacity of the private pension system—on a representative sample basis—to meet the obligations that it had. With that kind of information, one would be in a much better position to answer questions as to the extent of the liability that one would be undertaking in a reinsurance system of this kind, and some other important questions that underlay the proposal in this bill could also be answered.

Senator ANDERSON. We have large numbers of workers in the automotive industry, for example. Do they not have some program that covers this?

Mr. BALL. There is a very large number, 25 million workers, covered by private plans, Senator, but none of them have the kind of insurance of their pension rights that this bill contemplates. That is, the rights that, for instance, workers in the auto industry have are to an extent dependent upon the continued contribution of the employers to those funds. As was indicated in the Studebaker situation, when the plan was terminated in that plant some of the workers who were covered by the plan got only a small proportion of the benefits that they were entitled to under the plan. So, although there is large coverage, it is perfectly true that there is a considerable amount of insecurity about the protection of rights of the people covered.

Senator ANDERSON. I had the impression when a company in which I had some interest put through a pension plan they had an insurance company as a bidder for it rather than the bank taking it up and handling it as the agent.

Mr. BALL. Perhaps I should expand a little on this point. There are several different kinds of pension plans. An insured plan—fully insured—would guarantee the payment of those rights that had actually accrued to the point where it was covered by insurance. Under some of those plans, for instance, each year that the employee is under the plan he gets a certain piece of a pension that is fully funded and that is definitely payable and underwritten by the insurance company. But it is difficult for there to be full funding of past service credits. That is, employees who were working for the company at the time the plan went into effect usually get additional rights for service that they had prior to the inauguration of the plan. Quite typically these past service credits are not fully funded but rather funding is planned over a period of time. Then the plan may be liberalized, and when it is liberalized the past service liability grows because of the new liberalization. It is very, very common, therefore, for pension rights, even in insured plans, not to be fully funded at any one time, particularly because of these past service credits and liberalizations in plans, to keep up with rising prices and wages.

Now, trusteed plans, which are very common, covering large numbers of employees in mass production industry, may depend very considerably on continued contributions of the employer for the payment of benefits—even those vested under the plan. The ability to pay off fully on those vested rights may depend upon continued contributions of the employer and the continued existence of the plan. I think that is our problem.

The bill is designed, within limits, to protect the rights as defined in the plan through a reinsurance program so that people would get payments based on those rights even if the assets of the pension fund were not sufficient to cover the cost of the rights that had accumulated.

Bob, would you want to comment further on this point?

Mr. MYERS. I think that you have covered it well. The only thing I would add is that when, as Commissioner Ball has said, money has been paid over to the insurance company, the benefits arising from that money are almost certainly payable—at least as long as the insurance company remains solvent, which you might say is a virtual certainty as far as the vast majority of our insurance companies.

On the other hand, when the money is put into a trusteed plan, as long as that money is there, and as long as the money has been paid

in for certain benefits, they, too, will be payable. But this also assumes that the investments of the trusteed fund remain sound and that the employer is putting the money in currently for current service as he would in an insurance company.

Mr. BALL. And the problem is one of the termination of the plan and the safety of the investments. The plan in the bill is aimed at both of these risks, Senator.

Senator SMATHERS. All right. Senator Williams?

Senator WILLIAMS. Mr. Ball, as I understand it, the purpose of this bill would be to insure the actuarial solvency of the respective pension plans.

Mr. BALL. I think it has a somewhat more limited purpose than that, Senator, as I understand it.

Senator WILLIAMS. That is, to pay limited benefits, I mean.

Mr. BALL. Yes. It might make the payments, you see, under reinsurance even though the plan met only those actuarial tests that are now required by the Internal Revenue Code for approval. It would not assure full solvency of the plan.

Senator WILLIAMS. Has there been any survey by your Department as to the amount of unfunded liability of the respective pension plans?

Mr. BALL. This, Senator, is what we would get from the study that we are now financing at the Wharton School of Finance. This is the first time that this kind of information on a general basis will be available. We hope to have some preliminary information in probably about a year on this study but we do not have it as yet.

Senator WILLIAMS. That is information that we would almost have to have before we could proceed.

Mr. BALL. I think we would certainly need it before we concluded consideration of this subject.

Senator WILLIAMS. That is what I was speaking of. I do not mean to stop the study. I think it is well to continue. But I mean it is an answer you would almost have to have before you could know the size of the problem.

Mr. BALL. Yes, to set rates and so on, we would need that kind of information.

Senator WILLIAMS. As of the moment, how many plans in America are actuarially solvent?

Mr. BALL. I just feel, Senator, that the variety of definitions of actuarial soundness make an easy answer to that impossible. But——

Senator WILLIAMS. Well, I will modify that. How many of them are actuarially solvent to the extent that the proposed bill would insure them if we adopted it?

Mr. BALL. Let me ask Mr. Myers if he would like to comment on this general question. It is a matter of actuarial definition as to soundness and——

Senator WILLIAMS. Well, I will use the same actuarial definition that is embraced in this particular bill. I am just trying to get the size of it.

Mr. MYERS. Senator, the generally used definition of actuarial soundness as it applies to private pension plans is that there is a definite financing program underway so that, within a foreseeable future period, the plan will be fully funded as to all the benefits rights earned to date. In other words, according to the definition that most

actuaries use, a plan can be actuarially sound, and yet if it terminated at that moment, it might not have all the money on hand for all the benefits based on past service that has occurred and for which benefits are payable.

Senator ANDERSON. Will the Senator yield there? Supposing that same thing happened to life insurance, everybody died. They would be insolvent, would they not?

Mr. MYERS. Yes, that is, if everybody died or a large proportion died at one time, it is possible for a company to be insolvent.

Senator ANDERSON. You do not figure everybody dying. You do not figure everybody could not work at the same time. They are actuarially sound if there is enough money to pay off, is that not right?

Mr. MYERS. Senator Anderson, I think it is a little different. Here under the definition of actuarial soundness as usually used for private pension plans, it assumes that the plan is not going to terminate as of the moment, but rather that the employer will remain in business and pay off the unfunded accrued liability within a reasonably foreseeable future period.

Senator ANDERSON. That is the same period as life insurance. They do not imagine everybody in America is going to die the same day.

Mr. MYERS. That is correct, and the insurance company computes its individual life insurance premiums that way. In the aggregate, if this was done for all private pension plans in the country, there would be no problem, but each private pension plan in a sense is operating independently. I think one of the basic principles of the bill is to try to spread this risk around among the different pension plans, just as life insurance spreads the risk around among the different individuals insured.

Senator WILLIAMS. You gave me an excellent actuarial definition of the question but now I would like to have a layman's definition to the question. Using the actuarial definitions as embraced in this bill, deficiencies, how many plans would be exempted from this insurance by virtue of the fact that they are already actuarially solvent beyond that which would be required?

Mr. MYERS. Well, as I——

Senator WILLIAMS. Are there any?

Mr. MYERS. As I understand the provisions of the bill, participation is completely voluntary on the part of each pension plan. They are not compelled to take this insurance.

Senator WILLIAMS. Do I understand that this would only be available to those who need the insurance?

Mr. MYERS. Well——

Senator WILLIAMS. Or want to buy it? You'll get only the bad credit risks if you do that.

Mr. MYERS. No. The participation would be, of course, a condition of getting the appropriate income tax deductions, so you might say, from that standpoint, it is really compulsory.

Senator WILLIAMS. Then it is compulsory, we might just as well say.

Mr. MYERS. There are two parts of the premium. One is where the premium rate is based on the unfunded accrued liability and the other is based on their investments. I think that probably the very vast majority, in fact, I would say probably virtually all pension plans in the country now have some unfunded accrued liability. There are

a few that have paid it all off, but the vast majority of them are in the process of an orderly payment of amortizing the unfunded accrued liability for past service.

Senator WILLIAMS. Many of these pension plans have investment in common stocks and I notice that on page 3 of the bill—section 4(a)(2)—there would be insurance against "losses realized from the sale of investments of such fund if the sale is required to provide benefits payable by such fund."

Now, would that not in effect be guaranteeing the fund against any decline in the stock market or decline in the bond market if the sale of those investments was needed to pay the funds?

Senator ANDERSON. That is right.

Mr. MYERS. That is the way I would interpret the bill, the only point being that virtually all pension funds, at least now and for many years, will be taking more money in currently than they need to meet their benefit payments.

Senator WILLIAMS. Yes, but that is a sizable—I mean, that is the effect of their particular guarantee, is it not? You are guaranteeing them against decline in the market of either the bonds or stocks in which it has invested if their sale is needed to pay the proceeds. I am not disputing. I am just trying to establish the facts.

Mr. MYERS. Yes. I think that is correct in the long run. Also, this opens the question, when they need to sell investments to meet benefit payments, which investments will the plan sell? If it picks out that part of its investments that would result in a loss, this would create a rather serious actuarial problem in determining premiums.

Senator WILLIAMS. That is the point I was going to raise next. If in the portfolio they had to sell and they had some investments that had gone completely sour this would be an excellent chance to recoup all of their original investment, would it not, and this choice would be with the managers of the fund under this program.

Mr. BALL. I was just going to say, Senator, I think one would have to make some change in the plan so as to protect against that kind of dumping that you suggest. Under the bill as written——

Senator HARTKE. Would the Senator yield?

Senator WILLIAMS. Just a moment. We could not make a change until we recognize it but the situation I describe would be possible, would it not?

Mr. BALL. Yes.

Senator WILLIAMS. I want to emphasize this. I think the Senator from Indiana served a useful purpose in giving us a forum for these studies because I think this is an area that needs study. I am only raising these questions because these are questions that have to be answered before the committee could come up with any conclusions.

Senator HARTKE. I think just for clarification, if you look on page 5, beginning at line 4, "The premium rates established"—and after all, this is a self-funding operation, not using Treasury funds—"premium rates established under this section shall be uniform for all pension funds insured by the program and shall be applied to the amount of the unfunded obligations and assets or class of assets, respectively, of each insured pension fund," which would mean that you would take into consideration the class of assets.

Now, as far as guaranteeing what the net results are going to be, I think that this is true of practically every other investment in the

United States. That is also true in banks. You have the same problem of the type of loans they make.

Senator WILLIAMS. Well, I am not raising these points as faults of the bill. These are just points that have to be taken into consideration. There is no use coming up with an insurance plan unless the insurance plan itself is solvent, and you can't make it solvent unless you have at least some idea of what is being protected and the cost of coverage.

The Federal Government has about 25 or 30 different pension plans, all funded differently. How many of the Government pension plans are funded, completely funded, as to actuarial solvency? Are any of them?

Mr. BALL. No, Senator. None are fully funded.

Senator WILLIAMS. That is my point. I can understand why they are not, but I think it should be pointed out that we are proposing here to move over into a field to provide insurance for something which as yet is not even provided for many plans operated by the Federal Government itself. In the civil service retirement fund, we are told, there was about a $40 billion deficiency.

Now, I realize that that is projected on the almost impossible situation, so you have got that continuing factor, but nevertheless it shows the dimensions of the problem that we are trying to cope with here. Has your Department any estimate at all, either you or Mr. Myers, as to the amount of the unfunded liability of the private funds? Have you ever seen such an estimate prepared by anybody?

Mr. BALL. No. That is the kind of thing we hope to get out of the study by the Wharton School of Finance.

If I might just comment on the point you were making earlier, for clarification in the record, perhaps, Senator, and that is that our feeling—and I believe that of all the advisory councils that have ever worked on the social security program and most outside experts—is that there is a real difference between the need to fully fund governmental systems and such need as to private pensions. It has seemed to most of us that it was quite reasonable to set up governmental systems on the theory that the system was going to be continued indefinitely, and that, being backed with the taxing power of the Government, you could hold a plan to be actuarially sound if it were a governmental plan as long as it was set up in a way that its income was estimated to meet benefit payments as they fell due. Thus, it is not necesasry to take into account any risk of termination—going out of business.

Now, the opposite has been felt to be true in the area of private pension plans where there is always present over a long period of time the possibility of an individual company or even perhaps an industry declining to the point that you just couldn't assume it was always going to continue. Therefore, the test of adequate funding or being actuarially sound has been thought to be much more strict—to require much more funding—in the private area. When the test of full funding is not met—as it frequently is not—in the private pension plan area, then the whole question that this bill is directed to arises. That is, if the plan is not funded sufficiently to pay for all accumulated rights and it goes out of business, there is a very serious problem, of course, for the people who have been counting on those pensions. Therefore I believe that Senator Hartke has performed a real service

in putting forward this bill for study and attention. The kind of detailed criticism that we are making of it and our indication of the need for additional studies does not take anything at all away from the importance of the problem which has been highlighted or the credit which should come from directing public attention to the problem.

Senator WILLIAMS. I agree fully with the statement you made and there is a vast difference in the requirement of funding of a Federal pension plan as compared to private pension plans. There is this element of the company going out of business, also the possibility that the company will have invested in some industry, in a declining industry, where the portfolio may be invested in their own company. Sears, Roebuck, for instance, has been very profitable. It could be invested in one that would not be so profitable.

So we do have a problem here that needs our study and attention and my questions were not being directed here this morning to discourage the studying of the problem, but only to the fact that we cannot approach a solution until we recognize the problems that do exist and what creates them.

Mr. BALL. Yes, sir.

Senator WILLIAMS. And I agree completely with the statement you just made.

Mr. BALL. Thank you.

Senator SMATHERS. Senator Gore?

Senator GORE. One of the problems involved here is the multiplicity of pensions and pension plans of which a person may be a beneficiary. I have heard of people who are the beneficiaries of as many as 100 pension plans, all made possible by very generous tax benefits.

Don't you think that point should be considered in this study?

Mr. BALL. Senator Gore, this bill, of course, as has been pointed out, deals with one aspect of many problems that are involved in private pensions as a whole. You are directing our attention, I believe, to another very important problem, and that is the matter of the ability of workers to carry rights as they leave one employer and go to another and how that should be handled.

If vesting were complete in private plans so that if a person worked just for a short time for this employer and a short time for another and a short time for another, I suppose all of those small pieces would accumulate in a way that would be equitable and desirable, and then your only problem would be the administrative costs that are involved in handling so many small pieces.

Senator GORE. Well, in this case the man works for himself and vesting is complete.

Mr. BALL. Oh.

Senator GORE. Yes. Real nice. It is all possible under our tax laws. And now if we are to reinsure these, it seems to me we might look into that, too.

Mr. BALL. Yes, sir. This bill, first of all, excludes the self-employment plans under H.R. 10, and then it protects against a situation where the plan would be rigged, really, toward the benefit for an owner or single high-paid employee in the plan. I think that is quite carefully protected against in the bill, but your fundamental point I agree with 100 percent—that the matter of movement creates a very serious problem for private pension plans.

Of the 25 million workers that are now covered under plans, many will never get a pension from the plan they are supposedly covered under because there isn't early vesting and they will move and the coverage won't result in a benefit.

Senator GORE. So we have at one extreme the problem of no vesting, and almost economic peonage, and at the other extreme there is the case of the family corporation or closely held corporation, employing one or two people who are also the owners of the corporation, and here we find cmplete vesting in one pension plan after another.

Now, in raising these aspects of the problem, I wish the committee to understand that I in no way wish to throw cold water upon the initiative of Senator Hartke. He is to be commended, in my view, highly. I am doing so to illustrate that the problem is a big one, that it has many facets, and that in my view, both the administration and the committee have been remiss in being tardy in going into this problem. I congratulate the Senator from Indiana.

Senator HARTKE. Thank you.

Senator SMATHERS. Senator McCarthy, any questions?

Senator MCCARTHY. Yes. Roughly 50 percent of all the money that goes into these pension funds is there in consequence of tax deductions, is it not?

Mr. BALL. I think that is somewhat high, Senator. That would assume that everybody was pretty close to the maximum corporate rate, wouldn't it?

Senator MCCARTHY. Yes.

Mr. BALL. I think it is probably closer to 30 percent.

Senator MCCARTHY. Thiry or forty percent. What kind of authority does Internal Revenue exercise over the funds as they are established, or the Labor Department?

Mr. BALL. Senator, I believe the next witness is from the Treasury Department. I would prefer to defer to him for an answer to that.

Senator MCCARTHY. Does your agency have any jurisdiction?

Mr. BALL. Under the bill?

Senator MCCARTHY. No. I mean by common practice.

Mr. BALL. Under present law we have no responsibility.

Senator MCCARTHY. Who does? Does the Labor Department have some?

Mr. BALL. The Treasury Department through the Internal Revenue Service has jurisdiction over the approval of plans as to whether they can receive tax exemption. The Labor Department has the authority under the Disclosure Act.

Senator MCCARTHY. Most of these started during World War II?

Mr. BALL. There was a big upsurge in private pension plans at that time. I don't really know whether the absolute majority started then because there have been a lot started since then, especially in the late 1940's. But that was the first big wave of private pension plans in this country. It was really the first time that they moved in large numbers to protect wageworkers. What had been in existence before, with few exceptions, were apt to be for salaried and managerial employees.

Senator MCCARTHY. Was it developed as a way around the wage-price guidelines that were in force then?

Mr. BALL. In essence, I believe that is right, Senator. This was one of the few places left that employers could get an advantage in

attracting workers and one of the few places where workers could press for additional compensation.

Senator McCARTHY. Or appear to move ahead. It is a delayed benefit.

Mr. BALL. Yes.

Senator McCARTHY. But the tax advantage was immediate, was it not?

Mr. BALL. Yes, sir.

Senator McCARTHY. And the bulk of these started during World War II?

Mr. BALL. Yes, or shortly afterward.

Senator McCARTHY. I have no more questions.

Senator SMATHERS. Senator Hartke?

Senator HARTKE. Mr. Secretary, under this bill you would be the administering agency. Do you want this job?

Mr. BALL. I certainly would want to know a lot more about it, Senator. I think that the sheer administrative aspects are not too difficult. I think our real problems are one of defining risk and setting rates, and if we had the information and could overcome these problems, I think this would be a very important social contribution.

Senator HARTKE. Yes. Now, quite honestly, though, as far as administration is concerned, isn't your department the proper place for such administration, in your opinion?

Mr. BALL. Senator, I really have not taken this question up within the executive branch. It seems to be a perfectly logical place and I have no objection.

Senator HARTKE. Quite honestly, also, isn't it true that with the social security system the way it is today, that there probably could be a utilization of the social security system itself, the numbers and the whole operation of pension reinsurance which could be dovetailed with the social security operation, could it not?

Mr. BALL. If a plan like this were in operation, I do see one important point where the two systems could be brought together. The need to inform people of their rights to insured pensions as they reached a pensionable age might well be made easier if we mark our records and gave such an indication to individuals as they applied for social security.

Senator HARTKE. The concept of social security is that it does not provide a complete income coverage for a person at the age, say, of 65, roughly speaking, but that it provides a supplementary income coverage. It is not expected to really provide a standard of living in the manner in which the retiree has been accustomed prior to the time he retires, isn't that true?

Mr. BALL. I would like to phrase it just a little differently. I am not sure I am quarreling with you very fundamentally, but at the present time probably 80 percent of the aged population has only social security as a pension and even in the long-range future it is going to be the great majority who have only social security as a pension.

Now, already this program has been designed so that for people earning near the maximum amounts covered by social security, that is $6,600 a year, the payment to the beneficiary and his wife would be about 50 percent of wages. Now, I think that leaves a substantial area for supplementation by private pension.

At the lower levels of earnings, if you take the worker at the minimum wage—say the minimum Federal wage—the program is designed in the long run to pay a man and wife about two-thirds of the previous wage. The President has indicated that he is going to recommend some increases in social security for next year, increases that I think are very, very much needed in the cash benefits area. To answer your question more directly, then, I would say that even after all the improvements in social security are made that will be and should be made, there is undoubtedly significant room left for major private pension supplementation.

I just don't think on the other hand, though, we can count on designing a social security system as if everybody is going to turn out to have a private pension. That just won't be true. For perhaps the majority, social security has to be complete coverage.

Senator HARTKE. No. I am not saying that. But you will administer this job faithfully and truly to the best——

Senator SMATHERS. Is the Senator swearing him in?

Senator HARTKE. Thank you very much. That is all.

Senator SMATHERS. All right. Thank you very much, Mr. Commissioner.

Senator SMATHERS. Our next witness is Mr. Jerome Kurtz, of Tax Legislative Counsel, Treasury Department.

STATEMENT OF JEROME KURTZ, TAX LEGISLATIVE COUNSEL, TREASURY DEPARTMENT; ACCOMPANIED BY WILLIAM T. GIBB, ASSOCIATE TAX LEGISLATIVE COUNSEL, AND PAUL M. DODYK

Mr. KURTZ. Mr. Chairman, members of the committee, I have with me Mr. William Gibb, Associate Tax Legislative Counsel and Mr. Paul M. Dodyk of my office.

We appreciate your invitation to present the views of the Treasury Department on S. 1575.

Generally speaking, S. 1575 would establish an insurance program to protect beneficiaries of private pension plans against loss of their pension benefits on account of the closing down of a plant or other facility or on account of the forced sale of plan assets to meet liabilities. The program would be administered by the Department of Health, Education, and Welfare and financed through contributions by participating pension plans.

To encourage participation in the insurance program the bill would deny tax qualification under section 401 of the Internal Revenue Code to any pension plan which is not insured under the program. This particular provision would undoubtedly serve to encourage broad participation by pension plans in the insurance program by reason of the many substantial tax benefits that flow to both the employer and employees when their pension plan attains tax qualified status.

The Treasury Department supports the objective of S. 1575. We are in agreement with the conclusion in the report of the President's Committee on Corporate Pension Funds that—

> The value of private pension plans as a socially desirable supplement to the public retirement system depends on the degree to which accumulated funds are sufficient to pay the pension benefits of workers as they reach retirement. This is a matter of utmost public importance.

A program which would help assure employees of receiving their accrued benefits on the termination of a pension plan would, in our opinion, be a meaningful step in strengthening the private retirement system in this regard. To this end, the President's Committee recommended, and this Department agrees, that serious study be given to considering whether a system of insurance would accomplish this objective. If so, the Treasury Department believes that conditioning a plan's tax qualification on its participation in such an insurance program is an appropriate method for encouraging plans to adopt this program.

On the other hand, as the report of the President's Committee recognizes, the development of such an insurance program raises a number of difficult questions. Since many of these questions are not within the particular competence of the Treasury Department, we are not in a position to make a judgment as to whether the program contained in S. 1575 is an appropriate solution.

The Treasury Department believes that there are certain guidelines which should be followed in developing any insurance program of the type envisioned by the bill.

First, we believe that such an insurance program cannot be considered independently of the question of what funding standards should be applied to private retirement plans. In this regard, the report of the President's Committee contains a series of recommendations for improving the funding of private retirement plans as well as for verifying that the funding standards are, in fact, met. An insurance program without adequate funding requirements could well operate to encourage employers to rely on the insurance rather than on prudent funding, especially if the insurance premiums were significantly less than the costs of adequate funding. If reliance on the insurance were to become a widespread practice, the whole program could well become self-defeating.

Moreover, we believe it is essential that the type of risks to be covered by the insurance be carefully defined in order to prevent the possibility of corporate maneuvering to shift plan liabilities to the insurance program that were not intended to be within its scope.

In addition, we note that the Departments of Labor and Health, Education, and Welfare have raised a number of other issues including questions regarding investment standards; the determination of insurable risks; and the adequacy and method of calculation of the insurance premiums, including the problem of rating various types of risk.

The Treasury Department would be willing to cooperate in the study of an insurance system, as well as in the development of sound funding standards for private retirement plans. In this regard, the Internal Revenue Service is presently participating with the Department of Labor in compiling information on the reasons for plan terminations and the number of plan participants who lose benefits by virtue of terminations. Moreover, the Treasury Department is participating on an interagency task force which is in the process of holding meetings with a number of interested private groups to discuss some of the proposals included in the report of the President's Committee. One of the topics on the agenda for these meetings is the matter of insuring employees against loss of benefits on termination of the plan.

Again, I wish to thank the committee for this opportunity to present our views on this matter. I will be happy to join the representatives of the other Departments who are here today in attempting to answer any questions the committee may have.

Senator SMATHERS. Senator Anderson, do you have any questions?

Senator ANDERSON. In the beginning, the third paragraph, "To encourage participation in the insurance program the bill would deny tax qualification under section 401 of the Internal Revenue Code to any pension plan which is not insured under the program." In order to get tax deductions for setting up of a program, you make them go under the Government insurance whether they want to or not.

Mr. KURTZ. That is what the bill provides.

Senator ANDERSON. Why do you do that? Why is it proper for a company to insure with Prudential for example? What is so sacred about insurance in a Government program?

Mr. KURTZ. Well, the thought is that the losers, where there is no insurance, are the beneficiaries of the plan, and in order to assure that the beneficiaries of the plan will not be the losers by reason of the closing of a plant or the other contingencies covered, the bill provides that the companies insure against these risks, and as an incentive, and encouragement to do that, conditions tax qualification on their joining this program. It might be possible to provide for another type of insurance. However, we would require additional study to see if there are possible alternatives.

Senator ANDERSON. But you are setting up here a complete Government monopoly on the right to guarantee pension funds. Don't you have any faith in the private insurance system of the country?

Mr. KURTZ. The bill provides for these Federal insurance funds.

Senator ANDERSON. Yes. Didn't you endorse the bill here in your statement?

Mr. KURTZ. We endorsed the bill to the extent of saying that while the actual methods of insurance are not within our competence, nevertheless, if insurance is decided upon, we feel that conditioning tax qualification upon compliance is an acceptable way to the Treasury Department to encourage compliance with the bill.

Senator ANDERSON. Do you think any corporation is going to insure in a private company when it doesn't get any tax deduction?

Mr. KURTZ. In the face of this bill, I doubt it seriously.

Senator ANDERSON. So you are setting up a complete Government monopoly fund.

Mr. KURTZ. At the moment I don't believe private insurance companies would insure this risk.

Senator ANDERSON. Do you know?

Mr. KURTZ. No, I don't.

Senator ANDERSON. Wouldn't that be interesting to know?

Senator MCCARTHY. It is like Federal deposit insurance.

Senator ANDERSON. No, it isn't like Federal deposit insurance at all.

Mr. KURTZ. This is one of the things that is being covered in the study that is now going on; that is whether insurance companies would be willing to undertake it, whether that is a possibility.

Senator ANDERSON. But the funds that a corporation puts into their pension plan cannot be deductible if they are not insured by the Government.

Mr. KURTZ. That is true under this bill; yes, sir.
Senator ANDERSON. And you favor that?
Mr. KURTZ. Well——
Senator ANDERSON. Well, you are testifying for the Treasury Department. What does the Treasury Department feel?
Mr. KURTZ. As to the insurance aspects, the method of insurance, the Treasury Department is not in a position to recommend the best method of insurance. This is not within the competence of the Treasury Department. The Treasury Department's only position is that, assuming a method of insurance is worked out, we feel that it is fair to condition qualification on a company's obtaining such insurance.
Senator WILLIAMS. In other words, you are recommending that it be made mandatory that they participate in this Federal program if and when such a program should be started.
Mr. KURTZ. Yes, sir.
Senator ANDERSON. That is the whole point. I haven't heard one of those arguments made for a long, long time, that you should absolutely set up a Government monopoly to insure the success of these funds.
Senator SMATHERS. Is that what you are saying? Your statement says the Treasury Department supports the objectives of S. 1575. I don't know that it goes any further than that.
Mr. KURTZ. That is right.
Senator SMATHERS. It stops right there.
Senator ANDERSON. One of the objectives is to set up a complete monopolistic fund and not allow a man to take a deduction of any kind for the payment he puts into the fund.
Mr. KURTZ. The objectives in the bill as we view them are to guarantee employees against losses due to the contingencies covered by the bill. This is the broad objective. As to methods of working this out, this really is not within the competence of the Treasury Department.
Senator ANDERSON. One of the objectives is to set up this Government monopoly fund as you view the objectives of the bill.
Mr. KURTZ. If that is viewed as one of the objectives of the bill, then that is one of the objectives we are not prepared to comment on, Senator.
Senator ANDERSON. But you do. You say to encourage participation in an insurance program. The bill would deny qualification under section 401 of the Internal Revenue Code to any pension plan which is not insured under the program. Are you willing to apply that all across the board, to fire insurance, casualty insurence, bonds, et cetera, and have to have a Government monopoly fund?
Mr. KURTZ. No, sir.
Senator ANDERSON. Why do you pick this one out?
Mr. KURTZ. Well, if there were to be private insurance available to cover this kind of risk, and tax qualification were conditioned upon insuring either with a Government fund or private industry, the Treasury Department would support either position.
Senator ANDERSON. Regardless of this language here about monopoly?
Mr. KURTZ. Well, the language may be inappropriate, sir, but in my view, that language referring to objectives of the bill did not view a Government insurance monopoly as one of the necessary objectives.
Senator WILLIAMS. Do I understand that you are reversing your previous statement and you would be willing to allow them tax deduc-

tions for their contributions if they insured with a private insurance company?

Mr. KURTZ. Well, we have no idea whether that is a possibility, Senator Williams, whether private insurance would be available.

Senator WILLIAMS. If it was available?

Mr. KURTZ. If a workable program were developed that would help to ensure that employees received their benefits under these funds, the Treasury would not oppose conditioning tax exemption on participation in such a program.

Senator WILLIAMS. And you are not wedded, then, to that language, that it will only be deductible if it is in the Federal insurance program.

Mr. KURTZ. No, sir.

Senator ANDERSON. Then why did you put it in the statement?

Mr. KURTZ. Well, on page 2 of the statement, there is other language which is perhaps an explanation of that. We say a program which would help assure employees of receiving their accrued benefits on termination of the pension plan would in our opinion, be a meaningful step in strengthening, and that is what we were emphasizing, the security of the employees' benefits.

Senator ANDERSON. If some large corporation like New York Life or Mutual of New York or Prudential or Equitable was going to do it, would you think it much better to just put it in the Government funds or let them have it?

Mr. KURTZ. I wouldn't be prepared to say whether it would be better. I would say it is something that certainly warrants study.

Senator ANDERSON. You haven't studied that up to this time?

Mr. KURTZ. No, sir.

Senator SMATHERS. Senator Williams?

Senator WILLIAMS. Are there any investment standards provided in this bill before us?

Mr. KURTZ. Investment standards?

Senator WILLIAMS. Yes.

Mr. KURTZ. No; sir.

Senator WILLIAMS. Would not investment standards be a requirement if you are going to insure them?

Mr. KURTZ. Well——

Senator WILLIAMS. This provides—let me phrase it this way: The bill, under section 4(a) (2), provides for insurance against depreciation in the value of the investments and that is not described. That could be common stocks, could be any type of an investment, and you are insuring that investment. Now, would not it be mandatory, almost, that if you are going to insure the investment that you have to have some standards of investment?

Mr. KURTZ. This is certainly a very substantial problem and this is one of the areas which we feel needs considerable study.

Senator WILLIAMS. Has there been any estimate by the Treasury as to the additional cost, dollarwise or percentagewise that would be added to the respective private pension plans if vesting were placed in there as a requirement?

Mr. KURTZ. If vesting were made as a requirement? There has been no detailed study made, although some very preliminary, rough calculations have been made which indicate 5 percent additional cost.

Senator WILLIAMS. You think that could be done with 5 percent additional cost?

Mr. KURTZ. That is a very rough estimate.

Senator WILLIAMS. Whose estimate was that? Was that the Department's?

Mr. KURTZ. Department of Labor.

Senator WILLIAMS. Department of Labor's estimate. Vesting rights of the employees, as the Senator from Tennessee pointed out, is one of the points that is of major interest as far as the employees are concerned, is it not?

Mr. KURTZ. Yes. Certainly.

Senator WILLIAMS. Has there been any estimate made by the Treasury Department as to the extent of the unfunded liability of the private pension funds now in force?

Mr. KURTZ. No, sir. The Treasury Department has made no independent estimate.

Senator WILLIAMS. But you are willing to insure?

Mr. KURTZ. Well, I was just reminded, this will be one of the things that comes out of the Wharton School study.

Senator WILLIAMS. Then are we correct in understanding at this point that you are not endorsing the bill? You are only endorsing the study of this problem that is referred to in here.

Mr. KURTZ. Yes. The overall objectives of the bill of guaranteeing pension rights we are certainly endorsing, but we feel that there are a number of problems in the bill requiring further study.

Senator WILLIAMS. As one who served as a salesman before he came down here, I would like to have had you as a customer who would sign the order before you knew what the price was.

Now, I wonder, you endorsed a noble objective but can you intelligently endorse that objective without having some idea, even some remote idea, as to what you are endorsing? Is it $10 billion, $100 billion, $200 billion? What is the potential liability that you are suggesting here that we endorse under a Federal insurance program? I am not speaking against it. I am trying to find out what are you endorsing, that you are just not putting out words.

Mr. KURTZ. Well, I think, obviously it is possible that the costs of fully insuring all of the possible risks could be so enormous as to be out of question. What we are endorsing is the general idea and proceeding to try and determine what the costs involved would be and whether there is an economic possibility of doing it. It is something we would like to do if it is possible.

Senator WILLIAMS. I see. Well, that is what I wanted to get clear. You are endorsing the idea if it is possible and feasible, but you are not sure yet that it would even be possible or feasible; is this correct?

Mr. KURTZ. Yes, sir.

Senator WILLIAMS. If and when you get the extent of the costs——

Mr. KURTZ. Yes, sir.

Senator WILLIAMS. And also the extent of the premium that would have to be charged.

Mr. KURTZ. Yes.

Senator WILLIAMS. So you are more or less just plainly endorsing a study of the whole problem at this moment.

Mr. KURTZ. That is right.

Senator WILLIAMS. Thank you.

Senator SMATHERS. Senator McCarthy?

Senator McCarthy. Mr. Chairman, I would ask the same question. How did so many of these programs get in such bad shape when the Labor Department and Treasury Department have the responsibility of approving the plans? It seems to me they should have disapproved them and not let the members of organized labor be deceived into believing they had a sound program.

Mr. Kurtz. Well, the Internal Revenue Service does review plans prior to granting a letter of determination that the plan qualifies under section 401.

It is true that there have been a number of plan failures and a study is now being conducted to determine just what the reasons for the various plan terminations have been.

There are any number of reasons, some of which arise from the operations or closing of plants or one thing or another which in the normal course is not subject to Treasury approval. The Treasury approves the plan. That is, that it provides for equitable treatment, and so on. And on audit, as a general matter, supervises it. But as the law now stands, there is a limit to the power of the Service to deny qualification to the plans.

Section 401 sets out what the standards of qualification are and if they are met, the Service has to grant qualification.

Senator McCarthy. Have you made any recommendations along the way that the provisions of section 401 be changed?

Mr. Kurtz. Well, yes. The pension report prepared by the President's Committee on Corporate Pension Funds, in which the Treasury Department was a participant, makes good many recommendations to that effect.

Senator McCarthy. What is the general effect of the recommendations?

Mr. Kurtz. One effect would be to tighten the supervisory power and control over pension plans.

Senator McCarthy. So you would have more control.

Mr. Kurtz. Yes.

Senator McCarthy. What about the question of vesting? Do you have any recommendation with reference to vesting?

Mr. Kurtz. There is a recommendation in the report which doesn't go into any great detail but sets forth that a reasonable measure of vesting should be provided for in plans. In all plans.

Senator McCarthy. The general effect of adoption of legislation of this kind would be, if we did follow the reinsurance principle here, to impose a high rate of contribution to the insurance program on the part of those companies that have had what you consider weak pension programs with a questionable future.

Mr. Kurtz. The provisions of this bill?

Senator McCarthy. Yes.

Mr. Kurtz. Well, I don't believe that this bill differentiates rates from company to company.

Senator McCarthy. Wouldn't it have to if there are bad risks? It says a maximum, but I think it allows for differentiation.

Mr. Kurtz. It does it on the basis of unfunded liability but not on the basis of one company perhaps being a worse credit risk than another. That kind of differentiation is not made by this fund

Senator McCARTHY. So you have two problems. One is the question of what to do about the basic funds which are to be reinsured.

Mr. KURTZ. Yes, sir.

Senator McCARTHY. And the second one would have to do with what kind of assessment you would make on the basis of the reinsurance program.

Mr. KURTZ. Yes. Those are two of the most substantial.

Senator McCARTHY. Your immediate interest up to now, until the bill was introduced, was with the basic programs and with efforts to make them somewhat more sound and equitable and just.

Mr. KURTZ. Yes, sir.

Senator SMATHERS. Senator Hartke?

Senator HARTKE. The Senator from New Mexico referred to this lack of appreciation of the great private enterprise system. Don't you think some type of criteria ought to be established before you give a tax subsidy to any corporation or any employe?

Mr. KURTZ. If you mean in terms of——

Senator HARTKE. Isn't there a tax subsidy now to the pension plans?

Mr. KURTZ. Yes.

Senator HARTKE. Why don't we just do away with that tax subsidy and go back to the great private enterprise system that you are talking about? Why should you give a tax subsidy to somebody. Why just hand it to them? The rest of us who don't participate in the pension plans are paying the tax bill. The people not working in the United States, why should they pay the tax bills. Why not count on private enterprise, on the private enterprise system, and I say that with quotes, to which we referred.

Mr. KURTZ. Well, the President's Committee did address itself to all of those questions.

Senator HARTKE. I am not interested in the President's Committee. You said you came here and endorsed a principle—the principles of this plan. You should have stayed with them instead of letting him take you down that alley. You stay with your own ideas and you will be a lot better off than letting somebody take you on down a blind alley on these things like subsidies, like I am doing now. You see, this is just as bad a term, and I don't approve the use of those terms for myself or anybody else. I am in favor of continuing this program, but I do think there should be some criterion. When a man takes a tax benefit from the Government, there should be some criterion of standards under which he is going to receive that benefit. I think one of them is that there are these employees who absolutely never will receive, or only about 4 out of 10 are all that will ever receive, the benefits of what comes out of these tax plans, and the rest of that money is being paid for, at least to the extent of 30 percent, according to your general testimony, by the general taxpayer. I am saying that this is a serious problem, and I don't think that you should be taken down these blind alleys as to what the bill will do.

Now, let's take the bill itself. Forgetting tax subsidy and forgetting monopoly, isn't it true that this bill does not require mandatory participation?

Mr. KURTZ. That is right.

Senator HARTKE. All right. Only those who seek the privilege of the tax exemption—I am not using tax subsidy—only those who receive

the benefits of the tax exemption will be required to participate, isn't that true?

Mr. KURTZ. That is right.

Senator HARTKE. And on this basis it is a relatively small portion of the total pension costs, isn't that true?

Mr. KURTZ. I'm sorry. I don't understand the question.

Senator HARTKE. In other words, as far as the total pension cost is concerned, this will be a relatively small amount compared to——

Mr. KURTZ. The premium.

Senator HARTKE. That is right.

Mr. KURTZ. Yes, that is correct.

Senator HARTKE. That is all the questions I have.

Senator ANDERSON. I have another question.

Senator SMATHERS. Senator Anderson would like to ask another question.

Senator ANDERSON. You spoke about plan failures. What percentage of pension funds have failed over the country?

Mr. KURTZ. We don't have those statistics.

Senator ANDERSON. How can you call it a series of plan failures if you don't know?

Mr. KURTZ. There are some we know of.

Senator ANDERSON. What percentage?

Mr. KURTZ. We are now conducting a study to compile these statistics on how many there are, what percentage, what the causes are.

Senator ANDERSON. Now, as to tax subsidy, there is a representative here of the unions that deal with the auto industry. Do you regard, if General Motors sets aside some money for pensions of its employees, that is a tax subsidy?

Mr. KURTZ. It is a benefit.

Senator ANDERSON. Ah, what difference is there between benefit and subsidy?

Mr. KURTZ. I am not sure.

Senator ANDERSON. Isn't it true that there are two questions involved in this? You can either take an insured plan or trusteed plan and under the bill, whichever you take, you will still have to buy the Government insurance on top of that, isn't that right?

Mr. KURTZ. For those risks the bill covers. If you want tax deduction for contributions to the plan; yes, sir.

Senator ANDERSON. Well, any person who had any sense at all would want the deduction, would he not?

Mr. KURTZ. I would think he would.

Senator ANDERSON. Why, sure.

Senator WILLIAMS. Are not pensions for employees considered as a part of what they are actually earning as they work for the employer?

Mr. KURTZ. Considered to whom?

Senator WILLIAMS. To the employee, and to the employer. At bargaining conferences, are not pension rights considered a part of the earned income of the employee?

Mr. KURTZ. Well, I believe Secretary Wirtz talked about that and said that it varies, that it certainly is a part of it, but as to how much it is and how it is regarded——

Senator WILLIAMS. I am not getting into percentage. But it is a part. A man working in a plant—he considers the pension rights that he is working for as a part of his pay for employment, does he not?

Mr. KURTZ. Yes.

Senator WILLIAMS. Labor is deductible, a deductible item for tax purposes, is it not?

Mr. KURTZ. Certainly.

Senator WILLIAMS. But does the Treasury consider that in allowing deductions for costs of labor, that you are subsidizing the cost of labor in the country?

Mr. KURTZ. I don't believe subsidy——

Senator WILLIAMS. Do you consider that you are subsidizing the pensions? Are you not proceeding on the premise that all of the money that a corporation earns belongs to the Government and if you allow them to spend any of it, you are giving it back to them?

Mr. KURTZ. Certainly not, sir.

Senator WILLIAMS. Is the cost of operating a pension plan in any plant a part of the cost of doing business?

Mr. KURTZ. If the company has a plan and if it forms a part of the compensation to which employees look and to which the company looks, it is a cost of doing business and that cost is deductible providing the plan meets the criteria set forth by the code.

Senator WILLIAMS. But on a personal basis, both you and I are working for the Government and as such we are earning pension rights. Now, are you considering that the Government is going to subsidize you in your old age or are you earning those as a result of the work you are performing today?

Mr. KURTZ. Well, I would say they are earned.

Senator WILLIAMS. They are earned.

Senator SMATHERS. You have earned them this morning. [Laughter.]

Senator ANDERSON. I just want to say to the representatives of the Treasury Department, I think one of the finest things organized labor has done is to insist all across this country on decent pension plans and what you call fringe benefits. I think some of these are more important than some of the wage scales, but extremely important are these pension plans which labor has done and which I think is the finest piece of work.

Senator WILLIAMS. I agree completely with that and I don't think they should be considered as subsidies by the Government.

I think once these pension plans are created they belong to the workers and this is the reason I mentioned these vestings. Pension rights belong to them as their earned rights.

Senator SMATHERS. Thank you very much.

We would like to have one more witness before the lunch break.

Senator HARTKE. Just take your time. We are in no big hurry.

Senator SMATHERS. The Senator can speak for himself. Only for himself.

Senator HARTKE. If you don't want any more questions, I will be glad to quit.

Senator SMATHERS. I thought we would get Mr. Reuther on and then go to lunch.

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Senator HARTKE. Mr. Reuther hasn't told me he is in any big hurry. Maybe he is. If he is—I want to ask just one question.

Senator SMATHERS. Go ahead.

Senator HARTKE. Isn't it true when you talk about these pension rights, that it is a matter for economic consideration in collective bargaining, generally speaking, but when you pass that point, how you determine it as to how it affects each and every individual down the line becomes very complicated for the simple reason that there are a lot of things which are taken into consideration as to how that man is going to actually receive that pension. His longevity, for example, is a big factor. His mortality. The turnover in the plant. All of these factors come into the package. So when you come back to how it affects an individual within the group, it is very difficult to determine how much of that actually belongs to him percentagewise or dollarwise.

Mr. KURTZ. Well, that is right. It certainly varies considerably from man to man.

Senator HARTKE. That is right. So when you take it in broad, general terms, what the Senator from Delaware has said is true, that it is, generally speaking, as Secretary Wirtz referred to, it is a general item in the total wage package and therefore is given in lieu of wages. To spell it out for each individual employee requires an awful lot of computation. We also have in the long run the complication that only 4 out of 10 actually receive the benefits put aside for them. So that adds to the problem, too.

Mr. KURTZ. Yes, sir.

Senator HARTKE. You see, that didn't take very long.

Senator SMATHERS. Thank you very much, Mr. Kurtz.

Mr. KURTZ. Thank you.

Senator SMATHERS. Our next witness is Mr. Walter Reuther, president of the Industrial Union Department, of AFL-CIO.

The Chair will announce that after we complete the testimony of the witness—the witness now ready to testify—we will stand in recess until 2:30. We will reconvene in room S-126 which is in the Capitol.

Mr. Reuther, happy to have you. Go right ahead.

STATEMENT OF WALTER REUTHER, PRESIDENT OF THE INDUSTRIAL UNION DEPARTMENT, OF THE AFL-CIO; ACCOMPANIED BY LEONARD LESSER, GENERAL COUNSEL OF THE INDUSTRIAL UNION DEPARTMENT, AFL-CIO AND NOLAN MILLER

Mr. REUTHER. Thank you, Mr. Chairman and members of the committee.

I have with me Mr. Leonard Lesser, general counsel of the Industrial Union Department, AFL-CIO, and Mr. Nolan Miller, who is a Studebaker worker, 59 years of age, who has worked for Studebaker 40 years and is a victim of the problem that we are discussing this morning.

I appear in a dual capacity, Mr. Chairman, as the president of the UAW, with 1,650,000 members, and also as the president of the Industrial Union Department with 8 million members. Both of these organizations are on record in support of Federal legislation to reinsure private pension benefits, and we would like to express our very sincere

appreciation to Senator Hartke for the initiative and added leadership he has provided in submitting his bill. S. 1575, we believe, is soundly conceived and will be an effective instrument in dealing with a very serious and compelling human problem.

Now, I would like to put my prepared statement into the record and then briefly make an oral statement, if I might, Mr. Chairman.

Senator SMATHERS. Without objection, so ordered.

Mr. REUTHER. I believe as one American that the genius of our free society is our capability to work out a harmonizing of a public approach and a private approach to the solution of basic human problems. I think that in the whole broad area of how our free society provides income security in the years of retirement, we have developed a pattern quite differently than any other democratic nation in the world. If you look at the democratic countries of Europe you will find that they rely exclusively upon governmental programs in the fields of social security. But in America, we have developed a very unique approach to this.

We have developed the program which covers most every American which is public in character, but we have supplemented that public program by providing pension programs in the area of private initiative, in the broad area of labor-management relations, and in some cases, programs that flowed out of the action of corporations unrelated to collective bargaining. But, when a worker looks at his income security problem, he doesn't read the fine print and he really relies upon both segments of this protection; and if we are to protect the soundness of this unique American approach in which you have both private and public sharing of the responsibility, then I believe that we must take action to make secure both portions of their total income passage. And this is the area with which the bill that Senator Hartke has proposed deals.

Secretary Wirtz has indicated in his testimony the dimensions of this problem. Twenty-five million Americans are probably covered by privately negotiated pension programs and it is estimated that by 1980, the number will be 42 million. So this is not a problem that bears upon a small segment of the American people. It is a tremendous problem now and its dimensions will increase in the period ahead.

The United Automobile Workers, where I am directly involved in the collective bargaining process, has done some very important pioneering in this broad area of how do we in a free society begin to provide adequate income security for workers in the autumn years of their lives. In 1949 we made our historic breakthrough, the first basic mass production collective bargaining agreement that provided for a sound actuarially based pension program. And since then we have negotiated more than a thousand plans covering one and a quarter million workers in the automobile the agricultural implement, and the aerospace and related industries.

When we started out, we made a very important policy decision we decided to make our pension program sound, even though it created very real collective bargaining problems, because obviously a sound program is more costly than an unsound program. I would like to underscore two principles that we insisted upon.

First of all, we insist that the plans be actuarially sound and funded. We rejected the pay-as-you-go system because we knew that you could

not, in good conscience, tell a worker that he had a pension benefit coming when he reached the point where he qualified for retirement, unless the money was in a trust fund to guarantee the payments for all those benefits. To tell a worker that he had a pension benefit coming without having the funds to back it up, we thought was morally wrong and would be misleading the workers.

So that principle was one upon which we were prepared to struggle. And we did struggle. The Chrysler strike of 1950 went 104 days. It was not about the size of the pension. On that we were in agreement with management. It was about whether the pension would be based upon pay as you go or whether it would be a funded plan. And the Chrysler workers, about 90,000 of them, walked the bricks for 104 days on that principle alone, because we felt that we should not start down the road of a pension program excepting as we funded the pension and backed up the benefits with an actuarially sound fund.

The other thing on which we worked equally hard on was the vesting principle. We believe for a worker to be chained to a job as the only means by which he can protect a pension equity, is incompatible with the values of a free society. We believe, and our pensions programs provide vesting at 10 years, that a worker ought to be able to improve himself by going to another job without forfeiting his pension equity. We believe also that in a free society, vesting is essential to provide that maximum degree to mobility in the work force which will enable workers to upgrade themselves and open the less skilled job for the unemployed workers.

These are several of the principles that we have insisted upon. And I believe that any objective evaluation of what we have done at the bargaining table will lead anyone to the conclusion that we have done a reasonably good job in protecting our members in terms of pension benefits.

Yet, despite all of the efforts that we have made, we have to plead that we have not found the answer to the basic problem that this bill before your committee deals with. That is what happens to the equity of a worker if he has a vested right, if he has a funded plan, but the corporation that he works for goes out of business and the plan is terminated.

Now, obviously, if that takes place at a time when the plan is fully funded there is no problem, because the money to meet all of the claims is there. But I think that everyone who is familiar with the whole question of pensions recognizes the problem of backing up for 50 years, which represents 50 years of neglect. The failure to have met this problem in the past means, that the cost impact in trying to pay for past service credit is too great to pick up in any short period of time and therefore has to be amortized over a long period of time.

Thirty years I think is the standard period for the amortization of past service credits. What happens to a worker's equity, if before the company has amortized this past service credits and thus fully funded the pension, the company goes out of business?

This is what has happened in a number of our programs. In the last 15 years we have had 113 of UAW pension plans terminated. We have gone through the agonizing experience of sitting down with these workers who were told that their plans were funded and they were, who were told that they had a vested right and they did, but suddenly the company goes out of business and the plan is terminated.

We believe that this is the kind of problem that is beyond the capability of a given company or a given union dealing with a given company to deal with because the crisis occurs precisely when the financial resources of the company are in jeopardy and when those resources are totally inadequate to meet the kind of problems with which we are dealing.

No one can project which company is going out of business. You can't when you sit down to negotiate a pension agreement, say, well, let's figure in trying to structure out the funds whether you are going out of business in 15 years. The next company is going to go out of business in 18 years. The next company may go on forever. No one has that kind of crystal ball and therefore you have to make your projections on the assumption that the company will continue to be in business and it will continue to make its annual payment into the fund which is actuarially projected to meet the schedule of benefits.

We are living in a very exciting, but a very difficult period of the human family. When you recognize that 95 percent of all the scientists who live in the history of the world are alive today, and their creative and productive minds are going to accelerate the technological revolution, this means greater and greater change and it is going to come at an accelerated rate. What kind of a practical impact will that have upon the ability of companies in certain industries to survive. No one knows. There will be change in products. There will be change in the market. There will be many other changes. Our relationship with the whole free world must be considered. Take the United States-Canadian automobile agreement.

All of these things will have a tremendous impact upon the economic capability upon a given company or firm or industry to survive.

We want change, because change is the inescapable price of human progress, but the real question is should a disproportionate economic burden of the cost of change be placed upon a worker at the very time when he is approaching retirement and when he is least able to carry that burden? Or shouldn't we, in order to shore up this uniquely American concept of a public social security system supplemented by private systems, shouldn't we meet the problem by sharing the cost of change through the application of a very sound insurance principle?

Take the Studebaker situation, which is a classic case. Senator Hartke talked about it. The chairman of the committee this morning opened up with it. Secretary Wirtz talked about it. The Studebaker company was the oldest automobile company in the business. We celebrated some years ago with the Studebaker management their 100th anniversary. They started out making some of the wagons that were used by the early settlers that crossed this continent. Yet the Studebaker Corp., as an automotive company is no longer in existence in the United States of America. They have got a small operation in Canada.

No one could have anticipated that, yet fundamental economic changes which came about in the automotive industry finally reduced the volume of production in Studebaker to the point where the unit cost was so high that they could not compete. And volume is the key. When General Motors makes 3 million Chevrolets and they can amortize the cost of their engineering and their tooling over 3 million cars, then the cost impact on the unit car is microscopic. But if they spread the tooling costs and the engineering and fixed the overhead over a

volume of 250,000, then, the unit cost is so high that you can't compete. These are the kinds of economic factors that ultimately determined the fate of the Studebaker Corp., as well as Packard, as well as Hudson. As the economic concentration in this kind of industry gets greater and greater, this will be the kind of problem that smaller companies will face.

Let's look at what happened in Studebaker. We had a sound plan. The company paid into their plan over the 14-year period, and when the plan was terminated it had $25 million in assets. But assets are a relative thing. You have got to measure the assets against the obligation. And when we did that, we found that there were 10,500 workers who had a claim on that $25 million.

When we were faced with this very difficult problem at Studebaker, we looked at these 10,500 workers, all of whom had a claim upon that $25 million, and found that there were really 3 groups of workers that we had to deal with. There were 3,600 people who either had already retired or had reached the retirement age of 60 and were still working. They had the first claim and we allocated that portion of the $25 million to guarantee pensions for the balance of their lives to those people on retirement and those people who had reached the age of 60.

In the second category of employees, there were 4,000. They were in the age bracket of 40 to 59 with at least 10 years of service—which qualified them under the vesting provision. Now, some of these workers missed being 60 only by a couple of months. And because they missed that magic date by a couple of months, they fell in the second category and as Secretary Wirtz pointed out, they only got 15 percent of their equity, because after we took care of the first group, there was only that much money remaining.

The third category of 2,900 workers under age 40 got absolutely nothing.

Now, that is the kind of problem that we are confronted with. We can't solve that at the bargaining table. That is beyond the economic capability of finding a rational answer at the bargaining table because you can't anticipate these things. And when the problem occurs, you can't bargain with the company that is going out of business.

It seems to me that the only way that this problem can be dealt with is by the application of the very sound insurance principle which we have applied in other areas. When we recognize that the burden of a risk is too great to place upon the back of a group of people, we share the burden of that risk by an insurance concept.

When we were faced with a very similar problem at the bottom of the great depression, in 1933 I think is was, the Congress enacted the legislation to reinsure bank deposits. We recognized that you couldn't deal with the problem excepting as everyone shared the cost of that risk. We recognized that if one bank went under, the people who had their deposits in that bank shouldn't carry the total burden because the economic factors that make for termination of a plan and sometimes the bankruptcy of a bank are beyond the influence of the corporation or the company or the bank. We believe that just as there was sound reason for the Federal Government to apply the insurance principle to guarantee $10,000 deposits for people who have their money in banks, that that same principle should apply here.

Now, there are obviously technical problems, and these were discussed here this morning when you had representatives of the Social

Security Department and the Labor Department and the Treasury Department appear. But there were technical problems when the legislation was considered in terms of insuring bank deposits.

Obviously you have got to have some basic minimum standards but there are minimum standards now for a company to get its pension plan approved under the tax laws. It has to be cleared by the Treasury Department and I must say this is not automatic. In some of the plans that we negotiated in the earlier days when we were all somewhat new at this sort of thing, there were many technical problems that our actuaries and the company's actuaries had to spend considerable time in Washington working out. So that this isn't just a kind of routine automatic clearance. There are standards.

But this is equally true in the bank deposit insurance field. A bank who wants to be covered has got to meet certain minimum requirements in terms of its investment policy, and so forth, or otherwise what we would be doing is insuring incompetence. We would be underwriting irresponsibility. They have got to be standards in any kind of a program. But none of these things are beyond management and we believe that the technical problems can be worked out.

I believe that there is a growing awareness on the part of both management and labor and people in Government about the need for dealing with this kind of problem. How many hundreds of Studebakers do we have to have before we recognize that people who look forward with a sense of security and a sense of dignity to their retirement years, based upon the fact that they figured how much they were going to get in social security and how much they were going to get in their private pension plan, who have their whole life planned should not suddenly be denied half the benefits. This is wrong and we have got to find an answer or we will put in jeopardy this unique approach in which we rely on both the public and private contribution to the total welfare of the worker and his family in the years of retirement.

It is in recognition of this—that I think is a very compelling and urgent problem—that the President's Committee that Secretary Wirtz chaired, got into this. I had the privilege, Mr. Chairman, of serving on the President's Labor-Management Policy Advisory Committee which is made up of some of the top industry people in the United States and labor people and representatives of the public. We have discussed this and it is our unanimous belief that we need to do something about this problem.

I served as a member of the Special Commission authorized by the Congress to deal with problems of automation and technological progress. That Commission worked for more than a year. Its membership was composed of top industrial leaders, labor leaders, and an equal number from the public. It also, in its recommendations, urged the enactment of legislation to reinsure pension benefits when the plans were terminated because of economic circumstances beyond the control of any given company.

It is in this spirit that we urge that the Congress take action. At the same time, we are very practical. We know that in terms of the legislative procedure you have got to plant some seeds and then you have got to nurture those seeds and water them carefully and tend them with great care and tenderness and then finally as they begin to take roots we get more people interested.

This is how we have made human progress over these many, many years. We are realistic to know that this session of Congress at this late hour is not going to enact this measure. But we believe that the bill 1575 is a sound, reasoned approach to meeting this basic problem.

There are technical questions that obviously will have to be probed out. But we hope that we will not get involved in a long extended academic study of a human problem that requires attention quickly. We hope that all the study that must be done will be done so that early in the next session of the Congress we can get prompt and favorable action on this bill. If we are going to place in our kind of free society, as we all do, maximum reliance upon individual initiative in the broad area in which we try to find nongovernmental answers to human problems and if we try to supplement what we do together through the instrument of Government by maximum initiative in the private sector, then we must shore up the contribution of the private efforts. It must be equally as reliable as what we do in the public sector or what we do in the private sector will be in great jeopardy.

It is in this spirit of trying to maintain that unique balance between collective governmental action and the supplementation of that governmental effort in terms of private efforts that I think action is needed to meet this very real and serious human problem.

Thank you, Mr. Chairman.

Senator SMATHERS. Thank you, Mr. Reuther. That is a very splendid statement.

Senator Anderson, do you have any questions?

Senator ANDERSON. A few. I think it is a fine statement. I am glad to have it.

When we discuss need for reinsurance, I am sure Mr. Reuther will recall in the atomic energy work the Price-Anderson Act above what the ordinary groups could take care of. I think that is the situation of Studebaker. You had enough money to take care of the most immediate and then the 15 percent, and the last got none at all. Reinsurance would be useless at this point. I think if we try to combine reinsurance with this problem, we will get along very well. I commend you on a very fine statement.

Senator WILLIAMS. I, too, want to compliment you on your statement. I think it is generally agreed that the greatest contribution that organized labor made to the American workingman was the initiation of a pension system. And, while we have made great progress in that area, I am one who likewise thinks that there are weaknesses in our present system that have to be corrected.

Maybe they can't be corrected entirely by management and labor. It may be necessary for some such program as is being suggested. I don't know.

I am glad that you are adopting the principle here this morning that this is an area that needs study, careful study, to develop all of these problems so we can reach a solution. We can't find a solution until we realize the extent of the problem.

Now, would you not agree that one of the problems that we are confronted with is that we need investment standards that could be laid down on these pension funds? I have had a few workers cite cases where their funds were invested, maybe unwisely. I have often

wondered if we couldn't have investment standards, requirements on contributions to pension funds that would put them on par with, we will say, the investment standards of banks or trust funds in the respective States.

I wonder if we couldn't have some such approach as that to consider along with this. I think it is very important. There is the tendency, and it is a natural tendency—if you or I were managing a company and we had control of the pension funds and the company was having difficulty raising money, we would be maybe attracted toward the idea of investing some of the pension fund in our own company. The investment of Sears, Roebuck funds in their own stock has proved most satisfactory, and Sears, Roebuck stock would qualify under most any investment standards in any State. But there are other cases not so clean.

Do you know—do you not think that investment standards are essential to these funds?

Mr. REUTHER. Senator Williams, I certainly do. I think that when a trust fund has the responsibility for investing the funds to provide pensions for workers for during their retirement years, that there is a very grave responsibility and it ought to be carried out with certain basic standards for investment, and we are very much in favor of that. I think we need to keep in mind, however, the case of the Studebaker company. They met all of the highest standards of investment.

Senator WILLIAMS. I agree.

Mr. REUTHER. But then the company terminated and the problem that we faced there was not the result of the failure to meet adequate investment standards. The problem was the company went out of business.

Senator WILLIAMS. I appreciate that and I didn't mean to indicate that that would solve it. In many of these private pension funds that have been established, particularly those that have been negotiated over the bargaining table, there are investment standards. But there is nothing, as I understand it, in the law today that would require minimum investment standards in order to get credit for the deduction of the contributions for tax purposes.

Mr. REUTHER. I think there are standards. Now, perhaps a study of them might suggest that they are to be tightened up and maybe made a little more rigid, but the Internal Revenue Service does currently have standards. There are standards. Whether or not they are adequate, this is a matter I think that ought to be looked into.

Senator WILLIAMS. As to vesting, I agree with you completely. That is very important. I know that as a result of a company merging or going out of business, in addition to the situation with Studebaker—workers 55 or 60 years of age—are left with no retirement benefits whatsoever, and I don't know what the answer to the problem is. But it is a problem that we should all give our attention to, and as I say again, I think the Senator from Indiana has made a constructive contribution in providing us a forum to discuss this openly so that we can all approach this problem and try to see the scope of what we are trying to handle.

I just have one other question. In your negotiations in your Department, have you ever arrived at any estimate as to the extent of the unfunded liability of the respective pension funds that have come

under your jurisdiction? In order that we could approach this to see just what the problem would be?

Mr. REUTHER. We could determine that. We know the projected total liability. We know that portion that is funded to date. We know the unfunded portion. We could get those kinds of figures before the committee if you so desire. I don't have them at my fingertips.

Senator WILLIAMS. I would appreciate it, and if for any reason such figures are not supposed to be public, at least they could be made available to the committee because I think they would help us in this study. As I stated earlier, you can't solve a problem if you don't first sit down and frankly recognize what that problem is. If that could be furnished to the committee, either for our use in executive session, whenever that may be, it would be most helpful.

Mr. REUTHER. We should be glad to cooperate.

Senator SMATHERS. We would like to have any of that type of information which you might be able to provide us with because it is rather obvious from what we have heard this morning that there is a lot about this that we don't know and even the agencies of Government don't know.

Let me ask in that connection, did you not mention that you had experienced some 109 failures of pension funds, that you had been through that——

Mr. REUTHER. 113—UAW—113 in the last 15 years have terminated. Pension plans have terminated because the company went out of business.

Senator SMATHERS. What percent would you say would that be with respect to coverage of workers, of all the workers in the United Automobile Workers?

Mr. REUTHER. In the automotive industry it is a small percentage. And I think if you took the total number of terminations of the pension plans in the United States generally, there, too would be a small percentage of the total work force. But, from the point of view of the individuals, it is a total tragedy.

You can't really measure the human impact of this kind of a problem by microscopic percentage. It is a microscopic percentage of the total number of workers involved but to the individual and his family it is a total tragedy.

Senator SMATHERS. Right. I totally agree with that. I am not trying to denigrate the idea that we must do something about those people who lose their pension rights. I just wondered how widespread it is at the moment. That would give us some idea as to how fast we have to move on this. It is obviously a very serious problem. That was the reason I asked the question.

Senator WILLIAMS. If you can furnish that in the light of information raised, it would give us some basis upon which we could estimate the cost of such a program.

Senator SMATHERS. There is a need, but if the need is not too large, then there is some reason to believe we could move a little faster because it requires less governmental obligation.

Mr. REUTHER. First of all, it is of no cost to the Government at all. This is a self-financed program, the same as the bank deposit reinsurance program which doesn't cost the Government. The point is if you

spread the cost of this small group that gets victimized over the total, then it is microscopic in terms of its impact.

As for General Motors Corp., I have every reason to believe that they are going to be in business quite a few years from now. I would hope so. Therefore, they have got to help carry the cost just as the Chase National Bank, which is a rather solvent financial institution in New York City, I am told, and has every reason to believe that they are going to continue. But they are helping to protect the depositor in some little county bank that may not make the grade because the economic conditions in that area where they are may have changed. This is the same sound principle of insurance that we want to apply to this other kind of a human problem.

Let everybody carry a little share of the load and then one family or one worker won't have to carry a disproportionate share.

Senator WILLIAMS. I have just one question. As these plans are negotiated or as they are established on a voluntary basis, some are funded to a greater extent than others. Now, if you have a uniform insurance rate to insure the solvency of the plan at the Federal level, you would almost have to have a standard as to the extent to which the respective plans were financed or have a difference in the rates, would you not?

Mr. REUTHER. You see, I think Senator Hartke's bill, as I said earlier, is soundly conceived, because it proposes a fixed premium rate, but the amount that you pay would depend upon your unfunded liability.

Assume a company decided, and this may be a company where you have got a relatively small number of older employees and therefore your past service credit liability is relatively low, that they would fund that liability in 10 years.

At the end of the eighth year they would be almost funded, and if this program were in effect they would only pay the premium on the unfunded portion.

Another company that wanted to amortize it over a longer period and therefore had a larger percentage of their total obligation unfunded, would have to pay the premium upon a larger unfunded amount. So that the thing flows from there. I think that is a sound principle and it gets back to the banking approach.

Does the Chase National Bank get a different premium when obviously you can argue that it is less risky to reinsure a $10,000 deposit in the Chase Manhattan Bank just as you can argue that it would not be risky backing up the pension benefits of a General Motors worker? The law says that Chase National Bank will pay the same premium as that little bank in Podunk. Why? Because that is the only way you can share the cost. Otherwise you place a disproportionate premium burden upon the fellow least able to carry it, and all you do is accelerate the economic factors that might terminate his plan.

Senator WILLIAMS. As I understand, there would be some variation if the company chose to fund it over 10 years, 20 or 30 years in the rates.

Mr. REUTHER. That would be determined under the funded portion and therefore would reduce, if they funded it faster, the premium based upon the unfunded portion.

Senator SMATHERS. Senator Hartke?

Senator HARTKE. Mr. Reuther, I compliment you on a very fine statement and a fine analysis of this problem. I am hopeful we can

have the statement from Mr. Miller here which I do not think will take very long. Let me come on back to this problem of solvency for a moment which seems to be bothering the Senator from Delaware.

The problem that we have here generally speaking, is that we are not in a position, as you said, to indicate what is going to happen economically, or how many companies are going to terminate their businesses at this moment. Hopefully none. Right?

Mr. REUTHER. Correct.

Senator HARTKE. As long as the economic conditions expand, the chances of termination are relatively less then they would be if you have an economic decline. This is the general period. In other words, during periods of prosperity, generally speaking, businesses don't fail as often as they do during periods of recession or depression. So this imprecision of our ability to really predict a level of employment doesn't undermine the solvency of the unemployment compensation system, does it?

Mr. REUTHER. No, it doesn't.

Senator HARTKE. So you see what we are saying here is that there are factors in which the Government has been able, with the help of private enterprise and the whole operation in the private sector to take real difficult problems and reduce them to an operative system, isn't that true?

Mr. REUTHER. Correct.

Senator HARTKE. And this is what we have done as you have indicated in bank deposit insurance. I might point out with regard to the Senator from Florida's statement about the need, whether by looking at how many companies are failing now, or in the future. Let me say that those people in Idaho, some 20,000 depositors who found themselves in an uninsured savings and loan institution out there, they probably wish they had the savings and loan insurance that the Federal Government provided for them to participate in, isn't that true?

Mr. REUTHER. Right.

Senator HARTKE. Now, they were a State operation and therefore they had the option of excluding themselves from the insurance, but if as a condition precedent, they wanted a Federal charter, they would have had to come into the savings and loan guarantee system, as a condition precedent, and then they would have had a guarantee for their savings.

On the other side, we have the recent failure of the savings and loan institutions in Arizona which was federally insured, and all those people who had deposits up to $10,000 had no worry. Although that savings and loan institution failed, the broad insurance coverage provided those depositors made sure that their life savings weren't wiped out overnight.

Talking about immediacy, I would like to point out that William Jennings Bryan in 1907 made a speech in which he advocated Federal bank deposit insurance, but it took them some 26 years to get it. I just hope we don't take 26 years to solve this problem, and then meet it in a period of crisis and try to take care of it then.

Now, this pension problem wasn't existent in the depression of 1933 but it could be a serious problem today. For that reason I would hope that the chairman would permit Mr. Miller to read what is a one-page

statement, a copy of which I happen to have, because he is from my home State of Indiana, and I think he represents the real human phase of this problem.

Senator SMATHERS. We always are happy to indulge the distinguished gentleman from Indiana.

Mr. Miller, you go right ahead.

Mr. MILLER. My name is Nolan Miller, I live at 805 30th Street, South Bend. I am an employee of Studebaker at the present time. I am 59 years of age and have worked at Studebaker since 1926. I have a boy 16 at home yet and I don't see any possibility, unless things change, for him to get a college education.

I had depended on my Studebaker pension along with social security for a living when I reached retirement age because my savings from income at Studebaker were far too little to provide for retirement income.

I and the other employees at the plant looked forward to our Studebaker pension in the same way as we did to our social security and had the opinion that we were just as sure to get it. There was never any serious thought that we might lose it because of the plant closing. Even when the Studebaker Corp. announced in December of 1963 that their plant in South Bend would be closed down most of us felt our pension was secure and that when we reached retirement age we could depend upon getting it. This was the only bright spot we could see in the terrible prospect of being thrown out of a job at the age of 59 when finding a job was almost impossible.

When we finally came to realize that only those already retired, or who would reach age 60 by November 1, 1964, could get a pension because the plan wasn't sufficiently funded to do more, it was probably the most bitter news we ever received.

The pension plan terminated on November 1, 1964, but out of the approximately 5,000 who had from 10 to more than 40 years of credited pension service, only some 1,300 employees were eligible for pension by virtue of having reached age 60 or by being totally and permanently disabled.

All that was left for those of us under age 60 was the amount of money in the pension fund not needed to guarantee pension for those who were eligible to retire by age or disability. This remainder was divided among us according to our ages and credited pension service. The individual entitlements ranged from $200 to $1,600.

Senator SMATHERS. All right. Thank you very much, Mr. Miller. And in order that we don't wait 26 years, we will adjourn now and go to lunch.

Mr. REUTHER. I would like to assure you, Mr. Chairman, that we are going to be down here and you aren't going to wait 26 years.

Senator SMATHERS. I am sure you will be.

Thank you very much.

(The prepared statement of Walter P. Reuther follows:)

STATEMENT OF WALTER P. REUTHER, PRESIDENT, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, AFL-CIO, AND PRESIDENT, INDUSTRIAL UNION DEPARTMENT, AFL-CIO

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before this Committee to urge prompt consideration and early enactment of a self-supporting Federal reinsurance program to safeguard at least a basic

portion of the retirement benefit promises currently held out to millions of wage earners in America under private pension plans.

The basic concepts of such a program are embodied in Senate Bill 1575, introduced by Senator Hartke in the First Session of this Congress and now in the hands of your Committee. The concepts are soundly conceived and there is urgent need for Federal legislation based on them.

My appearance here is in two capacities: as President of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), with more than 1,650,000 active and retired members; and as President of the Industrial Union Department of the AFL–CIO, whose constituent unions represent more than 8 million members. Both the UAW and the IUD, by unanimous action of their constitutional conventions within the past year, have reaffirmed and reemphasized positions taken at prior conventions going back to 1961, calling for development and implementation of a Federal pension reinsurance program.

UAW EXPERIENCE

We in the UAW are proud of our Union's role in the growth and shaping of private pension arrangements in America. The fact that these arrangements are looked to as a vital and significant supplement to the basic Social Security system in most segments of American industry, reflects in very substantial measure the results of free collective bargaining between unions and management.

The first UAW pension plan was negotiated with the Ford Motor Company in the fall of 1949. It constituted a historic break-through in the establishment of formal funded retirement programs for hourly-paid workers in the mass-production industries.

The UAW now has over 1000 pension plans with employers in automotive, aerospace, agricultural implement and related industries. These plans cover over 1¼ million active workers and are currently paying monthly benefits to more than 180,000 retired UAW members. Estimated assets currently accrued in the pension funds of the plans are approximately $2½ billion. Annual contributions to these funds, apart from interest earnings, total an estimated $350 million and annual pension disbursements exceed $220 million.

From the outset, the Union has placed emphasis on certain basic principles which we considered essential to the building of sound retirement security programs. These have included:

> Insistence on responsible arrangements, as part of the collective bargaining contract, for the progressive funding of agreed pension benefits through regular contributions into an irrevocable fund (held either by a bank or trust company, as a trustee, or by an insurance company) based on determinations by a qualified independent actuary;
>
> Benefits based on recognition of past service accrued before establishment of the plan, or before the date of a negotiated benefit improvement, in order to give meaningful protection to the older and long-employed workers with little or no opportunity to build such protection through "future service";
>
> Benefit provisions both for normal and early age retirement and for disability retirement, supplemental and in addition to the worker's Social Security;
>
> Achievement of pension portability through progressively improved vesting features to preserve earned pension rights in case of employment termination prior to retirement.

In the great majority of UAW pension plans, the application of these principles has provided and may be expected to continue to provide a significant measure of retirement security, with assurance that promised benefits will be delivered when due and will be paid for life to eligible workers and their spouses. Our concern here is with the problems created in the minority of situations where, as a result of business failure, plant closing or removal, discontinuance of manufacturing operations, or other factors, the pension plan terminates at a time when currently accrued assets are insufficient to provide promised benefits.

Over the past 15 years the UAW has had direct experience with 113 pension plan terminations invloving companies ranging in size from Studebaker, which employed 7,000 workers in South Bend when it discontinued auto manufacturing in that community in December 1963, to an independent parts supplier with less than 20 employees.

A number of the terminations affected only particular subsidiaries or divisions of larger corporations with which, in several cases, our Union still has collec-

tive bargaining relations and going pension plans at other locations. This is true, incidentally, of Studebaker Corporation. Most involves complete liquidation of a business.

Mergers, technological change, marketing problems or competitive pressures played a part in most of the management decisions to close out or move operations. In nearly all of the situations, when we sat down with management representatives to examine fund balance sheets and to agree on termination procedures, both sides of the table were brought face to face with the human problem of telling at least some of the workers that, in addition to the loss of their jobs, all or part of the pension expectations on which they had reasonably relied could not be fulfilled.

Such news can be a heavy and tragic blow for the workers affected—its impact increasing in direct proportion to their ages, their length of service at stake and chances for further employment. In some of the more fortunate situations, denial or proration of accrued benefits on plan termination was limited to relatively young workers or those with recent hire dates. More typically, available assets have been sufficient to provide full benefits for retirees and also for nonretired workers at or close to minimum retirement age, but could provide only two-thirds, one-half or less of earned pensions for those in the next lower priority group specified in the plan. In a few instances involving a large concentration of older long-service workers eligible to retire in the first years after setting up of the plan, termination early in the process of funding initial past service liabilities necessitated cuts in pensions already granted.

The Studebaker experience, to which Senator Hartke made specific reference in introducing his bill, has attracted national attention. What happened in that situation will illustrate the general problem.

Although car manufacturing at Studebaker South Bend plants ceased at the end of 1963, the Studebaker-UAW pension plan was not formally terminated until November 1, 1964, following expiration of the collective bargaining agreement. As of that date, Studebaker's contractual funding obligations ceased and employees, former employees and pensioners could look only to the approximately $25 million in assets built up in the Fund during the 14-year life of the plan for dscharge of their pension equity. At that time, the schedule of past service liability amortization, provided contractually on the same actuarial basis as in other auto industry plans, would have brought the plan to "fully funded" status by 1989.

In round numbers, a total of approximately 10,500 persons were determined to have a potential equity in the fund on termination date by reason of retirement, current seniority status or former employment with vested rights. These persons could be roughly divided in three groups:

1. About 3,600 were on pension or were eligible for pensions on the basis of having reached age 60 with 10 or more years service by the termination date.
2. Another 4,000 employees and former employees fell in the age 40–59 bracket with at least 10 years of service, qualifying them for full vesting of their equity under the terms of the plan.
3. About 2,900 were still on plant seniority rolls but were either under age 40 or lacked service for vesting.

The assets were adequate to guarantee full lifetime pensions for the first group (age 60 and over) only. After purchase of paid-up annuities from an insurance company selected on a competitive bid bases, approximately $2.4 million remained for the second group. This represented *only 15%* of the reserve estimated as necessary to provide their accrued pensions. Because of its insufficiency for any meaningful retirement benefits, the money was distributed by agreement in the form of lump sum payments averaging $600. Individual amounts ranged from $200 to $1,600.

No benefits were available for the 2,900 employees in the third group.

Statistics on the second group of 4,000 "vested" Studebaker workers show an average age of 52 and an average service with the Company of just under 23 years. Averages, however, give only part of the picture. One of the members of the local Union Committee participating in the plan termination discussions was 59 years old with 43 years of Studebaker service since entering the plant at age 16. He was one of the more than 20 workers with service in excess of 40 years who missed by a few months the minimum retirement age of 60 and could not receive a pension.

THE NATIONAL SITUATION

The situations confronting workers involved in the Studebaker and other terminations of UAW-negotiated pension plans are in no way unique.

Available government statistics indicate that some 7,000 retirement plans in the United States, previously approved for tax exemption by the Internal Revenue Service, were terminated between 1953 and 1965. Approximately 500 were terminated in each of the years 1964 and 1965. Although data are not currently available on the numbers of employees affected or on the funding condition of these plans at the point of termination, there can be little doubt that their discontinuance cancelled or drastically reduced the pension expectations of many thousands of workers.

Secretary Wirtz in his testimony on May 9, 1966, before the Fiscal Policy Committee of the Joint Economic Committee, mentioned the need for definitive research in this area and indicated that the Bureau of Labor Statisics and the Internal Revenue Service are currently collecting and analyzing data on the reasons for terminations of tax-qualified retirement plans over the past 12 years and the effect on plan participants. I heartily concur in the need for research of this type and for continuing study by these agencies and other groups, in government and without, in order to shed as much light as possible on the size and scope of the problem. Data collected will be of great value in implementation of a sound and effective program. But the filling of every last data gap should not be allowed to become a basis for delaying responsible consideration and early action on the legislation here under discussion.

In the case of Federal insurance of bank deposits and Federal insurance of mortgages, the consideration and enactment of legislation by Congress was based on examination of basic concepts and issues. I believe the same approach can and must be followed in extending the tested principles of these vital and universally accepted pieces of social legislation to create an effective mechanism for reinsuring private pension plans.

Today more than 25 million Americans are covered by such plans. Estimates indicate that this will increase to 34 million by 1970 and 42 million by 1980. Some 2½ million retired men and women are currently drawing benefits under these plans, and estimates place the number at 7 million by 1980.

According to most recent SEC statistics, the invested reserves of private pension plans at the beginning of this year exceeded *$85 billion*, with $58 billion represented by assets in self-insured trusts and the remaining $27 billion by reserves held by insurance companies. The net increase last year was approximately $8 billion in both types of funds and projections to 1980 indicate a potential private plan reserve total of $225 billion. By that date, it is estimated that the present annual benefit payout of almost $3 billion will have tripled to at least $9 billion.

Figures such as these give some indication of the degree to which the public interest is involved in private pension plans and their impact, present and potential, on the operation of the economy and on the retirement security and expectations of millions of working men and women. The necessity and justification for governmental concern is further underlined by the fact the plans are to a significant degree subsidized by Federal taxpayers through the favored tax treatment accorded them under the Internal Revenue Code as part of a long-standing public policy of encouraging their growth and development as a significant supplement to our basic Social Security system.

The extent and nature of this public interest have been dealt with at length by the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs (the Cabinet Committee) in its January 1965 report on "Public Policy and Private Pension Programs."

As you are undoubtedly aware, that report included a recommendation, concurred in by the President's Labor-Management Advisory Committee, that serious study should be given to a pension reinsurance system. More recently, the National Commission on Technology, Automation and Economic Progress, in its report to the President and Congress, under the heading "Protecting the Earned Benefit Rights of Displaced Employees," states:

"We favor whatever legislative or administrative measures may be necessary to promote greater equity and security in the establishment and administration of private pension plans. Specifically, we recommend that careful study be given to a legislative system of reinsurance for private pension plans similar to the reinsurance of bank deposits through the Federal Deposit Insurance Corporation."

CONCEPTS AND ISSUES IN REINSURANCE PROGRAM

Various methods and degrees of funding private retirement plans, whether instituted through collective bargaining or unilaterally by employers, have been developed as a rational way of spreading and allocating benefit costs which sooner or later must be met if promised pensions are to be paid.

Put in the simplest terms, the risk of non-payment arises, as I have indicated in discussing of UAW experience, when the plan is terminated at a point where a significant gap exists between available assets and the value of accrued benefits. Such gaps are bound to exist in newer plans which have undertaken to provide benefits based on past service of employees. Also, updating and improvement of benefits, which have been and will continue to be characteristic of most plans if they are adequately to perform their supplementary role in a dynamic economy, inevitably increases funding requirements and the risks of insufficiency of assets in event of unforeseen termination.

To meet this problem a first basic concept of the Federal reinsurance program is that all IRS tax-qualified plans will be required to participate as a condition of continued favorable tax treatment. This approach is the only one which can assure the broadest possible pooling of risk so that premium rates can be held to a minimum and at the same time remove the hazards of "anti-selection" and the essential unpredictability of the factors which may sooner or later require termination of any particular plan. A further compelling reason for the approach lies in the fact that in our interdependent economy, the failure of an enterprise or the closing of a plant is frequently the result of action by others and the cost of insuring the risk of lost pensions for the workers involved should very properly be assessed in some measure against firms directly or indirectly profiting from the action.

A second basic concept is the reinsurance of the risk of investment losses through any forced liquidation required for payment of benefits. This is a relatively minor part of the total risk and provisions of the proposed bill seem to me sound and closely analogous to the principle of reinsurance of bank deposits under FDIC.

A third and possibly the most fundamental concept is the reinsurance of the gap between assets and liabilities on the basis that the reinsurance program will not be providing additional assets for a private plan, but will in effect be guaranteeing missing benefits to the extent that the total entitlement of the beneficiary does not exceed prescribed limits. I strongly endorse this approach, which is, of course, again similar to the well-established principle in FDIC of a limited liability of $10,000 with respect to a single bank deposit.

A fourth concept, involving the framing of the program as a whole, is the establishment of maximum premium rates for both investment and benefit loss risks, within which there is flexibility for the Secretary, with the advice of the Advisory Council to develop and adjust required premiums. There is also similar discretionary authority for determining and limiting, if necessary, the priority categories of benefits to be covered by reinsurance protection. In my opinion, this provision for flexibility within prescribed cost limits is a sound and prudent basis for initiating the program and, as an important consideration, it should facilitate early initiation and implementation of this vitally needed social legislation, leaving leeway, as was the case with FDIC, for adjustments which can best be made on the basis of operating experience.

CONCLUSION

With the treendous expansion of private pension plans in America, and their development as a flexible and significant secondary source of retirement income, the security of the pension promise which they represent to millions of wage earners has clearly become a matter of vital public concern.

Establishment of a national mechanism to insure a portion of the risk of inadequacy of plan assets to meet benefit obligations in event of termination is in no sense a threat to the private pension system. On the contrary, such an undertakng will serve to strengthen the private system and to make it more effective while continuing to permit a wide latitude in the design and operation of plans to meet varying needs and circumstances.

The program will be self-financing and constitutes a direct and practical approach to a critical problem which only national legislative action can solve. Such action is consistent not only with the public policy considerations which have led to special tax exemptions for qualified plans but with the concepts

underlining such long-established measures as governmental insurance of bank deposits and mortgages.

Senator SMATHERS. We stand in recess until 2:30 p.m.

(Whereupon, at 1 p.m. the committee recessed to reconvene at 2:30 p.m. the same day.)

AFTERNOON SESSION

Senator SMATHERS. The meeting will come to order. We will proceed with the hearings on S. 1575.

The first witness this afternoon is Mr. Bernard Greenberg, a representative of the Insurance and Pension Department of the United Steelworkers of America. He will be accompanied by Mr. Nordy Hoffman, distinguished representative of the United Steelworkers of America.

STATEMENT OF BERNARD GREENBERG, REPRESENTATIVE, INSURANCE, PENSIONS AND UNEMPLOYMENT BENEFITS DEPARTMENT, UNITED STEELWORKERS OF AMERICA; ACCOMPANIED BY NORDY HOFFMAN; AND MURRAY LATIMER, ACTUARIAL CONSULTANT

Mr. GREENBERG. I also have with me Mr. Murray Latimer, our actuarial consultant, Senator Smathers.

Senator SMATHERS. All right, sir, you may proceed.

Mr. GREENBERG. I want to apologize for not having any prepared statement to offer because I did not hear about these hearings until Friday.

Senator SMATHERS. You are in the same boat with a lot of us, but you go right ahead. We just have to listen and you are having to talk.

Mr. GREENBERG. I am a representative of the Insurance, Pensions, and Unemployment Benefits Department of the United Steelworkers of America. I am testifying on behalf of my organization in support of the principles involved in Senate bill 1575.

Senator SMATHERS. We might as well stop right there because, unfortunately, that bell indicates a vote.

(Short recess.)

Senator HARTKE. The committee will come to order. We will proceed as best we can. We are on a quorum call now. There probably will be a vote just as soon as we get started. We will do the best we can.

Mr. Greenberg, will you proceed. I understand you had gotten started.

Mr. GREENBERG. All I had said was I was testifying on behalf of my organization in support of the bill.

The Congress has long since established that the Federal Government has a responsibility for the protection of private pension plans. In the Taft-Hartley law and in the Reporting and Disclosure Act, the Congress has assumed that there is a need to insure that workers who participate in private pension plans will receive the benefits of the plans when they become entitled to them.

It has been suggested this morning that an element of the tax laws includes the notion that the tax laws or the regulations under the tax laws have been devised for the purpose of protecting pension

rights, but I think that this is an erroneous notion. I think the essential purpose of the regulations under the tax laws is to protect the Federal Government, to make certain that pension plans are not used as a means of evading taxes, so that the thrust of all the income tax regulations is to insure that the employer does not put that much money away, that the Federal Government is unfairly deprived of taxes that it is entitled to. And it is interesting of course that the laws were particularly, and the regulations, were particularly amended during World War II when so much work was being done on Government contracts, and it was felt that this was an opportunity to load onto the Government a lot of costs for plans that were not intended to be permanent.

Unfortunately, thus far the Congress has assumed that the main threat to the receipt of the promised pension benefits lies in the possible bias or dishonesty of the plans' trustees or administrators. This proposed act tries to rectify that erroneous notion. In fact, the far greater threat to the receipt of promised private pension benefits lies in the premature termination of the pension plan as a result of market or other impersonal forces over which neither the unions, employers, nor the Congress have any control.

In 1964, we made a study of the pension plans that we had in the industries in which we represent workers and, at that time, we had 1,337 units in the United States with a total employment of nearly 800,000 employees covered by pension plans. This meant that 91 percent of all members of the Steelworkers Union were covered by pension agreements. I might say that it does not by any means cover the same proportion of companies because, in fact, most of our small units are the ones that are not covered, and the fact that we have 91 percent of our members covered by pension plans merely means that we have practically all of our larger units under pension agreements, and that many of our smaller units employing, say, in the area of 100 or so workers, are not at the present time covered by pension agreements.

To a degree, by the way, the concern over the establishment of plans in these small companies is the fear that it may not be possible, in the event of an early termination of the plan, to provide sufficient moneys to pay the benefits promised.

I might, by the way, indicate to you that about 19 percent of our pension plans are in units that have fewer than 500 employees; 58 percent are in units with fewer than 10,000 employees.

This morning there was a very considerable discussion about the merits of vesting, and in the discussion it seemed to me that one very important point was lost. To discuss vesting exclusively in terms of voluntary quits by employees loses sight of the fact that in fact possibly the major reason why employees obtain vested rights is that their service is involuntarily terminated as a result of layoffs, plant shutdowns, or disability, disability of a nature which does not qualify them for an immediate disability pension. In those circumstances, it can hardly be argued that vesting is in any way going to disrupt the employment relationship between an employee and his company.

In the case of employees who desire to quit but who are held back from quitting by fear of losing their pension rights, I can only say that I would suspect that few employers think that this is the kind of employee they would care to keep on their payroll anyway, and

I have yet to hear any complaints or any suggestion, any proposals from employers with whom we have negotiated vesting for any reason of a break in service, that the vesting provisions be rescinded.

I have asked Mr. Latimer, our consultant on pensions and actuary, to state later what the possible costs of vesting are, and I think that he can illuminate another question that has troubled many members of the committee this morning.

The Steelworkers' plans are financed pursuant to two major classifications of provisions. The first provides that a company is solely responsible for the provisions of the benefits agreed to. I might say that that statement is in conflict with the statement of the Secretary of Labor this morning, who said, if I remember correctly, that practically all plans limited the liabilities of the company. At least in steel that is not true. To the contrary, in steel, in most companies the obligation of the employer to provide the benefits agreed to is unlimited. He simply agrees to provide or cause to be provided the benefits of the agreement.

There are two subdivisions under that, but I would like to withhold my comments on that for a moment.

The second major classification provides that the company is responsible only for the setting aside of specified amounts of money which are to be the source to which participants may look for their benefits. The first classification of agreements has two major subdivisions. The first subdivision leaves the company completely free to determine the manner and means of fulfilling its obligation undertaken to provide pension benefits.

The second subdivision provides for the setting aside of certain specified minimum amounts of money, but the responsibility in the end to provide the benefits continues to be the company's, not the fund's. Thus in some companies we will provide that when an employee retires, the company is obliged to immediately have put aside in the pension fund a sum sufficient to pay that employee his pension for the rest of his life. In other cases we may provide for payment over a period of years. But in no event, in the type of situation that I am discussing now, does the provision for putting money aside relieve the company of the obligation of providing the benefits that have been agreed to.

No matter which method of pension financing is agreed to, the payments of benefits in the event of a permanent shutdown may be a problem, and sometimes is an insoluble one. It is necessary, therefore, to recognize how the problem arises.

May I also say that in this morning's discussion, I think there was an almost exclusive emphasis on the possibility of the plan terminating in time. In fact, the proposed act says that the benefits will be payable if such failure "is attributable to cessation of one or more of the operations carried on by him"—that is, the company—"in one or more facilities of such employer."

Therefore, I would assume, and I think properly, that this should be the presumption of the act, that shutdowns are intended not only to cover the situation in which the entire plan is terminated, but also a plant of a particular company, a department of a company, and even a subdivision of a department.

I have some examples to illustrate the importance of including these several categories in the shutdowns we are talking about.

In the nature of things, pension plans are infrequently fully funded. To begin with, pension benefit levels are being constantly revised. This is due to at least four major factors: The rise in the cost of living in recent years, the rise in wage and salary rates, the rise in the standard of living made possible by the growth of the Nation's economy and wealth, and the diminution of the work force and the consequent increased age of the participants, all leading to increased costs which were usually not foreseen or even if foreseen, could not be funded against at the beginnings of the plan.

Therefore, even if a sound conservative pension funding program has been in effect, a permanent shutdown creates a liability against which counterbalancing assets have usually not been fully set aside, and which sometimes cannot ever be met. This, of course, is true in the event of the complete shutdown of a plant.

At this moment plant and departmental shutdowns are occurring in three plants in circumstances with which I am personally familiar. Perhaps these permanent discontinuances of operations will prove to be illustrative of the type of problems we in the steelworkers face. The first shutdown involves the permanent closing of a wire mill by a very large steel company. Hundreds of employees are involved, and a very large percentage of these are entitled to immediate and deferred pension benefits. Their pension rights are as follows:

First, there are those who are age 65 or over with 15 years of service who are entitled to normal retirement. We have a special category of what we call 75–80 retirement pensions. These benefits which are payable specifically in a shutdown to those employees who have reached age 55 and whose age and service adds up to 75, or who are less than 55 years of age and whose age and service adds up to a total of 80.

A third category would include those who are entitled to disability and retirement by reason of having acquired 30 years of service regardless of age.

The fourth group includes deferred vested pensions which can begin to be paid at age 60. These are payable to employees who are not entitled to an immediate pension under any other provision of the agreements.

The average benefit to which normal retirees are entitled is about $150 a month. The average benefits to which the 75–80 retirees are entitled is about $225 per month until age 65, and about 150 thereafter. Disability and 30-year retirements will also average about $150 a month. Vested benefits will probably average about $100 a month. These are the benefits to which the employees affected by the shutdown will be entitled to, and, in addition, there are hundreds of former employees of this particular plant which is being shut down who are already on the pension rolls, and who will continue to be owed monthly pension payments for the rest of their lives.

I have no doubt at all that all of the employees now retired from this company, and all those who will become entitled to benefits as a result of this shutdown, will continue to receive their pension benefits for the rest of their lives. This certainly is based on two simple propositions.

First, there is a pension fund in existence at this company which is more than adequate to provide all the conceivable accruing benefits in the immediate future. I do not know what the long-term pros-

pects are but certainly for the immediate future there is little doubt that all of the pension obligations can be paid from the existing pension trust.

Second, the plant shutdown probably represents far less than 10 percent of the company's total employment, and the company will continue to produce at other and new locations the products made, previously made, in the plant which is being shut down, so that there will be a continuity of income to the company from other sources to displace the income that was being produced from a plant which is now being shut down.

The second shutdown is taking place not 10 miles from the first. It is also a wire products unit, but in this case it is a department in a company which can probably best be described as a large company, but a relatively small producer among the giant companies in steel. Here the circumstances are very much altered. The company does not have a large pension reserve, and it is going out of this particular line of business entirely. There will be no substitute income from the production of these products at other locations of the company. I might add that it is the company's allegation that in large part the cessation of these activities is due to foreign competition.

Senator HARTKE. I might say at this point that hearings on another bill will be involved with this one in that respect. The presiding officer has also introduced that measure.

There is a vote. If you will excuse me, I will be right back.

(Whereupon, a short recess was taken, after which the hearing was resumed.)

Senator HARTKE. The committee will reconvene. The vote is still going on, but I have voted. Proceed.

Mr. GREENBERG. This company has told us that its liabilities for the shutdown benefits for this particular shutdown provided by the pension agreements are in the area of $18 million. The company alleges that this sum represents far more than its profits have been over a period of many years. The union has agreed on an extended period for the funding of this liability if there is no question that the provision of these benefits creates problems for both the company and the union and indeed for the Nation as a whole.

This company provides employment for nearly 10,000 people. It is a major producer of high quality in those products in which it will continue to be competitive. To remain competitive, it must continue to invest, a task made more difficult by the shutdown liability it must now meet. Should this company founder on its pension liabilities, we all of us face a very cruel dilemma. Who should bear the burden of this shutdown, the company alone, the workers who will continue to work, the workers thrown out of work by the shutdown, many of them with more than 30 years of service with the company? The alternatives here are ones that I doubt that anyone would face with the assertion that we do not care, and it matters little to us exactly how this turns out.

The third company is a Midwest manufacturing plant which has been going down hill for 5 years and which will hit bottom on September 30. In brief, there are about $2.5 million in terminal liabilities under the pension plan, and $800,000 in assets. I wish the members of the committee could have been with me last week as I was leaving

the plant and a worker left his machine to walk over to me and ask: "Where do we stand? I am 58 years of age and I have worked here almost all my life. My wife wants to know will I get a pension. How much will it be? How long will it be continued?"

I had no answer. We are still bargaining with the company, and we are reviewing our rights under the plan.

Senator HARTKE. Is this company going to terminate all of its facilities?

Mr. GREENBERG. It is a one-plant operation.

Senator HARTKE. In other words, this is the end for them.

Mr. GREENBERG. It is the end for this particular operation, which is a completely separate subsidiary of a larger company. The subsidiary has existed on an independent basis. In fact this particular plant was purchased by the present owner about 5 years ago, and has since then been slowly transferred to another operation in another location in new buildings with new equipment. There are some legal rights involving transfer rights, but essentially the company always had it in mind when it purchased this property that it was going to discontinue operations in the original town and move them somewhere where they thought they could make more money. I dare say that what they were doing was buying the product line and the customers rather than the physical facilities.

Senator HARTKE. That is not an uncommon procedure, however.

Mr. GREENBERG. No, of course not.

Senator HARTKE. It is nothing to point to as a one-in-a-million operation. What I am trying to point out is quite the contrary, that this is probably a procedure which is going to be multiplied in the future rather than be cut down.

Mr. GREENBERG. I agree with you. In fact, I can tell you that this is not an infrequent experience. Now one of the questions that arises here is the standards of investment, the standards of funding that were discussed here this morning. As it happens, I would have no quarrel at this point, since I have no knowledge of the investments as yet made by the company, as to what the status of the fund is, but I think that when one inquires as to whether there is any authority in the Federal Government to review the investments of pension trustees, immediately the question arises as to whether this is an implied criticism of the present state of the control of trust funds and fiduciaries by the States. I might add that diligent inquiry on my part has failed to find any lawyer willing to tell me that we had any rights to proceed against an employer who acted imprudently, and it seems to me that one of the considerations that ought to be considered by the committee is the possibility that there would be a requirement in the Federal act requiring the funds to be invested prudently. I might say that it would certainly not be necessary to require that each of the funds get permission from the Federal Government or from any regulatory agency as to what they might invest their moneys in, but it seems to me that it certainly has been demonstrated that in the case of insurance companies, on the basis of very broad regulations and laws, it is possible to insure that pension funds or insurance funds are invested in conservative investments.

At this point also, we have no notion as to what our rights may be, notwithstanding that the plan may provide for limitations on the companies or the parent company's liability. I believe it to be a fact that

it is impossible by private contract to override benefits granted by law. The state of knowledge of what are the rights of individuals under either Federal or State law to collect benefits that have been promised to them and which cannot be paid because there is insufficient moneys in the pension fund I think is still a matter to be finally decided. Here again there may be room for legislation protecting those employees who may be participants in funds which are not participants in a Federal insurance or pooling scheme because their employers have either not funded in accordance with the regulations established by the regulatory agency, or who have invested their pension funds imprudently. Certainly if these people are not entitled to benefits by right from an insurance scheme, they ought to be granted at least the right to enforce their rights in a lawsuit.

Private pension plans have not only for steelworkers but for millions of American workers become an integral part of their standard of living. Should a substantial part of these benefits which are relied on for income after active work ceases be defaulted on, I think there is little doubt that we are going to face a chaotic situation. It was stated this morning that we did not face a similar situation evidently in the thirties. I do not know where this statement came from. That is certainly far from the fact. I myself have talked to people who have been the victims of reduced or eliminated pensions during the thirties, and who for that reason were very, very much concerned about the possibility of that happening to them in any future recession, and I doubt very much that we would have a Railroad Retirement Act were it not for the fact that the railroads were finding it extremely difficult to provide the pension benefits that were promised their employees.

In any event, I think that not only in the past but at the present time it has become a serious problem.

The funding of pension benefits by a private company, in anticipation of a permanent shutdown, is an extraordinarily difficult task. Indeed, it may well be impossible. Except in the rare and unusual case, where the ebb and flow of the business continues on a predictable cycle based on past experience, the task would seem to defy even the most fearless crystal ball gazer. In most years the companies with whom we deal claim they have insufficient funds to meet all their needs. Even if it was desirable for individual companies to set aside huge reserves they may never need, a very dubious proposition, it is difficult to believe that many business managers would take an actuary's word as to when the demise of all or a part of his business was going to occur, give or take even a couple of years. On a nationwide all-industry pool basis, an entirely different situation exists. The ebb and flow of all business activities occurs within limits which presently enable us to run a vast and successful unemployment compensation system. It is very wrong to attempt to set aside reserves against a risk which by definition probably affects a small minority of all businesses during any year.

Senator HARTKE. Let me stop you at that point, because I think you have touched upon the heart of what I consider to be the most serious opposition to this type of legislation, and that is the problem of how can you really insure this type of risk. In other words, is there really an insurable risk here, and since there is no Republican opposition

here to keep me straightened out as there was this morning, I will put my own opposition into it. There is a difference which I admit to in the situation, take for example, a bank deposit, the insurance of a bank deposit, because you are dealing there with a fixed sum, with fixed depositors, and with a very definitely identifiable item. In the field—to take the recent proposal, which I also was the author of this provision, that is the so-called insurable risk on guaranteed loans, again with fixed amounts, and with generally affixed identity, in the field of FHA, the Federal Housing Administration guarantee of house loans. Again you are dealing with what at least in the common term is an identifiable item, and therefore would be called an insurable risk in the common approaches of insurance philosophy.

Now I think the point that the Senator from New Mexico, Senator Anderson, was addressing himself to this morning, although I saw more a fear of the unknown, or let me say some of the old adage of let somebody else do it than I did of substance, but I think that what he was driving at, listening to what you are talking about on, is that if there is such an item that is insurable, why do you not permit the private insurance companies to do it, and if it is not, how can we handle it?

Of course I think the real element here is that we are dealing with something of an analogous situation with regard to unemployment compensation. I think this is one step removed. Let me point out, and I think this is something with which you probably would agree, that we are just on the fringes of the whole private pension scheme. We are covering about 25 million people today. In my own opinion this thing is going to develop much more extensively. It is going to become much more complex. It is going to become much more difficult, and the longer you put off the treatment of this real cancerous part of the pension plans, the more difficult it is going to be to be able to effect a cure.

Now there is one other point which I think should be pointed out at this moment, and that is that we are now in a period of relative economic prosperity for the vast majority, probably the highest peak this country has ever had. I am one who feels that there are some danger signs on the horizon which are not being properly looked at. Be that as it may, I am hopeful that I am wrong. Let us assume that we have a period of time in which we can act now. The time to act is before the things are in serious trouble on a nationwide basis, so that you can put these back into at least some type of organized scheme of things. If you are going to have any difficulties, let us find them in their early stages rather than later on.

However, let me say this to those critics of the bill. I hope that those who testify here this afternoon as well as those who testified this morning, the ones who supported it and the ones who got some cold feet in their support, that they realize that this bill is still before them, and to just say that you have big problems here does not mean that you cannot solve them. I think it takes some big thinking, and I appreciate their coming here. But I think, Mr. Greenberg, that you are at the heart now of the opposition.

All I am really going to say now is this: I think that if those who are counting on this type of opposition to be successful in defeating this legislation, then they had better put on their spurs toward a

real lobby effort, because on the merits they will fail. They might win on the lobbying effort among individuals, but on the merits of this bill they will fail, and I think we can justify that. So I say that now before we reach the opposition.

Mr. GREENBERG. Senator Hartke, I think that I too could join in raising some questions about, one, possibly the name of the bill, and, secondly, some of the questions that have been raised as to the basis on which the commonly recognized problem will attempt to be solved. First, as you have suggested, the term "reinsurance" is probably not an accurate description of what is involved here. It seems to me that this is essentially insurance or pooling to start with. There would be no reinsurance involved if there were funds, if there were specified obligations which are guaranteed wholly by some fiscal agency, but that is not what is intended here. It seems to me that what is intended here is that there shall be created a pool of moneys from which this recognized evil will be handled.

Now I say this is an evil, and I say it is an evil not only for the individual worker who is involved, though the Lord knows that he is of course the most harmed by what happens here, as we heard this morning from the lips of this worker from the Studebaker plant. But there are others who are hurt also, and not least of those who are hurt on this proposition are the companies who are forced to attempt to solve on their own a problem which was not created by themselves.

If in fact a plant goes down by reason of foreign competition, if in fact a mine goes down because its ores are depleted, if for whatever market reasons, transportation, raw materials, movement of markets, an event occurs which is beyond the control of this individual employer, to force him into the position where he is now to assume a liability which he could not have protected against in most cases—how did anybody know in a wire mill 25 or 30 years ago that in the year 1966 the situation that does exist would come about? How do we know what the situation will be in 1996, 30 years hence? It seems to me that we can have an agreement, and I might say I honestly believe that there are no actuaries who would tell an employer, "This is the sum that you ought to put away which, in my opinion, will be sufficient to meet all of of your shutdown liabilities over the next 30 years." That just is not possible.

And so the real question is the question of allocation of resources. This, by the way, I think is also important. What are we doing when we fund a pension plan? What we say is that we have assumed now a set of liabilities which will acrue in the years to come. We have an immediate number of people who can retire, but we can see ahead as the years go by that those who are now eligible for retirement will go on pension, will continue to increase in size, and new people will move in, and also being entitled to pensions. Now since we recognize that this liability is going to increase over the years, that for many reasons we cannot anticipate that ongoing income will be sufficient to meet this liability, we had better start putting money aside against this liability.

No one is going to suggest that he knows precisely what this liability is going to be. What the actuary, it seems to me, attempts to do is to assume a normal situation, one that he can cope with. He will not assume a shutdown. He cannot cope with that. He would find

enormous difficulty in trying to determine what the size of the plant is going to be 10 years from now. What he can do is suggest that he has a good idea of how long these people will live, how many will reach retirement age, and after they reach retirement age, on the basis of mortality tables, how long they will continue to live; what we may reasonably expect in interest from an invested sum of money. It is things like that that he can estimate on, and which serve as essentially a commonsense basis, if you please, for setting aside moneys against these future liabilities that may not mature for 30 or 40 years.

Now, if we agree that we cannot have the situation in which the income of literally millions of people will depend on the continued life of the individual company that he started to work with, then we have a problem, and I think that what is necessary here is, having once decided we have a problem, to have a reasonable dialog as to what constitutes the best way of meeting it. My own opinion is that there are two essential parts to this thing. The first one, most importantly, is that it is necessary to establish Federal standards for funding. No one may participate in this insurance scheme unless he has undertaken a reasonable program for meeting the obligation of his plan if he continues in business.

I might say that this is essentially the Canadian approach, and I think there is much to commend it to us. Once having established that every employer is meeting his minimum obligation, I think that we have met the objection to saying that beyond that, for those things that are essentially beyond his control, we have established a pool to which he has contributed over the lifetime of his existence, which will meet these contingencies against which we could not reasonably expect all employers to set aside moneys. I think it is possible, and I think that we should not wait until some years from now the Wharton School of Finance comes up with the conclusion, as they are bound to, that none of us know when any particular establishment, any particular plant, any particular department, is going to shut down. What they will undoubtedly conclude is that in good times lots of new companies go into business, and in bad times lots of companies go out of business, and I will write that result right now without having to make this elaborate study.

I think if we will sit down and say that we recognize the state of our ignorance, but we want to establish a pool from which we will meet certain defined liabilities, we can do so, in much the same manner as we did in unemployment compensation. We now have higher standards of what ought to be provided in unemployment. We can have larger tax rates now, larger wage and salary basis on which the tax is applied today than we could when we started, and I think that we will have to start here, probably modestly, and work our way up. I think that undoubtedly there will continue to be room for private arrangements above and beyond that which Federal law will provide as a minimum. I have no doubt of that either. All of this can be worked out, but we, none of us, want to face the situation where we say to the people, "I am concerned with the companies that I am concerned with. It is no matter to us whether you are driven to the wall or whether your income is cut by half of what you thought it was going to be, and we have now forced you into distress." I do not think that that is any solution.

Senator HARTKE. Let me say to you, since we are talking about good times and bad times, if we keep this tight money policy going long enough, we are going to have an opportunity to have that experience much quicker than I had hoped for. We have this tight money policy and high interest rate policy which I think is enough to scare most people. It should scare a lot of people at least.

Mr. GREENBERG. Senator Hartke, I am about through. I wonder if Mr. Latimer would be permitted to make some remarks on the cost of vesting.

Senator HARTKE. I would be delighted to hear from you, sir.

Mr. LATIMER. I did not get the context of the discussion this morning. The cost of vesting of course is not something that is given for—that can be spoken of in general terms. It must be related to the provisions for vesting, the kind of plan you have, and of course the composition of the employee force to which vesting applies. I would suggest, rather than my saying very much about the matter, that the Province of Ontario, in connection with legislation which has been put on the statute books in Ontario and has now been followed by Quebec and it will shortly be by Alberta, preceded by a very thorough cost study of what was involved in vesting, and that rather than attempting to say much about it, suggest for those who are interested in pensions and the vesting provisions, that the actuarial study, which was included in the second report of the Ontario Committee on Portable Pensions, be looked at. You will find there a great range in vesting costs, running from an increase of 2 or 3 percent for male employees who are in organizations which had heavily funding type plans and low turnover rates, and with a limitation to age 40 and 10 years of service as qualification, to somewhere around 150 percent increase for cases in which there was high turnover, where women were involved, and many purchase type plans were under consideration.

But the number of variables involved in the cost factors is quite large and I do not think any general statement can be made about it except that the commission did report that the increases were somewhere between 5 and 15 percent generally, which was a summarization which I think would probably not be applicable to the United States. The range here would be far larger, and the maximum cost would probably be higher than anything in Canada.

Senator HARTKE. Can we include that by reference, the document to which you refer?

Mr. LATIMER. Certainly. Ontario Committee on Portable Pensions.

Senator HARTKE. If you have an extra copy to provide to us, it will be included by reference rather than in its totality.

Is there anything else, Mr. Latimer?

Mr. LATIMER. No.

Senator HARTKE. I think I understand, and I appreciate it.

Thank you, gentlemen.

Mr. GREENBERG. Thank you, sir.

Senator HARTKE. Mr. Jean Lindberg, senior vice president, Chase Manhattan Bank, N.Y. With him is Mr. William F. Lackman, Morgan Guaranty Trust Co., N.Y.

Good afternoon, sir. You may proceed in whatever fashion you care to. But first let us do this:

A great number of interested persons and groups have expressed the desire to submit written statements for the record. In order that

they may do so, this record is going to be kept open until August 31, subject to the confirmation of the rest of the committee.

STATEMENT OF JEAN M. LINDBERG, SENIOR VICE PRESIDENT, THE CHASE MANHATTAN BANK; ACCOMPANIED BY WILLIAM F. LACKMAN, VICE PRESIDENT, MORGAN GUARANTY TRUST CO.

Mr. LINDBERG. Thank you, Senator.

My name is Jean M. Lindberg, a senior vice president of the Chase Manhattan Bank, National Association, New York, N.Y. I am division executive of the pension trust division of the trust department of the bank, which currently serves as trustee, agent, custodian, and investment advisor for more than 1,000 pension, profit sharing, and other forms of deferred employee benefit plans of all sizes and descriptions.

Accompanying me is William Lackman, vice president of the Morgan Guaranty Trust Co., who serves in a similar executive capacity for that bank, and who is chairman of the Committee on Employees Trusts of the Trust Division of the American Bankers Association.

I am here today as a spokesman for the Trust Division of the American Bankers Association.

Among the approximately 13,802 commercial banks in the United States, approximately 3,500 have active trust departments or are trust companies. As of the close of 1965 it was estimated that private retirement programs—of both the pension and profit-sharing types, had total assets of $85 billion and covered about 25 million employees. Approximately 20 million of these employees were covered under plans funded through trust funds with estimated total assets of $66 billion—with the great bulk of this latter figure—perhaps $60 billion being administered by banks and trust companies, principally as trustee, although also in certain other roles. The trust officers of these banks have contributed heavily of their time and energy over many years to stimulate interest in employers in private deferred employee benefit programs and have had a major role in assisting in the development of the plans in existence today. Consequently, the banking industry has a great interest in maintaining an orderly climate that will not upset present arrangements that have been painstakingly developed—often with some apprehension on the part of employers, particularly small ones, as to just what are they getting into—but also a climate that will continue to stimulate the further growth of an employee fringe benefit that is of great value to superannuated employees and to the general economy as well.

The ABA's trust position in regard to S. 1575 can be simply stated: We believe it would be most inopportune and unwise to enact legislation of this type at this time and perhaps for many years to come, even though the idea may appear attractive on the surface from a theoretical viewpoint. Our reasons are briefly stated as follows:

The bill deals with two types of risks—which from the technical standpoint of insurability are quite different; one is in regard to insuring, unfunded liabilities of pension plans—the funding process of which depends on the continuing existence of the contributing employer, whether this be a profitmaking or nonprofit organization. The other is a form of guarantee against market value loss of existing in-

vested assets. Accordingly, our comments will deal with these separately:

1. In regard to the unfunded liabilities—the main problem is that of accrued liabilities for past service credits—that is benefit credits for service rendered in the past—prior to the adoption of a formal funded program. Present IRS Code and regulations require that plans, in order to maintain continued qualification, be funded at least in regard to current service costs plus interest on the unfunded liability for past service credits at the interest rate assumed in the actuarial computations used in determining said liability. Under this minimum procedure, the unfunded liability is theoretically frozen, does not become greater nor is it amortized. It is next to not funding past service credits at all. Most employers when adopting plans, fully intend to amortize these past service credits at a rate that is substantially controlled by their future earnings (or other funds available if a nonprofit organization). Many proceed on the assumption that they will fund over a 10-year, 20-year or a longer period and use the resulting figure as a budget item in forecasting cash flows. As earnings on available funds fluctuate they may increase or decrease this standard amount—but they may not in any event fall below the minimum established by the code and regulations.

In negotiated plans, it is not unusual for the bargaining agreement to specify an amortization period with the annual cost of amortization being translated into the agreed upon wage package as "cents per hour." The much publicized Studebaker case is an excellent example of this—where the company was funding past service credits over 30-year periods, such periods commencing with each newly negotiated retroactive increase in pension benefits. In other words, when the plan was terminated in 1964, the original past service credits established at the inception of the plan in 1950 were approximately 47 percent funded whereas the successive increase in benefits were funded at a lesser percentage. The plan, as negotiated, set up an order of priorities as to the manner in which the then assets would be apportioned in the event of termination—first to retired pensioners and then so on.

Although negotiated plans are substantial in number and asset size, an even greater number of plans are what may be called single employer plans, unilaterally created by an employer whereby past service credits are granted voluntarily—to employees who rendered the service in the past with no thought or at least no legal reason to expect such credits. Of course there are many reasons why an employer establishes a pension plan—but the high point for purposes of this discussion, is that the establishment is voluntary and solely within the control of the employer. Past service credits can range from modest to generous.

From all this, a number of points can be made:

(*a*) Assessing a premium against existing plans is imposing a penalty against the very employers who are trying to provide financial security to pension expectations over and beyond the continued existence of the employer.

(*b*) Such a penalty is a retroactive one and had it been in force in the past, it may have discouraged the establishment of some plans now in existence or the past service credits previously

granted might have been reduced in order to give effect to the cost of the reinsurance premium.

(*c*) Since the amortization rate for 30-year funding of past service costs is about 6 percent of the original unfunded amount per year, that is for interest and amortization of principal, the suggested premium would increase the first year cost of an employer by about 16 to 17 percent on a 30-year funding basis; the increase would be 10 percent for the 10-percent funding which is the fastest method under the code, and 25 to 30 percent for the "interest only" method.

(*d*) These premium costs could seriously hamper the future growth of private pension plans, particularly for small employers.

2. In order to function properly, the assessment of a premium would have to be on unfunded liabilities which were computed on a uniform basis. At the present time there are considerable differences in actuarial methods and assumptions that are used in computing pension plan liabilities—all of which are technically appropriate in their application. Accordingly, the actuarially determined unfunded liability for a given set of plan benefits can vary depending on the factors assumed and methods used. Any standardization which might be decreed under the administrative provisions of the bill could develop a norm or standard for assessing the propriety of tax deduction by the Internal Revenue Service, requiring conformity or justification—a purpose which is other than the bill's intention and which could force conformity to a less conservative basis than an employer might wish to use to enhance the financial soundness of his plan.

3. The alternatives open to an employer who did not wish to be burdened by the premium would be—

(*a*) To forgo the establishment of a pension plan; or to grant credits and fund for future service only, leaving past service benefits to be granted on an informal out-of-pocket basis or not at all.

(*b*) Establish a profit-sharing plan—which is prospective only, and fully dependent on future profits.

4. Employers whose financial solvency or business future was shaky could be encouraged either on their own volition or through collective bargaining to adopt generous plans or increase benefits, hoping to stay in business just long enough to meet the minimum period under the bill.

5. The insurance factor makes no distinction between financially strong and mature employers and weak or insolvent ones. Previous testimony seemed to refer exclusively to corporation or corporate and profitmaking organizations, but questions can also be raised regarding coverage of employees of various unincorporated employers, associations, charitable organizations which can be easily formed and just as easily collapsed.

6. In regard to the second type of risk—that to protect against losses realized upon sale of investments if such sale is for the purpose of providing benefits—one broad point can be made. It is difficult to envision such a system of insurance that would not involve regulation of investment as to type and quality since the measure of risk is directly related to the type of investment. Experience shows that such regulation is difficult since at any given time there are reasonable

differences of opinion among investment professionals regarding specific securities and other forms of investment—regarding quality, prospects, timing, and so forth. Beyond this, losses could be, and have been suffered on bond issues of the highest quality—even on U.S. Government obligations due to market value changes based on changes in current interest rates.

On the other hand, the absence of such regulation, but the presence of an insurance feature could create tendencies on the part of some fund managers to be overly aggressive, "to reach out," in the parlance of the trade, because losses will be subsidized by others.

7. In conclusion, we can sum up our views in this manner:

(*a*) Although the concept is a worthy one, the areas of technical difficulty which will be created by the bill are many and varied. It is doubtful that satisfactory methods can be found to obviate these difficulties without restructuring the entire private pension plan field.

(*b*) Since a large number of existing plans were established on a voluntary basis, it would be unfair to apply the premiums suggested by the bill to existing benefits.

(*c*) The premiums suggested are substantial and would prove costly—thereby inhibiting adoption of past service liabilities.

(*d*) The bill is aimed at plans that are or will be in the process of funding to build financial security for employees but does not touch the employer who has no plan, or who is operating his plan on an unfunded basis—and therefore a less secure one.

(*e*) And, finally, the broad comment might be made, that if it is accepted that private pension plans are highly desirable and should be encouraged—and all quarters seem to be in accord on this—it is quite possible that the enactment of this bill will discourage rather than encourage the creation of new plans, or better benefits in existing ones—particularly among smaller employers—where the greatest number of uncovered employees are to be found.

As an aside, last year there was something like 10,000 new pension and profit-sharing plans created, and I think that the average coverage under such plans was in the neighborhood of 100 employees, so this is where the great bulk of new plans are going to arise.

My associates join me in thanking the Finance Committee for permitting us to appear here today and hope that our views will prove informative and helpful. I will be pleased to attempt to answer any questions you may have or to clarify any portion of our statement.

Thank you.

Senator HARTKE. Mr. Lindberg, let me ask you what would be the effect upon pension plans, if the tax benefits were removed tomorrow?

Mr. LINDBERG. I would say that, No. 1——

Senator HARTKE. On new plans, I mean. How many new plans do you think would be established?

Mr. LINDBERG. Very few.

Senator HARTKE. I think that is right. I think this is what you are dealing with. I think you are dealing in fairness here. I think you should be so—I don't think you should be so afraid, just because the American Bankers Association is a wonderful service organization looking out for the benefits of its people. There is no reason for you to be fearful of trying to make sure that these plans are operated for the purpose for which they are intended.

Now I think this: If it is proven, and if you had to go in front of these groups and say to them, "Look, 5 out of every 10 people covered by this plan"—I think this will be proven to be a fact—"are never going to receive any benefits out of this, that is just an illusion," don't you think that the wrath of those people could be brought down to such an extent that we couldn't justify this continuation of spending 30 percent of the cost of the taxpayers' money on such programs? Don't you think that is unfair, really?

Mr. LINDBERG. I think I would have to answer that I can't answer that "Yes" or "No." I think that whenever we look at private pension plans we have to go back to the way they were evolved, what their original purpose was, how they were created and formed.

At one point in time, before funding took place and before formal plans were in existence as such, the employer, out of benevolence or otherwise, would say to someone with him at a superannuated age, "Now you have been with me for 30 or 40 years, and I think it is about time that you stopped working."

You didn't say this to the fellow who left at the end of 3 years' employment or 8 years or anything else along the way.

Senator HARTKE. Generally speaking, there are very few plans that provide for very many benefits after 3 years of work; isn't that true?

Mr. LINDBERG. That is true.

Senator HARTKE. Here, I want to be honest with you now. I am going to try to go through, I mean I am not going to try to change your opposition to the bill, but you be just as honest with me as I am with you. Don't go into the exaggerated positions and try to make them the norm. Three years is not so.

Mr. LINDBERG. All right; I will say 10.

Senator HARTKE. But let's not try to exaggerate. Let's try to be reasonable about what we are dealing with. I think this is a real problem in society, which you say is at least theoretically good, though you think it has no practical application.

Now the point which I am going to try to bring you to is whether or not you are willing to even see whether there is a chance for you to come up with a workable plan. If you don't think this bill will do the job, then you come up with an alternative. Now, let's go back to the origin of these plans for a moment, as you stated, not to 3 years.

Mr. LINDBERG. Well, I was leading up to a point, Senator, and that is that when a plan is developed to be funded formally, let us even take the case of a negotiated plan, and the benefit structure is established in negotiations that all employees, upon reaching a certain age or length of serve, are to get *x* benefits. The aggregate cost of this plan is computed, estimated, and then this is translated into, let us say, a wage package of 10 cents an hour per employee, and as pointed out in earlier testimony today, every employee really doesn't get the benefit of this 10 cents.

Senator HARTKE. That is right.

Mr. LINDBERG. Now one alternative to solve all these problems, would be to create, to go back to what was called the money purchase concept, where each employee would get allocated to him this 10 cents per hour, so that the young employee with 30 years to go would wind up with a fairly substantial accumulation, the one who had 10 years to go would wind up with less, and the man who was retiring to-

morrow would get practically nothing. Now that would be a very equitable manner of distributing the so-called deferred compensation structure of this negotiation or plan.

Instead this doesn't serve the immediate pressing problem of the covered group, the employer and the employees. So what is done is to say we will collectively take this money, and you will first apply it to the people who are nearest retirement, and it is hoped that all of the employees covered understand that the young man who is 30 is in a sense subsidizing this particular older employee, and in time, 20 or 30 or 40 years hence, he too expects to be subsidized in the same sense. He will actually have earned his, more so than the man who is ready to retire. But he is giving this up in order that the man who is ready to retire will get his benefit.

Now what is happening here is that we are saying, No. 1, you give it up so that this man ready to retire can get his benefit, but you don't really give it up because if something happens along the way, somebody else will give it to you.

Senator HARTKE. Why should he give it up? I mean what reason is there?

Mr. LINDBERG. If he doesn't give it up, then the plan does not take care of the older employee who is ready to retire.

Senator HARTKE. But you see you are dealing with it from only one side of the picture. That is not necessarily so. If you get away from this idea, I mean let's assume that we forget all your other objections, as long as you have this insured system, what you say is not necessarily so.

Now you have to admit that if you can come up with a program where the worker doesn't have to necessarily give up these rights, that is a whole lot better than saying, "I am sorry, sir, it is just too bad, you are left out in the cold for the very simple reason that we expected to be able to meet this obligation, we hoped we could, but due to circumstances beyond our control, we can't."

Then you say, but there is another program over here which will step in to fill the gap. That is really what you are doing under employment compensation, isn't it?

Mr. LINDBERG. Yes, but that is not something that is for a terribly long period of time. One might say that with respect to this type of insurance program which is envisioned in the bill, it singles out pensions. The point has been made to me, "Well, why not single out a continuation of their group life coverage, their medical coverage, their jobs? Why pick out pensions as the sole thing here."

Senator HARTKE. But you see, this is sort of a peculiar argument to come from a banker. You say why pick out pensions. You pick out what you want to. If you want to go to the others, I am not saying you shouldn't. Maybe there should be programs in these other fields. Maybe you should have an arrangement. I am not saying you should or shouldn't.

But I do know that we are dealing with something which within a very few years, by 1980, is going to have assets representing more than the total assets of the life insurance business of the United States today. Now I am telling you that if you have this thing out here on a string, and if you have some type of economic collapse hit it is going to be much more damaging to these people than any one single thing that will probably hit them.

I don't think we are ever going to go through another wringer like the thirties and come up with the same type of government we have today. Maybe we can withstand another one, I don't know. I don't want that type of thing to happen.

Mr. LINDBERG. Nor do we.

Senator HARTKE. I know you don't. I am sure you don't. But it took that type of a crisis for us to make sure that the banking institutions of America were going to be able to honor their depositors, so that that type of situation couldn't happen where you could completely wipe out the small savings, the small holdings of all these people.

How many of the same things you are saying here could have been said about the banking institutions, the cost, some things that are not quite as complicated, but many of the same things could have been said of regulation. Sure you have regulations. The bank examiners come in on you. As long as everything is good, fine.

Mr. LINDBERG. This is a very good point actually, sir, because while some attempts to cite the FDIC as an analogous situation to this have been made, we don't believe that it is in quite the same ball park. The FDIC is a system which is applied to assets in existence.

Senator HARTKE. I understand.

Mr. LINDBERG. Which have been voluntarily created and delivered by people to the banking profession for safekeeping.

Senator HARTKE. That doesn't make any difference, that part of it. How does that represent anything different than the situation where you have these people making a contribution to a fund?

Mr. LINDBERG. Well, here there is an attempt at insuring a future promise or the continuation of a profitable corporation. This is insuring something that hasn't as yet been created compared to the FDIC, which is insuring something that is in existence and can be regulated.

Senator HARTKE. I think that is a play on words. I mean I grant you, as I have already pointed out, that it is not exactly the same insurable risk, but to indicate that there is any real difference in substance here is only one of degree and not necessarily of any great magnitude in my opinion. Certainly the mere fact that it is not a definite fund at this particular point is important, but it is an identifiable object which can absolutely be determined within at least reasonable grounds. The truth of it is that if all the banks of the United States go broke tomorrow, there probably is going to be a difficult time to pay out all the insurance claims anyway.

Mr. LINDBERG. That is correct.

Senator HARTKE. This is nothing new. I think really you are afraid of something here that is not real, and rather than go back point by point with you and try to get you to change your mind, which I am sure I couldn't do today, and I am not going to try to persuade you, I would just like for you to go back and take a second look, and not look at this as a giant Federal monster, trying to move in on you in a coveted field for which you are paid a price.

We don't intend to do anything, so far as this bill is concerned, to remove you from this lucrative practice. I think you should continue. This is a fine business just like all trust businesses are, a fine clean business to be in, and lawyers who deal in that type of operation, they

have a nice field too. It is a steady income, and there isn't any problem. You get your percentages, and that is fine.

I think you do a wonderful service for those people. But the fact is that just because you have had a field here in which you have had no definite responsibilities to make sure that others and the beneficiaries are protected——

Mr. LINDBERG. The beneficiaries are protected in regard to the assets that are in existence.

Senator HARTKE. That is right.

Mr. LINDBERG. We are now talking about future assets not yet created.

Senator HARTKE. You don't guarantee to them that the investments you have will stay the same, for example, that the stock market is going to stay up to 1,000 when it drops down to 840, and it is off again today. Something is wrong there. It is not your fault, I hope.

Mr. LINDBERG. A good buying opportunity.

Senator HARTKE. Good buying opportunity. But the point I am getting at is that no one asks you to be perfect, and I am not asking that you think about this in perfect terms. But you have two problems here which you cannot ignore. You have the human problem here, which at the moment is an item which is almost as important to at least elderly people as any one thing I know. This is something that shakes them to the bottom of their shoe soles. And I don't know whether you have been able to put enough away for your nest egg or not, but you deal with an operation which you think is not going to go broke, and it has certain guarantees written into it.

But if you were in an operation in which you had this pension negotiated for you or given to you voluntarily by an employer under any circumstances, and if you had to face the fact that you had lost your pension and you were 59 and had a 16-year-old boy, and you knew you were going to be able to send him to college, as that man did this morning, and then have a nervous breakdown as a result of this coming true, or at least it followed, then you would think twice about this problem on an individual basis.

Now let me come back to another point. When you have a situation in which you are in effect saying to society, "you are paying a third of the bill on a general overall total basis for other people, so that they can have a pension plan over one-half of whose participants never receive anything in return for what is set aside for them," then I would think that you would maybe look at this again. With that in mind I am going to let you go and not try to argue any further.

Mr. LINDBERG. Thank you, Senator.

Senator HARTKE. Mr. Merton C. Bernstein of Yale University Law School.

I might point out for the benefit of all of us here that "The Future of Private Pensions," by Merton C. Bernstein, is probably the first book in this field, and is authored by the witness here today. We are glad to have such distinguished company with us.

STATEMENT OF MERTON C. BERNSTEIN, PROFESSOR, YALE UNIVERSITY LAW SCHOOL

Mr. BERNSTEIN. Thank you, Senator. I might say that I also claim the distinction unique among the company here, I am the only witness,

I believe, on the agenda who does not represent a financial interest in this area, or any political interests, which is testified to by the fact that I believe I am the only witness paying his expenses.

Senator HARTKE. Let me say to you that we are delighted that you are here. We are glad you are paying your own expenses, because that is an item which indicates in the end that the academic society of America still has many virtues that others of us cannot claim.

Mr. BERNSTEIN. Senator, I think that the hearings today represent, along with those that were begun in the spring of this year by the Joint Economic Committee as a point of departure, a new departure in the private pension field. I will shortly come to the proposals of the Cabinet committee report, but I think that the two hearings that have been launched in 1966 indicate that there is an awakening interest in this much neglected field, that the pension industry should now be on notice that business as usual will not suffice.

I find that there is a great deal of concern among pension professionals, many of them here today or represented here today, in approving private pensions, but they also feel that there is no heat, there is no heat from Congress, there is no heat from workers.

I think that the hearings that were launched by the Joint Economic Committee, and which you have instigated here, should put the pension industry on notice that that no longer is true, and that there are new forces at work in this area, and that they are under an obligation to themselves, if to no one else, to be affirmative in the proposals that they make in this area, because they hardly need outsiders like myself to tell them where the deficiencies of plans are.

But these deficiencies must be dramatized, and the responsibility it seems to me rests with the pension industry and employers and unions to come forward with comprehensive remedies, or else Congress will take the ball from them. And I think that what has occurred here today presages just that kind of development.

I would like, if I may, to concentrate my fairly brief remarks. I will not adhere to my prepared statement.

Senator HARTKE. The entire statement will appear as though it were read.

(The statement referred to follows:)

EXCERPTS FROM TESTIMONY OF PROFESSOR MERTON BERNSTEIN

Private pensions plans as presently designed cover less than one third of the working force, less than one half the full-time, non-farm private work force—and well under half of them will actually receive plan benefits. Indeed, the lucky minority may be as small as 20% of those with plan coverage.

Although modern employees are highly mobile, and a strong and flexible economy needs their mobility, private plans are based on the outmoded conception that plans will discourage job separations. The irony of this is that a large proportion of job changes are involuntary—but the loss of pension credits is nonetheless real.

Single employer plans, which account for roughly 85% of employee coverage, limit benefits to those who retire from a company after at least 10 years of service at age 65. Frequently the length of service required is greater. Early retirement often is possible, but requires longer service and results in smaller benefits. Disability benefits are common, but qualifying for them is harder yet. The device of vesting—whereby a separating employee has a claim for retirement benefits if he survives to retirement age—has become quite common in single employer plans. For the most part eligibility depends upon either 10 or 15 years of continuous service with that one company, with an additional attained age requirement of age 40 or 45—and sometimes more. The age

requirement, in effect, often transforms the service condition into one requiring 20 or 25 years. Only a small minority of employees can satisfy these conditions and most of them will stay under the plan until retirement age.

Multi-employer plans enable employees to cumulate service by working for any of the participating companies. Most such plans are of limited geographic reach—usually within one state or even metropolitan area. Their benefit eligibility requirements are even more stringent—frequently exacting 20 or 25 years of covered service and often with the additional requirement of 10 or more years of continuous service during the years immediately preceding age 65. They often lack early retirement, disability and vesting provisions, thereby making benefit achievement that much more difficult.

Yet, every year hundreds of thousands of employees change jobs and change industry. The semi-mobilization of the Viet Nam War has marched tens of thousands of workers into jobs that will not last for many years. Pension plans are highly concentrated in manufacturing—accounting for over half the group pension coverage—and defense production provides a large portion of the pension coverage we have. But credits earned—more than likely an overwhelming majority—will produce no pension benefits. Worse yet, in the name of fighting inflation, substantial portions of compensation increases are being channeled into pension plans. The resulting plan improvements—largely higher benefits—probably will prove illusory for a large majority of present defense production employees.

What we have are mobile workers and immobile plans.

Changing technology, overseas competition, new emphasis upon serving overseas markets from overseas plants, changing defense needs, changing tastes, changing population patterns, all result in constant shifts in employment. So, for example in the two year period ending in June 1965, 180,000 workers were reported permanently laid off in mass layoffs, (affecting 100 or more employees). This figure tells only a part of the story—no check was made for non-reporting; the survey covered only large layoffs and only those understood at the outset to be permanent. Far more common are layoffs of indefinite duration from which large numbers of employees do not return to their old jobs. The reported layoffs took place in areas of heavy pension concentration—manufacturing, and especially defense production.

Some studies indicate that large groups of employees who lose pension covered jobs thereafter move to lower-paying, non-pension covered jobs in other industries. This is especially true of older workers, which today means anyone over 45 or even younger. These observed patterns do not fit the apologists for poor private pension performance that young workers are the job changers and older, steady workers stay put. Such a claim is rendered absurd when—as is so common—an entire plant, or warehouse, or store, is shut down and its functions moved great distances—sometimes overseas. For quite understandable reasons—including the lack of assured jobs—most employees do not follow their jobs—even when they can and often they cannot.

As a result, a minority of plan participants will achieve benefits. And most will have pension savings for only a minority of their working years—and most plans vary benefits in accordance with length of service.

If private plans are to continue to merit favored tax treatment—which runs to about $3 billion a year—a burden necessarily shouldered by all other taxpayers—the prospects for their payout should be much better.

Private plans should be more extensive—especially among small companies. Their credits should vest within a relatively short time—no more than one or two years. Only thus can this minority—often high paid and stockholder employees—be transformed into a majority and only thus can more years of employment be transformed into effective pension savings.

The inadequate single company base, and single industry and craft base, should be broadened to near universality. I suggest that the easiest way to achieve this would be under a National Pension Clearing House which would: provide basic pension plan coverage at manageable cost to employees of small companies and provide the mechanism for splicing bits and pieces of pension credits earned by an employee in many different jobs—often none substantial enough to be translatable into a benefit even if the credit was vested. The NPCH could be a part private—part public undertaking, utilizing the advantages of each.

Unfortunately the proposals of the Cabinet Committee on Private Pension Plans would be difficult to enact because of their compulsory nature and, worse yet, would be practically ineffective. The proposal for partial vesting after 15

years of continuous service would have little bite, except under some multi-employer plans. The proposal for full funding in no more than 30 years would be of no help in any situation I've ever heard of in which a plan ran out of money.

We either have to be more ambitious—and foresighted—about our private pension arrangements or settle for a second of third-rate private pension system which often favors upper income groups. Certainly such a system does not merit favored tax treatment.

The Committee on Finance might consider changing the tax laws to encourage vesting by making employee contributions—within the limits presently imposed upon employer contributions—tax exempt, on condition that they remain locked into a pension plan (i.e., can't be withdrawn on job separation—as most employee contributions now can be).

Contributory plans generally have higher benefits, more liberal vesting, and the employees' own contributions are fully and immediately vested. Such a change probably would require similar exemption for employee contributions to Social Security, Railroad Retirement and Civil Service Retirement. That would be an excellent way to cut taxes—when tax cuts again become possible—may that day come soon.

Private pension plans grew and improved rapidly during the 1950's. Their rate of growth and improvement has slowed markedly in recent years. Even the modest growth predictions of the Cabinet Committee Report are proving overly optimistic. At the rate we are going, private plan coverage will not reach even the predicted 65% of private, non-farm employees.

The elderly make up a large portion of the poor. Our Social Security system is inadequate. Our private pension system is inadequate. We can do better and we should. But if private plan performance is to be improved we must set about the job soon. They are not susceptible to 11th hour tinkering.

Professor Bernstein urged the Committee to undertake a full scale study of pension and retirement income problems with emphasis upon:

The questionable adequacy of plan funding

The problem of self-dealing by employers with pension trust funds

The almost total absence of effective provisions for widows

The impact of earlier retirement, which will tend to reduce both Social Security and pension benefits.

Mr. Bernstein is Professor of Law at Ohio State University. His book, "The Future of Private Pensions" (Free Press—Macmillan) received the Elizur Wright Award of the American Risk and Insurance Association as the publication which made the greatest contribution to the literature on insurance in 1964–1965; it also was cited for excellence by the Princeton Industrial Relations Section and *The Library Journal*. Professor Bernstein has been a consultant on pension problems to the Treasury and Labor Departments and HEW, as well as the Twentieth Century Fund. In the 86th Congress he was counsel to the Senate Subcommittee on Railroad Retirement.

Mr. BERNSTEIN. I think it is important to emphasize the setting in which your bill takes place, the importance of the associated problems, so that a fuller appreciation of the importance and the feasibility of your bill will be appreciated.

It is a cliche now to point out the growing ranks of the aged in this country, but we do have today and have had now since the close of World War II a new problem, the problem of vast numbers of elderly people who are being declared surplus to the economy, who need an income substitute. That is a new problem, and old methods will not meet that problem.

Senator HARTKE. You mean we are not going to send them over the hill to the poorhouse any longer.

Mr. BERNSTEIN. That is right, and yet this leads exactly to the next point, that despite the Social Security Act and despite the vast resources that private pensions now command, the demotion, the financial demotion of the elderly in this country approaches a national scandal, because millions of people who have been used to supporting themselves are no longer able to do so because the main means are

denied them, namely a current job. Social security benefits are dreadfully inadequate to self-support at a level of decency and independence, which I think ought to be our aim.

Private pension plans can, but as they are presently structured will not provide a supplement on a broad scale so as to save the elderly, formerly self-supporting, from the degradation to which they are presently committed.

This committee and the Congress in the next session will wrestle, I am sure, with the problems of the inadequacies of social security. But we always deal from what we have, and as a result, the amount of progress that can be made on any one program is limited.

I would expect that the social security program, when Congress has worked its will, will prove to be too ambitious for those who would assign a limited role to it, and inadequate to those who are concerned about a decent standard of living for the elderly.

I would expect also that the role of private pensions will come under closer and closer scrutiny as the inadequacies of the public program become more generally appreciated. It is a very popular program, but the meagerness of its benefits are not fully appreciated.

It is common today to hear that there are 25 million participants in private pension plans. As you and others have pointed out today, however, the key question is how many of those participants will actually achieve benefit eligibility.

I think when you and Secretary Wirtz this morning came to an agreement that roughly 40 to 50 percent of plan participants will achieve benefits, this as a rough dimension, you were being optimistic. I know of no pension expert who would set the figure above 50 percent. I myself would place it necessarily on a fairly impressionistic basis well below.

Under the assumptions of one of my critics, a nationally known actuary, using his figures, the rate of achievement could be as low as 20 percent of plan participants. Some of the examples in the Joint Economic Committee's hearings of this spring showed that even in a broad-scale multistate multiemployer plan, the expected rate of benefit achievement would be 40 percent, and this under a system which is designed to assure a continuity of building plan eligibility. A multiemployer plan of that scale is quite rare.

It is generally argued that a plan of that sort has the equivalent of vesting. But if that is what we can expect from a 13-State plan, with thousands of employers all in the same industry, this was the Western Conference of Teamsters plan, if 40 percent is what the plan actuaries and administrators expect, and that is a wealthy plan, what can we expect from plans which have a single employer base, given the mortality of so many employers?

Senator HARTKE. I might point out that that is true, 25 million covered, that would be on a 40-percent basis, it just means 10 million would actually receive benefits of the total employment of what is it—74 million at the present time?

Mr. BERNSTEIN. Well, in the course of a year, in excess of 80 million people working.

Senator HARTKE. In excess of 80 million people—so only 1 out of every 8 working today has any chance of receiving any real cash benefits from the pension plans, is that correct, sir?

Mr. BERNSTEIN. I think that that is a very likely estimate, and an estimate that errs on the conservative side; that given the rate of change in this country today, the level of performance could be quite different. And I think the major difficulty is that we are dealing with plans that are becoming outmoded.

I recognize that all institutions have their historical explanation, but that doesn't mean that they continue to be justified in their historical form. Individual plans still operate on the assumption that long-term employees will achieve benefits under it, and that no others will. And yet we have a highly mobile work force which, as several have pointed out, is one of the strengths of our economic system. We want employees to go where the action is, where they are needed. They are not to be chained to outmoded kinds of work, which don't fully utilize their skills.

Moreover, I think although the stabilizing effect of private plans has been much emphasized, what little evidence there is indicates that private plans at the blue-collar level and the salaried worker levels is not operated generally to inhibit mobility.

It may very well to the pension-conscious executive be a terribly important factor, but by and large studies indicate so far that most rank-and-file employees don't place much importance, so that they may quite improvidentially change jobs, and thereby sacrifice their accumulated pension credits, and one may say, well, they were not foresighted enough. But the fact of the matter is that as a broad national social problem, we have to deal with the consequences of actions of this sort.

Private plans then are posited on an assumption of work conduct that does not fit a large part of employment today. The forces of change that are in operation are tremendous. Very often the hand that strikes down an employee's job is an unhappy hand. Technological displacement does not come usually in the bare face of a machine shoving aside a worker at the same place on the same product. It may in fact make itself known by overseas competition. It may be shocking to us, but there are some areas in which overseas producers are more highly automated than American producers.

It is also a fact that more and more of the overseas market of American companies is being served from overseas plants which take the place of domestic plants that are shut down, when their machinery becomes outmoded, and then you have an automobile plant or a farm machinery plant or a rubber plant overseas which is the last word that has in fact taken the place of something in upstate New York or Evansville, Ind., which for some reason was a community hit again and again and again during the fifties by plant shutdown.

Plant removals are part of this. When a new plant comes into operation in a multiplant company, usually it is not at the old site, for any number of reasons. The original reasons for location may no longer be operative. Raw materials may be elsewhere. The skilled work force may not be any longer located there. Markets have shifted. Population profiles are changing radically, so that the markets of today are not the markets of tomorrow.

Demand ebbs and flows. And certainly one of the greatest areas of change is that in different operations. During the fifties aircraft manufacturers were tremendous employers. You need only walk out to Long Island or the Seattle area or southern California to say noth-

ing of Wichita, Kans., to find the debris, not literally but figuratively speaking, of former aircraft operations, where thousands of employees have been separated from their jobs, and this, of course, is one of the ironies of present pension structure.

Their vesting requires long service. Tremendous numbers of employees are separated from their jobs wholly involuntarily by forces that are completely impersonal. They have no choice. A study which is only suggestive, it is not definitive, by the Bureau of Economic Security, for a 2-year period ending in July 1965, just before the Vietnam buildup, showed that there was a minimum of mass layoffs involving 180,000 people heavily concentrated in defense industry. The layoffs—this was not a pension study—were very heavily concentrated in the areas where private group pension plans are common.

This study did not attempt to show, to determine underreporting. It was limited to layoffs which, at their inception, were known to be permanent, which is something of a rarity. It was limited to layoffs that involved at least 100,000 employees, which also is rather large scale, so that the dimensions of involuntary job separation can be expected to be many times that figure of 180,000.

Now I might say that plan termination, which has been the emphasis of much of this hearing, is only part of the problem. It may sound ironic, but ofttimes employees may be victimized on a large scale so far as their pension expectations are concerned, because the plan does not terminate.

One case that was litigated in court arose in Evansville, Ind., where a plant which at one time had employed as many as 10,000 people shut down. It happened to be the one plant of a multiplant corporation. That plant did not have vesting, and the terminating vesting provisions of the Internal Revenue Code and the regulations did not apply, and therefore thousands of employees were separated from their jobs, wholly involuntarily, and had nothing to show for having been under the plan for many, many years. The plant was put back in operation by a different employer making different products.

This is a phenomenon that can be expected to be repeated again and again. Some preliminary estimates of plans was given this morning, the figure was given of 180,000 workers affected as to plan termination. Now I don't know what "affected" means in those circumstances. It could mean those employees who were on board when the ship sank.

It does not account for the possibly much larger group that was separated while the ship was taking on water. The Studebaker employees, many, many hundreds, in fact many thousands were separated before the plant shut down. This was also true of the Packard shutdown in 1958.

It is typical that plants die slowly and separate lots of employees before the termination vesting provisions of the code set in. And so a very common problem I would like to emphasize is when plans do not terminate because of the limited reach of the code, and the Internal Revenue regulations, because upon plant termination, all credits are supposed to vest, and unless there is planned termination, that vesting by virtue of law does not take place and this may very well be a larger scale problem than that of plans which do come to an end.

Little has been said here today about benefits, but they are intimately related to the problems that we have been discussing, because under

the great majority of group plans, benefits vary in accordance with length of service. Therefore in the number of years during a man's working life that results in effective pension savings are a crucial determinant of his retirement income. A man may achieve benefit eligibility in his last job, but if he has only been in that last job 16 years, although he has worked in excess of 40 years, his pension savings have been effective for only a minority of his working life.

I think we ought to try to restructure the private pension system, so that it can result in more effective pension savings over a longer period of time, which incidentally would result in a lower contribution cost, because so much more of the benefit would be generated from plan earnings.

There has been discussion during the day, as there always is when people talk about vesting and the advantages of pension plans, about tax subsidy. Eschewing that loaded word, I think it is often overlooked that the principal advantage, tax advantage of private pension plans during periods when there is not an excess profits tax in operation, is not the deductibility of the employer contribution, but in the tax-free earnings, and I might add the tax-free earnings on earnings of the funds set aside for that purpose, whether a trust or under segregated accounts in insurance.

This I would agree with Secretary Surrey accounts for tax savings on the order of $3 billion a year. And as these funds get larger, the tax savings would be even greater.

Professor McGill, with some assistance from private actuaries, has estimated that for the same money to generate equal amounts if kept in the business, in the employer's own business, the rate of return would have to be double what it is on pension funds. If that isn't an advantage, I don't know what it is.

All of us would like to save in that way, and I would say that all of us should be stimulated to save in that way, if the savings will pay off, not to just a small minority, but to the generality of employees, because if it comes to be felt that plans in general are not paying off except to a favored few the favorable tax treatment which now seems like such an ordinary picture of life may indeed come under question.

I think we need some preventive medicine as well as some curative medicine, and I would class your proposal under curative medicine. I would like to suggest that we need some imaginative preventive medicine to avoid some of the pension problems that will beset us in the future if we continue business as usual.

It would seem to me we need more extensive coverage of plans which can be encouraged affirmatively. The large area presently uncovered is among small companies, for the very good reason that it is more expensive to install and operate a small company plan, and also it is probably uneconomic to do so, because of the high mortality of small companies themselves. Their own life is so brief.

We can achieve higher pension benefits, a higher rate of eligibility with a lower unit cost, if more years of work were to pay off. When the social security system was established in 1935, it covered roughly half the jobs in the country, and as a result, this was one of the reasons that social security benefits were unnaturally low or extremely low, not unnaturally. There is no benchmark, but were extremely low, because average earnings were kept down by the fact that people moved in and out of covered employment.

Now precisely this happens to hundreds of thousands of workers. They can work under a pension plan and then move out. This is particularly true for older workers who are under a pension plan. This was true of the Packard employees, the state of some of them as moderately well documented. A majority of them moved out into the service industry. They didn't stay in the automobile industry. They didn't stay in the manufacturing industry. They moved into an area where private pension coverage is practically unknown.

If we are to have an effective private system, we have to spread its coverage just as we found that under social security it would operate effectively only if its coverage was close to universal as it has become. But we don't have the mechanism today for achieving that close to universal coverage, and I would suggest that a proposal that I made in my book, for a national pension clearinghouse, might well be taken under consideration. The Cabinet Committee report did recommend that further study be given to the proposal. Some other groups have indicated their interest in exploring it.

Such a national plan could provide basic coverage for small employers, and also provide the mechanism for taking small bits and pieces of private pension vesting, if it were to become quite common, and piece them together into one benefit which could pay off in one sum.

More importantly, an important part of pension plans is ability, through the investment of funds, to participate in the growth of the economy, and the difficulty is that when plans vest today, when benefits vest today, they are frozen as of the time of the employee's separation, which may be many years before the benefit becomes payable, due to inflation and increased productivity, the value of that benefit in current terms at the time of retirement is severely eroded, leaving out of account the erosion that takes place after retirement, so that participation in a live fund rather than in a coldstored benefit as it is commonly referred to today is quite important.

A grave difficulty with the proposals in the Cabinet committee report—a grave shortcoming of the Cabinet Committee report proposals is that (1) they are going to be extremely difficult to achieve, because of their compulsory nature and, (2) even if they were enacted into law they would be of little practical effect. The vesting proposal is for 50 percent, the vesting of 50 percent of the credits after 15 years of continuous service.

Now this is already a common provision in plans. It has very little bite, and comparatively little utility in present-day terms. I feel that the Cabinet Committee report is buying a battle that is more symbolic than usual.

Similarly its proposals for funding over a minimum of funding past service liability over a 30-year period also would have little bite in most cases. The Studebaker plan had precisely that kind of funding, as did the Packard plan, and yet we know the trouble which it ran into.

I would like not to comment in detail about S. 1575, because a great deal has been said about the technical aspects of it already, and I must say I endorse those, I am with those who endorse the goal, and I must say I share the misgivings of many of those who see technical difficulties.

I would say this: that many of those technical difficulties might be minimized or greatly reduced, if it were part of a more comprehensive

plan of pension plan regulation. I think that the Hartke bill, which has served the important function of focusing these hearings on bringing attention to these terribly urgent problems, cannot be treated apart from the problem of standards of funding, of standards of vesting, of the nature of fund investment.

Strangely enough, some bank trustees have indicated that they would be extremely pleased, to me privately, if they were relieved of the pressures from some parties of being asked to invest in the employer's business. Even insurance companies are not free from pressures of that sort. I don't think that hanky panky is the primary problem of pension plans today, but I do believe that it is an area that cannot go untreated.

I look forward to these hearings today as marking a new beginning in the private pension field, in which a more comprehensive treatment will be given to the problems that have been discussed throughout the day, and the overall resolution may very well encompass and make more feasible the proposals that you put forward.

Senator HARTKE. Thank you, Mr. Bernstein. We are going to move right ahead here. I am limited on time too.

Mr. Preston C. Bassett, vice president and actuary, Towers, Perrin, Forster & Crosby, Inc., Philadelphia, Pa.

STATEMENT OF PRESTON C. BASSETT, VICE PRESIDENT AND ACTUARY, TOWERS, PERRIN, FORSTER & CROSBY, INC., PHILADELPHIA, PA.; ACCOMPANIED BY HERMAN C. BIEGEL, PARTNER, LEE, TOOMEY & KENT

Mr. BASSETT. Thank you, Mr. Chairman. My name is Preston C. Bassett. I am vice president and actuary, Towers, Perrin, Forster & Crosby, Inc. Appearing with me is Mr. Herman C. Biegel, a partner in the Washington law firm of Lee, Toomey & Kent, and counsel for our company on tax and other legal aspects of pension plans. After my presentation today, Mr. Biegel and I will be happy to answer any questions you have.

I have been an actuary since 1949 and am a fellow of the Society of Actuaries, a member of the Conference of Actuaries in Public Practice, and an associate of the British Institute of Actuaries. My company, Towers, Perrin, Forster & Crosby, Inc., is a firm of consultants and actuaries to management. It has headquarters in Philadelphia. We have been in employee benefits and pension planning since 1917 and the greater portion of our 800 client companies throughout the United States, Canada, and Europe use our services in these two important areas. I have been with this organization for more than 16 years.

Today, however, I am not representing any of our client companies. Rather I am here to express my personal views based on my own experience in the field.

Before commenting specifically on S. 1575, Senator Hartke's bill to establish a Federal reinsurance program, I would like to express my general observation that, by and large, the private pension and profit-sharing system is working extremely well with the social security system in helping millions of Americans attain financial security in their older years. There are, of course, certain deficiencies which

have been revealed in some of these plans; but my experience leads me to believe that many of these deficiencies are being rapidly and substantially alleviated through private, voluntary action. And the number of plans in which these alleged deficiencies exist has been extremely small.

It should be recognized, Mr. Chairman, that when a company undertakes a pension plan, it is assuming a long-term and frequently costly obligation that must be met through the years, in lean as well as in profitable years. First, because they desire to provide their employees with retirement security that can be provided at a practical and realistic cost; and second, because the financial security of the organization must be a consideration when it accepts any long-term commitment of this sort.

As companies gain experience with their plans, however, and as the trust funds grow through the years, the plans are usually improved in many ways—by adopting more rapid vesting provisions, sounder funding of past service liabilities, more comprehensive benefits, et cetera. Accordingly, there is widespread evidence that any major weaknesses in the pension system which were prevalent only a decade ago are being generally overcome at the present time, particularly with regard to plans which have been in evidence for a number of years. You are not dealing with a static situation. Plans are continually being altered and improved as companies and unions gain added experience in the field.

In my judgment, the true strength and unique value of private pension and profit-sharing plans lie in this inherent flexibility: their ability to meet the requirements and the capabilities of widely varying corporate situations, and to adjust to new experiences and new situations. I believe that the Government should be extremely cautious in trying to impose on these plans mandatory standards of a type which will tend to deprive them of this important flexibility—standards which would tend to convert the private retirement system into something akin to social security.

Senator HARTKE. Let me interrupt you a moment. The one thing that bothers me which you people who oppose this bill never take into account, is that you are receiving a special tax exemption, a special tax benefit from the Goverment.

Mr. BASSETT. I have not said I am opposed to this yet.

Senator HARTKE. I know you haven't yet, but you are going to. The point about it is this. All I am saying to you is that I can see that there is another alternative to this, and that is remove this tax exemption, and I would be inclined to do that, if we can't provide for a program of the sort described in my bill.

I don't think that there is any special reason to give one segment of society a special tax decrease. Why not give it to everybody? Let's figure out what this amounts to, and give it to everybody across the board percentagewise. Why not do that?

Mr. BASSETT. Senator Hartke, maybe I misunderstood the bill. I thought this bill relates to insuring against certain contingencies that might happen.

Senator HARTKE. That is right. That is what I am talking about. But I mean you find that now everything is going so wonderously, glowingly good, I wonder how good it will go if you take away this spe-

cial tax benefit. Isn't there any sine qua non for which we have to give some consideration?

Mr. BASSETT. I think the mere fact that the Government has given this incentive is part and parcel of the wonderful job that has been done in the past 20 years.

Senator HARTKE. But that is just so much talk.

Mr. BASSETT. No.

Senator HARTKE. All right. You can shake your heads back there if you want to, but as far as I am concerned, I am not worried about what it is going to do to an existing operation, if you cannot show that the benefit is coming to the general society, there is no reason for general legislation to be passed for just private groups, and I would say to my friends from labor this would mean probably to those people who are in organized labor, now listen, that probably the people who would suffer first are these people in organized labor.

Maybe this is a thing which we should take away. Maybe we should eliminate this entirely, because it only innures to the benefit primarily of corporations which have organized labor working with them, to the exclusion of those people who are not in the unions. This might be a good thought.

Mr. GREENBERG. Senator, I am certain that it would be revolutionary in its consequences.

Senator HARTKE. Let me say this to you. I am trying to get some of you people to start thinking. This is just one thing, I am not advocating it at all, but when I find people who want to protect special tax benefits without any reciprocal responsibilities on their part toward society in general, I start raising serious questions in my mind as to whether the benefit that is included is permissible in the first place.

If we are going to have to raise taxes, and it looks like the President is going to come in here with a tax raise, maybe this is a place where we can save a couple of billion.

Mr. BASSETT. Senator Hartke, I think that we are all in agreement that we would like to see pension coverage extended to as broad a group as possible. I think the tax incentives that were put in years ago has extended coverage to many millions of people. I think to extend it to a larger group, we have to maintain and continue a favorable atmosphere, in which to develop new plans and improve old ones.

Senator HARTKE. I don't like to include atmospheres, but I tell you what, I find that atmosphere doesn't get the job done.

Mr. BASSETT. It has in the past.

Senator HARTKE. I hear climate and atmosphere all over the place in all these things, and I am just going to tell you quite honestly that they don't persuade me much. Now go ahead. You come in here and brag about the traditional expense and unique values of private pension plans. If, as Mr. Bernstein says, that this applies to less than 10 million, and he indicated it was——

Mr. BASSETT. Yes, sir.

Senator HARTKE. On the basis of what we have done so far, with limited benefits to them, it looks to me like this has been a nice thing for you people who have been administering the program, and a pretty expensive proposition for the taxpayers.

Mr. BASSETT. Let's go back and examine that statistic. I think that is a good one.

Senator HARTKE. I don't know whether it is true or not.

Mr. BASSETT. But let's examine it.

Senator HARTKE. All right.

Mr. BASSETT. Let's assume that 10 percent are all that are going to benefit. That means there are 90 percent who do not benefit from a pension program that they are at one time covered under. Now how are we going to extend this so all 100 percent get protection, that all 100 percent who are in this plan get benefits when they reach 65? Is this the problem?

Senator HARTKE. That is a good question.

Mr. BASSETT. All right. We can't cover those that are going to die between now and 65. This eliminates maybe 10 percent. If we are going to give it to those who change jobs, we must have benefit plans in all companies throughout all of the United States, because that is probably where another 60 or 70 percent go into uncovered occupations. So we must encourage a greater percentage of employers to adopt plans. We must build more plans at more companies throughout the country. This means particularly the small employers. We have got to get them to adopt pension plans. These are the groups that we have got to cover, if we are going to raise——

Senator HARTKE. Can you tell me how many small employers have provided systems which provide any substantial numbers of coverage for ultimate cash benefits in the last couple of years? Do you have those statistics?

Mr. BASSETT. Well, we do know that there is a tendency for more and more small plans to be qualified for taxpayers. These provide protection, and we have to encourage them, if we are ever going to provide benefits for everybody when they retire.

Senator HARTKE. I don't want to discourage them, but I would be more interested in finding out just what happens as far as the employees are concerned. Look, quite honestly if you have got a pension plan, if it means anything to anybody at all, it should mean something to that employee.

Mr. BASSETT. Yes, sir.

Senator HARTKE. Not to actuaries.

Mr. BASSETT. Right.

Senator HARTKE. Not to trust companies, not to unions, and not to management.

Mr. BASSETT. I think we are all in agreement on that.

Senator HARTKE. I am not being critical, but you want it for that man who works in that factory. If it doesn't mean anything to him——

Mr. BASSETT. Exactly.

Senator HARTKE. There is no justification for going ahead with this type of program.

Mr. BASSETT. So we are trying to find out who are these 90 percent that don't receive protection.

Senator HARTKE. Right.

Mr. BASSETT. And we have got to find out what we can do to give them protection. Now I can give you several proposals. I have suggested one.

Senator HARTKE. You go right ahead if it is in your prepared statement. If you want to give it off the top of your head, it is all right.

Mr. BASSETT. You have torn it apart right now. I am off the text.

Senator HARTKE. Go right ahead.

Mr. BASSETT. Well, the other area in which a lot of people are losing their benefits, the part of this 80 or 90 percent that don't get them, is because they leave before they have vested rights. This has been pretty generally talked about today, and I think there ought to be more liberal vesting, and I have a suggestion which will help do it.

My suggestion is that you encourage employee contributions to plans by making employee contributions tax deductible as they are in Canada. This will cover the cost of vesting, and encourage vesting. With that kind of a program, companies and employees can afford vesting. We know for a fact, even without legislation, that contributory plans have more liberal vesting than noncontributory plans, and this is the way I think you should approach this problem.

But actually before any of this, you should look into why it is that 90 percent of the employees don't have protection—if this is the right figure—and when you find out why, we can consider how to correct it. Your bill is one possible answer, but there are many others.

Senator HARTKE. Let me say I am not wedded to the language or even necessarily to the principle of this bill. I am very definitely concerned about this problem.

Mr. BASSETT. I think we all are.

Senator HARTKE. And that is the thing I am driving at. Did you want to say something? Go right ahead.

Mr. GREENBERG. I hesitate, Senator. I would like to comment if I may after the presentation is finished.

Mr. BASSETT. Let me go back to my statement.

This is not to say that there may not be a need for further legislation or regulation. Improvements can and should be made in the statutes and in regulations; and in my judgment, companies with experience in this field are quite willing to work with the Government toward the development of such improvements where the need is demonstrated and where the benefits of such changes clearly outweigh the difficulties. It is my conviction, however, that some of the alleged weaknesses in present statutes and regulations have been overstated and that isolated examples of deficiencies have been cited as justification for sweeping new statutes and regulations affecting all plans—the overwhelming majority of which are soundly conceived and soundly administered.

To a certain extent, I believe that this comment applies to the proposal now before this committee for a Federal reinsurance system. In many respects the pending bill would institute a far-reaching, drastic, and untried approach to a problem which, to date at least, has not existed to any great degree.

In this regard, I understand from the testimony of Secretary of Labor Wirtz before the Subcommittee on Fiscal Policy of the Joint Economic Committee and before this committee this morning that a joint study is now underway by the Bureau of Labor Statistics and the Internal Revenue Service of 7,000 pension plans that were terminated between 1953 and 1965. The purpose of this study is to ascertain the reasons why these plans were terminated. It may also be possible to find out what effect these terminations had upon the employees. It would seem that the facts regarding the need for S. 1575 may be forthcoming, and thus action should be delayed until these facts can be studied.

Let me make it clear that I think it is appropriate for the Government as well as private companies and unions to give serious consideration to any and all means for adding greater certainty that pension plans will actually fulfill their announced obligations. Thus, I believe the broad objectives of S. 1575 are commendable. But, as I have mentioned, it is my conviction that these objectives are being achieved to an increasing extent through voluntary improvement of retirement programs and that further improvement will come through the years.

Here again, while this is my belief, facts will be available in regard to the extent of funding in private pension plans. This has to do with this Wharton School study. I think you are going to have some valuable statistics out of that.

The Pension Research Council under the auspices of the Wharton School of Finance & Commerce at the University of Pennsylvania is making an exhaustive study of funding in 5,000 private pension plans. Consulting firms and insurance companies are participating in furnishing data. This study is being financed by the Social Security Administration, private foundations, and by private sources. The study will probably cost in excess of a half million dollars. It holds promise of providing a definitive clue as to whether there is any necessity for further governmental action in the funding area. I am convinced that this study, as well as other studies now being conducted by the Government and by private sources, will lead to a better understanding of precisely which aspects of private retirement programs may be deficient, and which aspects could be benefited by new statutes and regulations.

The question is whether S. 1575 is a practical and the most appropriate approach in meeting these proposed objectives more rapidly. It is my opinion that the reinsurance program recommended by the bill is not a feasible approach for a number of reasons.

The purpose of insurance is to spread a risk over a large group in order to protect individual participants against the loss resulting from some uncontrolled event. The cost of the insurance to be equitable should be borne by the participants in proportion to their exposure to the hazards insured against. As presently written, S. 1575 fails in a number of areas to meet these requirements.

(1) In this situation, the risk insured against is not beyond the control of the insured. The insured determines, to a large extent, whether or not a certain facility or business operation will go out of existence. An analogy would be to issue fire insurance on a home and agree to pay the owner for the loss if he has the right to burn the home down. The risk insured against in S. 1575 is largely within the control of the purchaser.

(2) Such a program, I believe, may encourage minimum funding by employers, since the security of pensions will no longer be a compelling reason for funding. It may be cheaper to pay the "premium" than to fund adequately the pension plan, thus stimulating the wrong kind of pension planning.

(3) As stated above, the cost of the insurance should be borne by the participants in proportion to the risk involved. Under the proposal, the cost of the insurance is to be a function of the unfunded cost of the benefit expectations. This is only one small factor in the measure of

the risk. The risk also involves the probability of discontinuing the plan for business reasons. For example, three companies: a utility company in a metropolitan area, a manufacturer of hoola hoops and skate boards, and a large subcontractor supplying a very special item necessary for the operation in Vietnam might all have the same unfunded pension cost. It is evident, the risk of each of these enterprises going out of business is radically different, the probability of which would be difficult to determine. But certainly, some of them would be more likely to require the insured benefits than another. Yet, the proposed bill would charge each company the same premium. Thus, the reinsurance program would seriously discriminate against pension plans established by stable organizations which are likely to continue in existence for many years. The program would operate against our oldest and soundest corporations in favor of companies which may overreach themselves in assuming pension obligations, and other companies which do not expect to exist except for a relatively short time.

(4) The problem of measuring the risk also applies to the second part of the insurance proposal—namely, covering losses on the liquidation of assets. In order to properly assess the premium it is necessary to determine some measure of the risk involved in different investments made by the pension fund. I do not believe that it is possible to insure that the stock market will not go down in future years or that poor investments will not be made by pension trustees.

(5) If a reinsurance program were undertaken, I believe the Government would quickly find itself in the business of establishing a wide variety of investment standards, payment standards, funding standards, and other criteria for pension plans which would result in placing all such programs under a governmental straitjacket and thus depriving these plans of the inherent flexibility which, I believe, lies at the root of their success and value.

Earlier, I mentioned the studies going on by the Pension Research Council and the joint study by the Bureau of Labor Statistics and Internal Revenue Service. I understand that the SEC is making a study examining the financial data of trusteed pension plans. In addition to their regular annual report, it is stepping up their studies to include both book and market values of assets, and the purchase and sales of common stocks. I believe it intends to issue quarterly reports on transactions in these funds. Perhaps, this information will be of additional value and give more facts on which to determine the appropriateness of any legislation.

Until these studies are completed, Mr. Chairman, and until substantial consideration and evaluation have been given to them, I would urge the Congress not to take action on legislation such as S. 1575. Private retirement programs adopted by corporations for the benefit of their employees constitute a unique and constructive American development which, on the whole, is serving the Nation extremely well. In the light of the long-range nature of these programs, and their past success, the Government has an obligation to move deliberately and cautiously in changing the ground rules under which they operate. Certainly, to date there has been no clear demonstration either of the needs for or constructive results that would result from a program of Federal reinsurance for unfunded pension benefits.

I want to thank the members of the committee for this opportunity to express my views on this important subject.

Senator HARTKE. I am not going to ask you any further questions.

Mr. Greenberg, I am going to withhold your statement until I get through with Mr. Bert Roberts, Pension & Profit-Sharing Services, Austin, Tex.

STATEMENT OF BERT ROBERTS, DIRECTOR, ROBERTS PENSION & PROFIT SHARING SERVICES, AUSTIN, TEX.; ACCOMPANIED BY S. J. MAXWELL, ATTORNEY, AUSTIN, TEX.

Mr. ROBERTS. Senator, we too have come at our own expense. We don't represent anybody but us, and before this is through, I believe you and I are going to wake the whole bunch up.

Senator HARTKE. Let me say something to you and to all participants here—that we are not going to change the world today. For any of you people who are fearful there is going to be action in this session of Congress, just go on home. If that is all you are worried about, there is certainly nothing going to happen in this session of Congress on this bill.

That I know. Without me pushing it, I don't know of anyone else who is going to push this bill at this moment, so you can go home and have a good Christmas. Go right ahead.

Mr. ROBERTS. This is our first trip up here, and we tried to get reservations on the planes, and they weren't running, so we had to get private conveyance, but we are happy to appear before this group.

I would like to say that we are not in any way trying to change the forces of nature, nor are we against change of any type. However, I get from your statements that you are inclined of the socialistic nature, and we in Texas believe in furnishing the men with what they are able to work for.

Senator HARTKE. I am not inclined to a socialistic nature at all. I want you to know that I for one just opposed socialism in regard to the airlines strike, which the majority of the Congress insisted on following. I just want you to know that if you want to put a tag on me, you might find me putting one on you real fast.

Mr. ROBERTS. All right. I told you we were going to wake them up.

One of the things we asked a moment ago is about the tax deduction situation. I think one of the things that this group has overlooked is the fact that no employer is forced to put in a plan; that if he had a plan he wanted to put in $100,000 a year, he would be $52,000 better off if he was in the maximum bracket, to tell his employees to go provide their own benefits out of their own income after they paid taxes on their income, and he would be $52,000 better off in his own corporation. I think this is one of the things we have overlooked today.

Senator HARTKE. I haven't overlooked it. Maybe you have, but I knew that before we started.

Mr. ROBERTS. The way you questioned——

Senator HARTKE. You interpret how I question? You do your own. You come up here and you want to question me, you get elected Senator and you can do it.

Mr. ROBERTS. Thank you. I might.

Senator HARTKE. No, let's have a clear understanding. I am staying here to accommodate you people. I am not objecting to that. I could have put this over until tomorrow. Most Senators would have.

I understood you came here at your own expense, but If you want to ask me questions, you get yourself elected and we will go ahead, but in the meantime, if you have anything to submit which is of value in interpreting this, whether favorable or unfavorable, you go right ahead.

Mr. ROBERTS. Well, this bill as a whole requires that there is going to be some additional expense. This expense is going to have to be borne by the employer.

In keeping with our national structure of economy, we are trying to keep inflation down; this in itself makes the economy more expensive and makes it go up. There are several things that can be done and should be considered, that Internal Revenue should consider giving some additional increases in deductions in order to cover this, and in many cases this 5-percent increase, which has been projected here today as the cost of this coverage, in many cases this 5 percent is enough to fund a private pension plan by itself. So anyway this idea which we have here is in reality a way of job guaranteeing, whether the man works or not.

Take, for instance, a man who is working in a firm and they put in a computer. He refuses to be retained. He elects to take retirement, and under the provisions of this bill, he could determine himself whether he wanted to go on retirement.

At present there are three Federal institutions that are involved in these plans, Labor, Internal Revenue, and now we are asking Health, Education, and Welfare.

I would like to make a recommendation to this group that it give serious consideration to the establishment of one organization which will have under its jurisdiction the planning, the studies, and the handling of pension profit sharing and all of those types of tax exempt trusts.

There is another suggestion I would like to make. There is very little that has been said here today concerning insured plans, but that the insured plans be made exempt from this bill, because if a plan is insured with an insurance company, the insurance company takes the risks, especially under the investment program, so long as the employer makes the contributions, the benefits are guaranteed.

I also know that there is another bill being considered which would make it a crime for not making a contribution, so it might look like we are trying to choke the goose that provides the eggs that oils the wheels of the economy.

There is another suggestion I would like to make, and that is that by outlawing your entry age normal plan, and prior service participation, you have no problem.

There are a lot of statements which I could make concerning the bill itself and its inadequacies, but I realize that this is in its infancy, and I think those can and will be looked into.

Senator HARTKE. If you have anything specific you would like to say about them, you are certainly entitled to say them.

Mr. ROBERTS. A couple of questions.

Senator HARTKE. You don't ask any questions. If you have any statements about this——

Mr. ROBERTS. I would like to get it in the record.

Senator HARTKE. If you have any statement to make, that is fine. If you have any suggestions to make or if these are in the form of statements——

Mr. ROBERTS. We will just make them as statements. I see no reason why this should particularly pertain only to pension plans and exclude the self-employed and the profit-sharing plans.

Senator HARTKE. Would you like to have those covered?

Mr. ROBERTS. I see no reason why not. If you are going to make it for one, you should make it for all.

Senator HARTKE. Would you advocate having those covered?

Mr. ROBERTS. I don't advocate your covering any of them.

Senator HARTKE. That is what I thought. You see, we come right down to the basic problem, you are just against it, period.

Mr. ROBERTS. That is right.

Senator HARTKE. Well, be against it. There is nothing wrong with that.

Mr. ROBERTS. I don't have any questions whether I am for it or against it.

Senator HARTKE. All right, just go ahead and be against it, but don't try to give excuses why you are against it by saying we should include something else. You don't want to include anything. You don't want to even include this.

Mr. ROBERTS. Amen, OK, we understand each other.

Senator HARTKE. I am not sure I understand you.

Mr. ROBERTS. New increases, these at present look as if they are going to be made into an additional plan. This is going to cause additional expenses to the employers who create them, and the administration of this is going to cost some increases in taxes.

One of the things that concerns me most is the formula by which 1 percent is being guaranteed, I mean 50 percent is being guaranteed of a man's wage, or the lesser of $500. The average plans don't even have a formula which will allow a 50 percent income at retirement time with a maximum of $500. I say the average, because there are many of those which do, but the average plan does not.

The feasibility of being able to determine the risks as set out in this plan are highly improbable, and to give discretionary powers to any secretary of any functional body is a great latitude which I do not endorse.

In talking about actuarial soundness, I wish someone would have been able to ask Mr. Ball this morning how long social security would last if all the people stopped paying their contributions to social security. Everybody seems to be concerned about the actuarial soundness of our pension plans. Yet not too much thought is being given to the actuarial soundness of our social security system.

The point in commercial plans, and in our dealing with the men who are responsible for the creation of these plans, they are doing so out of the goodness of their hearts. They are trying to provide security for their employees, not a deduction from the income tax rolls, and a corporate owner is not forced to put in plans, and if we are going to hamstring and curtail this operation of pension plans so

that he is afraid to stick his head out the door, we are not going to have any pension plans, and we are not going to have any security for any of our old people except what social security is going to provide.

I highly recommend that we have a centralized system who can make a thorough study of all of these situations and correlate them in such a way that we can do something constructive, rather than legislating things that have to be done, and make it encouraging to the employers to install plans so that our employees can have adequate income.

Now we only heard about this on Friday. It took us 2 days to get up here with our mode of transportation. I pulled my attorney off of his vacation, and he is here on a voluntary basis also. I would like for him to be able to make any comments that he cares to make at this time.

Senator HARTKE. Identify yourself for the record.

Mr. MAXWELL. My name is S. J. Maxwell. I live in Austin, Tex. I am an attorney, and have been practicing law in Austin, Tex., for some 19 years.

I have just one or two suggestions to make, Senator. I am not going to keep us long now. I would like to have the opportunity though, if I may, and I do believe you permit this, to file a brief or statement of further suggestions and comments for the record within the deadline that you set.

Senator HARTKE. That is accorded not only you but to anyone else who wishes to make a statement.

Mr. MAXWELL. Thank you. Basically I believe that a large part of the problem that we are talking about today can be resolved by revising the Internal Revenue Code as it now reads, so as to permit the funding of past service credits in a much less time than is now permitted.

I believe the limit today is 10 percent per year. My personal view is that that ought to be accelerated, allow funding in as little as 3 years of all past service credits, and require that all past service credits be funded within 10 years, instead of allowing them to drag on and on and on.

Then these funds will be here that we are talking about. They are not going to be missing. They will be in the pot. That is what Mr. Reuther was talking about this morning. The employers have represented that the funds were there—maybe he didn't say they were there, but he led his employees to believe that they were there. They were led to believe that these are plans that have funds there. The employee thought "I am going to get a pension when I am 65."

Well, if the money is in the pot, it will be there when he is 65, unless there is loss on the value of the assets, and if the trustees are prudent trustees, and if they follow the laws of the various States in which they presently reside, the funds will be there in all probability, maybe not every penny, if the plan were terminated on a given date, because there are fluctuations in the stock and the bond market, but by and large the funds would be there.

Second, I would like to point out particularly that section 4(a)(2) is not needed insofar as insured pension plans are concerned. Where there is an insurance company holding those funds, those funds are going to be there when the time comes to pay off.

Now I spent many years with the State Board of Insurance of the State of Texas, and I am familiar with every insurance company doing business in the State of Texas, and that includes the New York companies as well as the Texas companies.

I am also familiar with practically every insurance company insolvency in the last 15 years in the United States, and it is my sincere belief that there has been not the loss of $1 in insured pension funds in the United States in the last 15 years, and I doubt seriously if there has ever been the loss of a single dollar of them in the history of this country, insofar as their being available at the time the payment to the beneficiary—the worker, or his beneficiary—was due.

So I see no necessity for section 4(a)(2) insofar as insured plans are concerned, and I think that insured plans should be exempted from subsection 2 of section 4(a) of the bill.

Then I would like to emphasize again regarding this 50 percent of the average monthly wage or $500 per month, whichever is lesser, maybe that is a common denominator in the wealthy Northeast, but it is not a common denominator in the poor South and Southwest. I think that that is exorbitant. I think the answer is this, Senator.

I think that this bill should provide that it should not exceed 100 percent of the benefits which the worker or his beneficiary would have received had the plan remained in effect. Let's don't give him more than he would have gotten. He is not entitled to a windfall. He is entitled to what he would have gotten, but he is not entitled to another dollar, that is if we are going to have such a bill.

Personally I am opposed to the bill, but I look at this thing constructively and I do realize we have problems, but as I said, I think part of the problem and a large measure of it can be solved by an amendment to the Internal Revenue Code which I outlined earlier. Thank you.

Senator HARTKE. Thank you.

Now Mr. Greenberg.

Mr. GREENBERG. Mr. Bassett—may I talk from here?

Senator HARTKE. Yes, go right ahead.

Mr. GREENBERG. Mr. Bassett made only one constructive suggestion, but it flies in the face of a principle now thoroughly established, and I think that it is a principle that must be kept in mind for all our deliberations here.

Seventeen years ago the 1949 steel industry factfinding board appointed by President Truman stated in substance: The responsibility for taking care of the worn out, and we should not add, discarded employees of the steel industry, is as much a proper cost of doing business as taking care of and replacing worn out equipment and facilities. To establish this principle a long strike ensued in the steel industry.

Suggesting that employees should be compelled by law to pay for their own pensions is a step backward which would only encourage labor disputes. Voluntary savings by all means. Compulsory sharing of the employer's responsibility by employees, no.

Senator HARTKE. Thank you.

These hearings are now adjourned. If you wish to submit any additional statements or any other parties care to, the record will be kept open until August 31. I want to thank you for coming.

(Whereupon, at 6:10 p.m., the hearing was adjourned.)

(By direction of the chairman, the following communications are made a part of the record:)

STATEMENT OF THE AMERICAN LIFE CONVENTION AND LIFE INSURANCE ASSOCIATION OF AMERICA, SUBMITTED BY GLENDON E. JOHNSON, VICE PRESIDENT AND GENERAL COUNSEL, AMERICAN LIFE CONVENTION, AND KENNETH L. KIMBLE, VICE PRESIDENT AND GENERAL COUNSEL, LIFE INSURANCE ASSOCIATION OF AMERICA

The American Life Convention and the Life Insurance Association of America are two associations of life insurance companies whose members in 1965 held $27.3 billion under pension plans, representing 99.9% of the reserves of insured pension plans in the United States. These plans cover more than seven million participants or 99.7% of those in insured pension plans.

S. 1575 would establish a comprehensive system of governmental guarantees for private pension plans which are qualified under the Internal Revenue Code. The program is designed to protect against the risk of loss of pension benefits resulting from declining asset values or from termination of a plan. The program would be financed by premiums from covered plans. The premiums would vary according to the unfunded liabilities and the kinds of assets of the plan.

As a business intimately involved in the development of pensions, we share the sponsors' interest in a sound private pension system. If that system is to grow, it is important that all plans be operated soundly and fairly so that the participants receive the benefits they are led to expect. Accordingly, we favor any practical improvements in private pensions that will serve these purposes.

Like the proponents of S. 1575, we recognize that the problem at which this proposal is aimed cannot be divorced from the other questions raised by the 1965 Report of the President's Committee on Corporate Pension Funds. Along with other groups both inside and outside of the Government, we have for some time been studying the private pension system to see whether there are steps which can be taken to assure that all pension plans are soundly designed and well administered in the interest of fair treatment for all pensioners. These considerations range broadly over all aspects of pensions but have centered primarily on: (1) adequate vesting and portability, (2) honest administration, (3) sound funding together with related proposals such as S. 1575 to increase the security of pension expectations, and (4) expansion of the system to those who are not now covered by a pension plan.

In this framework we have studied S. 1575 to determine whether it would aid in the sound development of private pensions. It raises a number of complex and interrelated problems for which we have found no satisfactory solutions but which, in the spirit of Senator Hartke's invitation, we are pleased to review with this Committee.

One aspect of the private pension system which must be kept in mind in considering suggested changes is that this system is a voluntary one. Thus there are limits on the extent to which additional costs or regulatory burdens can be imposed without slowing or even reversing the desirable growth of the system. It does not follow that there should be no changes in the private pension system. But in any attempt to improve the system, extreme caution should be exercised in the imposition of burdens which might lead to a decision against having a pension plan at all.

The proposed insurance arrangement of S. 1575 is often compared with that of the Federal Deposit Insurance Corporation, which basically protects depositors against the risk of declining asset values. S. 1575 would similarly insure against such risks, although the kinds of assets involved are more varied and the selection of investments much less restricted than those of FDIC member banks. Even more troublesome is the proposed protection against the possibility that contributions will not be made by an employer in the future because he has gone out of business. The FDIC guarantees deposits already in being. S. 1575 would guarantee additionally something which does not yet exist and which is most indefinite, a risk which is of a different order of magnitude from that covered by any existing insurance program—government or private.

It should be recognized that the total risk could be very large, particularly in times of recession. Moreover, the proposal is designed to be self supporting and yet has only very broad limits on the pension benefits to be insured. Even if much more restrictive limits were imposed some sort of governmental guarantee

would seem to be essential in view of the immense liabilities that could develop in a recession.

Another basic problem grows out of the fact that the insured would have a large measure of control of the risk, which could lead to abuses. Consider, for example, the temptation for an administrator whose firm is facing insolvency to increase the pension liabilities by liberalizing benefits or covering in additional employees. Perhaps an even more troublesome situation would be presented where an employer closes down one of several plants, or in a merger, where the interrelated interests of various groups of employees would add another level of complexity. While it is conceivable that some of these difficulties could be controlled, to do so would require extensive regulation that would tend to inhibit the desirable and traditional flexibility in the operation of private pensions.

Another serious concern is whether S. 1575 would encourage unfunded pensions. The proposal would condition qualification under the tax code upon participation in the proposed insurance program. This would exclude unfunded or pay-as-you-go plans under which an employer receives a tax deduction for benefits when paid directly to the beneficiaries. In such plans, since there are no reserves, the participants are even more vulnerable to the potential loss of pension expectations including the risk that their employer will go out of business. Inasmuch as compliance with S. 1575 could be avoided by operating on such a basis, the proposal might well cause greater use of such arrangements with a correspondingly increased risk for the participants. In addition to the decreased protection for employees, such a trend would mark an undesirable reversal of the extraordinary capital growth provided by the expanding private pension system. The total investments of pension plans, now nearly $85 billion, have been an extremely important factor in the economic development of this nation during the past two decades.

A related question is whether this proposal would serve to reverse the present desirable trend toward fuller funding of pension liabilities under qualified plans. Such a development would clearly not serve the best interests of the beneficiaries. We have considered whether it might be possible to design the premium rate schedule for the proposed insurance program in such a way as to discourage any tendency to avoid adequate funding but have concluded that the disparity is so great between the large cost of funding and the relatively smaller insurance premium that this would not be practicable. By way of amplification it should be explained that most pension plans when installed accord benefits to current employees for previous service which are not funded at the outset. These liabilities are so large that even in well-administered plans they cannot ordinarily be fully funded for 30 years or so. The maximum premium allowed by S. 1575 is much smaller by comparison. Thus there would be a natural tendency for pension administrators to minimize this funding burden, relying on the insurance program to protect against possible adverse developments. Yet the only complete security for pension participants is a fully funded plan. Thus, under any program such as that of S. 1575, it would be difficult but necessary somehow to make sure that the program did not encourage pension plan administrators to make a less determined effort to fund these liabilities promptly.

One final problem area should be noted—the need for precise definition of the risk to be insured. In any pension insurance program it would seem to be necessary to avoid inequities among the various types of pension plans and to avoid adverse selection by the weaker plans.

In conclusion we reiterate our interest in improving the young and growing institution of private pensions, and our willingness to assist in any practical effort to improve the security of employees' pension expectations. At the same time we urge that careful consideration be given to the need for encouragement of the expansion of private pensions. Certainly these two basic considerations must be balanced in evaluating any proposal to revise the private pension system.

AUSTIN, TEX., *August 25, 1966.*

Hon. RUSSELL B. LONG,
U.S. Senate, Committee on Finance, Washington, D.C.

DEAR SENATOR LONG: The captioned bill now being studied by your Finance Committee is too serious and has too many far-reaching ramifications to be considered in a hasty manner.

I urge you to reject this bill if efforts persist for its speedy approval without further detailed analysis of the problem by competent parties in government and industry of its cost and need.

Respectfully yours,

ALBERT P. MCKINNEY, CPA.

STATEMENT OF ALEXANDER L. STOTT, VICE PRESIDENT AND COMPTROLLER OF AMERICAN TELEPHONE & TELEGRAPH CO.

I am Alexander L. Stott, Vice President and Comptroller of American Telephone and Telegraph Company. This statement is made on behalf of the Bell System companies.

By way of background, I would like to give you a few facts about our companies and their experience with pension plans.

The Bell System companies consist principally of American Telephone and Telegraph Company, 21 regional telephone operating companies, Western Electric and Bell Telephone Laboratories. The Bell System companies have had pension plans since 1913 and thus have had over 50 years' experience in this field. The pension plans of the companies now cover approximately 800,000 active employees and about 90,000 employees retired on service pension.

The plans have always applied to all employees of the company from the first day of their employment. Retirement is mandatory for all employees at age 65 and there are also provisions for earlier retirement either at the employee's request or with approval of the Employees' Benefit Committee, depending upon the employee's age and service. The annual pension to which an employee is entitled is an amount equal to 1% of his average annual pay during the 5 years next preceding retirement, multiplied by his number of years of service, subject to adjustment, as provided in the plan, on account of specified minimum pension levels and Social Security benefits.

The cost of the plans has always been borne by the companies. In 1927 the Bell System companies set up trust funds with assets dedicated to the payment of pensions and thus have had about 40 years' experience in the funding of pension plans. At the present time the companies have 48 irrevocable trust funds held by 30 different banks as trustees. The total assets of all of these trust funds on December 31, 1965 were more than $5¼ billion. Last year these companies paid about $500 million into these funds.

Payments into the funds are made pursuant to the accural programs of the companies. Under the programs accurals are made over the remaining service life of the employees as percentages of payroll, which percentages are redetermined annually to reflect changes in actuarial assumptions and other factors affecting costs. In addition, regular uniform payments are being made to the funds for service pensions to amortize, in most cases by December 31, 1968, the relatively small unfunded amounts under the service pension accural programs adopted by the companies.

We are certain that the Bell System pension plans are well designed to serve our employees and our business. They have been modified and amended over the years to meet the changing requirements of the business and the needs of its employees. They are soundly and properly financed. The companies have an unconditional obligation to pay the pensions under the plans and they are in a position to do so.

It was possible to adopt the Bell System pension plans and to improve them over the years because of the freedom which has been afforded industry to adopt plans meeting their special needs both as to benefits and financing. We believe that the present public policy which encourages private companies to adopt pension plans suitable to their particular requirements and to improve and fund such plans should continue.

We are sure that most other companies have developed their pension plans to meet their unique needs just as we have in the Bell System. We are equally sure that the varied problems and circumstances in different businesses have brought about the many types of benefits and funding provisions that are now in existence. These provisions have undoubtedly been bargained out by labor and management to fit the economic, financial and other factors with which they had to deal. The tremendous growth of private pension plans in recent years is undoubtedly due to the ability of management and labor to bargain freely in this area.

We are in sympathy with the objective of safeguarding employees against the loss of pension benefits and our efforts in the Bell System have long been directed, and we think successfully directed, to this end. It is our belief, however, that this bill is not well designed to achieve this objective and that the premium costs assessed against all plans would impose serious burdens on soundly financed plans and would thereby restrict the growth of private pension plans generally.

THE FIRESTONE TIRE & RUBBER CO.,
Washington, D.C., August 12, 1966.

Senator RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Kindly have this letter made a part of the public hearings before your Committee beginning on Monday, 15 August 1966, on S. 1575 which would establish a self-supporting Federal reinsurance program allegedly to safeguard private pension plans.

Well managed companies with soundly financed plans should not be required by law to pay a premium for plan fund insurance to insure the risk of plan terminations or plan deficiencies of non-prudent employers who have carelessly funded their plans with high risk or reckless investments.

Such a requirement would force companies with soundly financed plans to contribute to the weaker plans.

For the above reasons, The Firestone Tire & Rubber Company is opposed to the provisions of the subject bill.

Very truly yours,

HAROLD E. WIRTH,
Washington Manager.

STATEMENT PREPARED BY ANDREW A. MELGARD* ON BEHALF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES

The Chamber of Commerce of the United States of America welcomes this opportunity to present its views on S. 1575, a bill "to establish a self-supporting federal reinsurance program to protect employees in the enjoyment of certain rights under private pension plans." Private pension plans are a complex subject matter. So is insurance. We are entirely sympathetic with the difficulties facing the Finance Committee in determining whether the insuring of pension plans is feasible.

The National Chamber cannot support the federal reinsurance program for private pension plans which is proposed in S. 1575. The reasons why we do not support this proposal are:

1. The exact extent of the need for such a program has not been fully determined.
2. There are grave unanswered questions as to whether the hazards proposed to be insured against constitute insurable risks.
3. There has been no reasonable determination of the cost of such an insurance program, and until such a cost is determined there is no way to decide whether the money from the funds could better serve to guarantee employees' rights if used for additional funding.
4. Such an insurance program, where rate feasibility and equity among the tens of thousands of diverse pension plans is in question, could lead to disincentives to funding and other possible abuses.

The extent of the need for such a Federal insurance program for private pension plans has not been fully determined at this time. The December 1963 edition of the Social Security Bulletin contained a report prepared by Joseph Krislov, Division of Research and Statistics, Social Security Administration, on private pension plan terminations. The report was based on the records of the Office of Labor-Management and Welfare-Pension reports covering all pension plans, including deferred profit-sharing plans, that became inactive during the ten-month period of September, 1961–June, 1962. Two of the conclusions reached by the researcher from his studies were that (1) relatively few private pension plans, affecting only a small proportion of all persons covered by pension plans, are terminated; and (2) most members of plans terminated because of mergers have their retirement protection continued.

Additional studies and research are being done in this area of determining why retirement plans terminate and what loss of benefit rights may be suffered by participants. The Bureau of Labor Statistics and the Internal Revenue Service are collecting and analyzing data on tax qualified retirement plans terminated during a twelve-year period beginning with 1953. The results of this study should give a clearer picture as to whether there is need for a system of

*Andrew A. Melgard, CLU, CPCU; Senior Associate, Human Resources Development Group, Chamber of Commerce of the United States.

insurance such as is proposed in S. 1575. Whether or not this study will confirm the indications found by Krislov remains to be seen.

In the discussions on pension insurance, it is unfortunate that comparisons have been made with the Federal Deposit Insurance Corporation plan for bank deposits. Basically, the FDIC insures against declines in the values of assets and reserves of banks. However, the risks involved in the insurance program under S. 1575 are quite different.

The insurance of money that has been deposited in banks is one thing. The insurance of unfunded liabilities under pension plans is quite another. When a pension plan is established, credit may be given for the past service of older employees back for a period of up to 50 years. It is anticipated that these liabilities will be funded or deposits made to cover the full liability in the future during the next 20 to 50 years. These future dollars for funding are not in existence—have not been earned. To insure such a contingency is to insure business continuance. In fact, it is insurance not only of business continuance but business continuance at a profit. The insurance would have to cover a level of future business profitability that would permit full funding. Neither business continuance nor the continuance of business at some specific profitable level are considered insurable risks.

The second form of coverage provided by the insurance program under S. 1575 would provide guarantees against losses realized upon the sale of investments from pension funds if the sale was required to provide benefits payable by the fund. Many funds have large amounts of their assets in common stocks, and some invest in real estate holdings. It appears that such an insurance fund would then in effect be insuring the performance of the various security markets and the level of the markets for various types of real estate.

Insurance of business continuance, insurance of sufficient future profits to fund past service liabilities in a pension plan, insurance of the performance of the security markets and of losses realized upon the sale of investments in real estate are all questionable as insurable risks.

Since insurance seems to be such a logical and appealing method of handling risks, and there are unquestionably some risks of termination and loss of benefits under some pension plans, why can't these be handled by an insurance arrangement? The truth is that in order for insurance to work, the hazards to be covered must meet certain broad tests.

One of the first requisites of an insurable hazard is that there must be a large *homogeneous* group of exposure units. Unquestionably, there is a sufficient number of pension plans, but the unique problem is their *dissimilarity*. Qualified private pension plans have been created by every type of corporation from those with a few employees to those with tens of thousands, for every type of business activity in every part of the country, for corporations with every kind and type of financial structure. Pension plans are established also by non-profit, charitable, and religious organizations. The plans vary greatly in their benefit structures and their funding instruments. Pension plans may be single employer or multi-employer; insured, non-insured, or partly insured and partly trusteed; contributory or non-contributory. In addition to retirement benefits, pension plans may also include death, disability, or survivor benefits.

Every expert who has ever analyzed the private pension plan system has remarked on its diversity. Considering the diversity and dissimilarity of the tens of thousands of qualified private pension plans, it is questionable whether they meet the test of a group of *similar* exposure units.

Another primary requisite of an insurable risk is that the occurrence of loss must be accidental or fortuitous. Ideally, this would preclude any possibility that the loss or claim would be under the control of the insured. *The liability involved in pension plans and the extent to which past service liabilities are funded are usually within the direct control of the employer. This poses the problem of pension insurance causing disincentives to funding, unrealistic benefits, and other possible abuses.*

An optimistic employer whose company was going through hard times might raise benefit levels more than was prudent on the theory that the plan would be insured. When better time came, he could do whatever funding was necessary. Without the insurance fiction to fall back on, he would be more prudent.

During business recessions, many employers might forego any attempt to make additions to the reserves for unfunded liabilities on the basis that the plan was insured. When better times came, he could do whatever funding was necessary. The moral commitments that employers feel so strongly toward pension funding could be weakened. Insurance would be acting as a disincentive to funding.

Insurance could then undermine, to some degree, the present prudence exercised in managing pension funds are the ever-present management desire to increase the adequacy of reserves which are the soundest bases for protecting employees' rights in pensions.

Furthermore, in collective bargaining situations, there is presently a hard-fisted approach; but it is usually based on reasonably conservative assumptions of cost and economic realities. An insurance guarantee could distort the free collective bargaining process. In the desire for higher benefits, unrealistic assumptions could be made of future mortality rates, future interest rates, future employees' turnover rates, estimated future retirements for age, future employee contributions and other factors. Such over-optimistic assumptions could play havoc with negotiated pension funds. One could even imagine a situation where one union wishing to start an organizing drive to compete for jurisdiction with another union would promise higher pension benefit levels which were not quite realistic but which—after all—would be guaranteed by insurance from the Federal Government. The magnitude of potential abuses and how they could be forestalled under S. 1575 is difficult to state.

Another requisite of an insurable risk is that the cost of insuring must be economically feasible. *No calculations have been shown yet to indicate just what the exact cost of insuring would be over a period of time under S. 1575; nor has any evidence been produced to indicate the extent of claims that might be made. It is clear, however, that the money paid for insurance premiums by pension funds under S. 1575 would cut down on the amount of money going into the funding of proper reserves for the liabilities of various plans.*

In connection with the premiums of any "self-supporting" insurance plan, it is desirable that there be rate equity among the various classes or types of insureds. Under S. 1575, it is difficult to see how different premium rates could be determined where the basic risk is whether or not a corporation will continue in business. This brings up the problem of whether the soundly managed pension plans would be subdizing the unsound plans under S. 1575.

The problem of rate feasibility and equity could pose some unusual problems in contributory pension plans. In these plans, employees take part of their already taxed take-home pay and contribute to the pension fund to help provide for their retirement pay. How would such employees feel about an insurance premium assessed on their contributions to provide coverage for non-contributing employees in other plans?

It is our understanding that studies are being made presently by various interested groups to determine if the severe technical difficulties and formidable problems involved in an insurance program for pension plans can be overcome. If a feasible plan can ever be developed, the Chamber would regard this as a function to be carried on as an integral part of the private enterprise system and not as a federal monopoly.

If a federal reinsurance program for private pension plans is not feasible—is not practical or workable—what are the alternatives? It is the National Chamber's position that maximum encouragement should be given to the continued growth and expansion of private pension plans. Governmental restrictions which would hamper such growth and expansion should be avoided. Employers and employees should remain free to work out pension plan arrangements best suited to their own needs and requirements.

We are encouraging all employers who do not have private pension plans to consider the establishment of such plans. The Chamber pamphlet FOR A BETTER TOMORROW—PRIVATE PENSION PLANS, which is a non-technical discussion of the principles and methods by which private pension benefits can be developed and maintained through voluntary action by American employers and employees, has been given widespread distribution.

The National Chamber has been encouraging all employers to adhere to certain basic principles applicable to the establishment and administration of private pension plans. These include:

1. A clear explanation to employees of the pension plan provisions, the employee's pension rights, and the extent of employer obligations and responsibilities;
2. A program of funding which can reasonably be expected to provide for the plan benefits;
3. The appropriate use of qualified actuaries, lawyers, accountants, and others competent to advise on such plans; and
4. The appropriate use of services and facilities of qualified trustees or insurance companies.

We also support liberalizing legislation to provide more incentive for the self-employed to establish pension plans. All individuals should be encouraged during their working lives to build private retirement income out of earnings, either on an individual or a group basis. It is unfortunate that preoccupation with tax matters has continued to obscure the fact that need for retirement income is as great for the self-employed business or professional man or woman and their employees as it is for the corporate executive and factory employee. Recent Treasury studies based on 1964 tax returns have indicated that less than 40 thousand individuals out of the over 15 million in the self-employed field are participating in qualified pension plans under the 1962 Self-Employed Individuals Tax Retirement Act. The present bill H.R. 10, which is before this Committee, contains provisions which would encourage more pensions in the self-employed field and guarantee to employees pensions and pension rights not now in existence.

In his appearance before the Fiscal Policy Subcommittee of the Joint Economic Committee on May 9, 1966, Secretary of Labor W. Willard Wirtz commented on the fact that private pension plans provide an extremely valuable supplement to the public retirement system, and that "Essentially, they have been conceived, established and administered without Government involvement." Secretary Wirtz, who has been Chairman of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs, said of the report of his Committee, entitled "Public Policy and Private Pension Programs":

"Essentally, the report represents a strong vote of confidence in the operation of the private pension system and the way it has functioned. The Committee specifically rejected any proposal under which the public system should somehow 'take over' the funds or the operation of private pension plans."

Our American private pension plan system is a flourishing, growing, robust institution. It has had its major growth only during the last 25 years. As an institution, it has not fully matured. It has grown through the voluntary actions of employers, unions and employees. Employers, for humanitarian, public relations and economic reasons, have enthusiastically supported the year-by-year progress being made in our private retirement systems. The history of almost every pension plan shows a consistent trend to liberalization every few years and improved vesting and funding. It is inconceivable that an activity of such magnitude involving tens of thousands of corporate employers and over 25 million employees would not develop some problems that require solving and some complaints from the dissatisfied. It is easy to focus attention on the "growing pains" and forget the phenomenal progress. However, the entire picture is one of steady progress, liberalization, greater funding and vesting, and equitable solutions to the problems which develop. It scarcely needs to be pointed out to this Committee that all of this is in the public interest and that our entire citizenry is infinitely better off because of this private voluntary system of retirement income.

Despite the enormous healthy growth of private pension plans, there is beginning to develop to day a climate of uncertainty. There is a growing fear that the Federal Government, in one form or another, may start to move into the private pension field with restrictive legislation. In such a climate, healthy growth is slowed, decisions are delayed, and those workers not covered—who could benefit from new plans—suffer. This atmosphere of anxiety disserves the public interest in our private pension plan system. Any unfounded fears about restrictive legislation being enacted in this area should be relieved. The National Chamber asks the Senate Finance Committee to help dispel this climate of uncertainty about a federal "take over" of the voluntary private pension plan system.

We believe that the objective of extending effective pension plan coverage to additional employees can best be served by:

1. A government climate, free from hampering restrictions, which encourages the establishment of new plans, especially by smaller employers, and the improvement of existing plans.
2. Voluntary private pension plan action programs of the National Chamber and other organizations.
3. Freedom for the collective bargaining process.
4. More effective utilization of authority presently existing under federal and state laws, decisions and regulations.

The Subcommittee on Employment and Retirement Incomes to the Special Committee on Aging, United States Senate, in its report of June 1965 entitled

"Extending Private Pension Coverage," states, "The Federal Government is not doing all it can do and should do to encourage and stimulate the extension of private pension coverage."

The National Chamber recommends to the Senate Finance Committee that it support the extension of private pension coverage to the maximum number of employees in both the corporate and non-corporate fields. We think this Committee should avoid any legislation which would inhibit or restrict the growth and expansion of the voluntary private pension plan system.

AUSTIN TEXAS, *August 26, 1966.*

COMMITTEE ON FINANCE,
New Senate Office Building, Washington, D.C.
(Attention: Tom Vail).

GENTLEMEN: As an attorney and citizen I am strongly opposed to the enactment of the captioned Act. I realize that it is a genuine disappointment to employees who have been led to believe they would get a pension and suddenly the plan is terminated. I am not opposed to granting appropriate relief, but this Act does not grant appropriate relief. I offer the following suggestions:

1. Section 404(a)(1)(C) of the Internal Revenue Code should be amended to read as follows:

"(C) in lieu of the amounts allowable under subparagraphs (A) and (B) above, an amount equal to the normal cost of the plan, as determined under regulations prescribed by the Secretary or his delegate, plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount not less than 10 per cent nor more than 33⅓ per cent of the cost which would be required to completely fund or purchase such pension or annuity credits as of the date when they are included in the plan, as determined under regulations prescribed by the Secretary or his delegate, except that in no case shall a deduction be allowed for any amount (other than the normal cost) paid in after such pension or annuity credits are completely funded or purchased."

Such amendment would tend to encourage the various employers having pension plans to fund past service or other supplementary credits much earlier than is now permittel by the Code. Funding of these supplemenatry benefits would be completed in 3 or 4 years under many plans. Under all plans such funding would be completed in 10 years. The chances of loss through unfunded benefits would thereby be reduced greatly.

2. It is entirely unreasonable to expect any type of insurance program to guarantee against loss in value of assets of a pension plan. It has been pointed out that we have Federal insurance of bank deposits. The proposed plan to reinsure pension plans can not be likened to the F.D.I.C. program, for the F.D.I.C. does not guarantee the value of the bank's assets. There are stringent capital, surplus and reserve requirements which banks must follow and the capital and surplus are a cushion of protection for the depositor. Pension plans do not have such a cushion of protection.

State insurance departments have had this same problem for generations. No scheme of reinsurance of the ability of an insurance company to pay its policyholders is practical. A remedy has been afforded, however. State insurance codes are rather specific as to the types of assets in which reserve funds of insurance companies may be invested. Since pension funds are, in effect, reserve funds (as they are to cover specific liabilities), perhaps the Internal Revenue Code should spell out the classes of assets in which pension funds may be invested. There is no need to extend such regulation to profit-sharing plans, however, as employees are not depending on benefits from profit-sharing plans to survive in their later years. This is not a complete answer, however, as the most blue chip investments will fluctuate greatly in value. For example, United States Treasury Bonds which only a few years ago were selling at par or above are selling for considerably less than par today, some as low as 80% of par value.

Perhaps an additional remedy that is needed here is to require pension funds to accumulate a surplus over and above the actual reserve liability. This could be done by an additional amendment to Section 404(a)(1)(C) which would permit or require an additional contribution by both the employer and the participants of the pension plans each year equivalent to one-tenth of 1% of the funded liability up to a maximum accumulation in this surplus fund of not more than 1% of the funded portion of such pension plan. One per cent is not a very high cushion, but it is better than nothing. The Internal Revenue Code should further provide that in the event of termination of the plan at any time under

such circumstances that such surplus funds were not needed to provide the pension obligations, then such surplus funds would be returned to the contributor thereof.

Such arrangements should solve the problem which Section 4(a)(2) of S. 1575 is designed to resolve and in a much more equitable manner.

3. As pointed out by Mr. Preston C. Bassett in his testimony before the Committee August 14, the proposed reinsurance program is not a proper subject of insurance or reinsurance due to the fact that the "risk insured against is not beyond the control of" one of the insureds. This makes such a program subject to innumerable inequities and even fraud.

4. In the event such a program as set forth in S. 1575 were adopted, it would be gross error to provide in such program for benefits greater than would have been received had the pension plan performed as contemplated. Section 4(b)(1) of S. 1575 would provide a windfall of much greater benefit than is provided in a large portion of the pension plans in this country. If this Act is to become law, a provision should be included to provide that the beneficiary would receive not only the lesser of 50% of his average monthly wage or $500 a month, but should go on to provide that in no case, however, shall such beneficiary receive any greater benefits than would have been received had the pension plan been completely funded and sustained no loss in the value of assets.

5. In the event this Act is given further consideration by your Committee, it is respectfully suggested that an exemption be included, probably in Section 4, for any pension funds which are funded through life insurance or annuities. I am familiar with practically all insolvencies of insurance companies in the United States in recent years and I know of no case where $1 of pension funds was lost by virtue of the insolvency of any life insurance company. Life insurance companies are closely regulated by the various states and pension plans are funded through life insurance which have substantial financial resources and which have been in business for many years. There is absolutely no need for double insurance or insured pension plans.

I appreciate this opportunity to offer additional remarks and if I may be of further assistance regarding the problem before your Committee, please let me know.

Respectfully yours,

SILAS J. MAXWELL.

STATEMENT OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, PRESENTED BY ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION

Mr. Chairman and members of the Senate Finance Committee, the AFL–CIO appreciates the opportunity of submitting its views in regard to Senate Bill 1575 which was introduced by Senator Hartke in this Congress.

The AFL–CIO supports this legislation and a copy of the resolution on "Reinsurance for Private Pension Plans" which was adopted at our last convention in 1965 is attached to this statement as part of the record.

Arrangements in the United States to provide income security for retirees reflect a typical American approach to the problem—an approach characterized by a combination of government and private efforts. The government program. OASDI, provides a basic protection to virtually all of the American people. Social Security has the advantage that coverage is so broad, it is now or will be almost impossible for those now covered not to meet the eligibility conditions established under the law. For those few who, through force of circumstances, fail to qualify, we have the back-up Old-Age Assistance Title. Moreover, social security credits are portable as between different employers and funding arrangements can be far more flexible than for a private pension plan because the OASDI system has an assured number of new entrants each year as the graduates from our public and private schools enter the labor market. The OASDI program is also supported by the credit of the United States.

The disadvantage, of course, of the public system is that benefit provisions are statutory and therefore equally applicable to widely varying conditions. Private pension plans, on the other hand, can tailor their programs to meet diverse needs of employees and employers in a wide variety of circumstances.

The spectacular increase in the coverage provided by private pension plans since World War II has been primarily the result of collective bargaining—either directly or indirectly. The AFL–CIO and its affiliates are, and quite justifiably, proud of their achievements. However, as stated in our 1965 conven-

tion resolution on "Pensions," these accomplishments "have not blinded us to the limitations of private pension plans." One problem is "the loss of pension credits when plants shut down or when there are company mergers or acquisitions . . ."

Witnesses who appeared before the Committee have testified about the number of pension plan terminations and have cited examples of the hardship that has resulted from some of these terminations. Testimony has also been presented on the lack of basic data concerning the gross amount of the unfunded liability of terminated plans as well as lack of information regarding what happened to the affected beneficiaries. The AFL-CIO does not wish to burden the record with repetition of facts. The AFL-CIO will therefore confine its statement to the following points:

1. The feasibility of providing some form of insurance or re-insurance of the unfunded liability of terminated plans.
2. The feasibility of providing some form of insurance or re-insurance for losses realized on investments where the sale of such investments may be required to provide benefits.

In regard to (1), above, we believe such a program is not only feasible, but the protection could be provided for a very modest premium. A study on "Private Pension Plan Terminations" which appeared in the December 1963 issue of the Social Security Bulletin, indicated that: 1) relatively few private pension plans are terminated, 2) most of the beneficiaries terminated as a result of acquisitions and mergers have their retirement protection continued.

The study covered 168 pension plans that were judged to have terminated in the 10-month period September 1961-June 1962. Of these, some membership and financial data was available from the D-2's filed with the Office of Labor-Management and Welfare-Pension Reports of the U.S. Department of Labor on 137 terminated plans. Retirement protection was continued for about 70,000 beneficiaries of 80 of the terminated plans, but 6,700 pension plan members of 51 plans had their retirement protection discontinued.

Data on the amount of assets in the pension trust and on the total membership of the plan were available for only 29 terminated plans. The assets available for distribution to the members was as follows:

Assets per member	*Number of plans*
$1 to $499	7
$500 to $999	9
$1,000 to $1,499	4
$1,500 to $1,999	2
$2,000 to $2,499	4
$2,500 or more	3

The table, above, would strongly indicate that most of these 29 plans could not have met their accrued obligations to those who may have been eligible for retirement or who may have had a vested right to a benefit.

In regard to (2) above, S. 1575 would also provide protection beneficiaries where pension trust funds suffered investment losses. We recognize that the implementation of Section 4(a)(2) may require some standards of fiduciary conduct on the part of the trustees of pension plans, but those retiring under private pension plans have every right to expect fulfillment of their pension expectations.

We do not believe a program to insure against such losses would require a substantial premium because if an employer goes bankrupt it does not necessarily mean the pension trust must cease as an entity. If market conditions are very poor so that the immediate liquidation of the trust (normally accomplished through the purchase of annuities, deferred annuities and cash payments) would result in loss, the trust could defer liquidation and continue to pay benefits as they accrue until market conditions improved. In short, the timing of the sale of the assets of a trust can, to a substantial extent, be controlled.

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS POLICY RESOLUTION ON REINSURANCE FOR PRIVATE PENSION PLANS, ADOPTED, DECEMBER 1965

REINSURANCE FOR PRIVATE PENSION PLANS

Private pension plans have become a major element in providing an adequate income to workers during their retirement years.

Yet because of the many years required for full funding of past service liabilities, too many workers of companies who go out of business may find that they are denied the pension benefits on which they had relied. As more rapid technological change results in the moving of plants, the disappearance of employers from the industrial scene and even the decline of some industries, more and more workers will lose the retirement security they thought had been accumulated through their years of service.

Other workers face interruption of, or a cutback in retirement benefits when pension fund resources are diluted through declines in the value of investments. A recent disclosure of a sharp drop in the investment equity of a major pension plan underlines the need to protect workers who would be the victims of fluctuations in the value of pension fund investments.

To prevent such tragedies the IUD and the AFL-CIO have urged a system of government reinsurance for private pension plans similar in principal to the reinsurance of bank deposits through the Federal Deposit Insurance Corporation. At the cost of a very small premium payable by each pension fund, reinsurance could fully guarantee the security promised workers; Therefore, be it

Resolved, We renew our demand for the enactment of pension reinsurance legislation. We call upon the appropriate congressional committee to begin hearings and to report a measure to afford full protection to workers against the catastrophe of the loss of accumulated pension credits.

Statement of National Association of Manufacturers Submitted by Eugene J. Hardy, Assistant Vice President

This statement on the proposed Federal Reinsurance of Private Pension Plans Act is submitted by the National Association of Manufacturers, a voluntary association whose members companies—large, medium and small in size—account for about 75 per cent of the nation's production of manufactured goods and about the same percentage of employment in manufacturing.

American industry takes pride in the tremendous progress that has been made in providing expanding retirement security programs for all classes of employees. Industry's initiative in providing such coverage on a voluntary basis over the past half century has been one of the marvels of our complex industrial society.

In his testimony before this Committee on August 15, Labor Secretary Wirtz underscored the importance of this coverage when he said: "We recognize full well the key role which the private pension system is playing in assuring retirement security to millions of employees. In general, this system has operated effectively, efficiently and honestly." Secretary Wirtz was Chairman of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs which, in January 1965, reported that private retirement plans at that time covered about 25 million workers, or about half the employees in private non-farm establishments. The report estimated that by 1980 the number of employees covered will increase to 42 million, or three out of five employees then expected to be employed in non-farm establishments.

NAM has played and will continue to play its part, as spokesman for American industry, in assuring the growth of a flexible, healthy private pension plan system designed to meet the widely ranging needs of employee and employer alike. We will support those measures which we believe encourage this growth and will oppose those which would serve to retard it.

NAM has consistently emphasized in all forums available, public and private, its willingness to support measures which would eliminate abuses and strengthen the private pension system. We continue to reiterate our belief that continued management, employee and public faith in the utility and soundness of voluntary pension plans, is essential. The reasons for any relatively minor abuses or imperfections must be sought and remedied but they must be kept in proper perspective as being a minor part of an overwhelmingly useful and thoroughly dependable institution.

S. 1575 purports to be aimed at curing an alleged imperfection in private pension plans, but if there is such an imperfection, it is not inherent in well-managed plans—rather, it is the obvious fact that under our free competitive system, there is no way to insure that all businesses will survive. S. 1575 would provide insurance against insufficient funds to pay pension benefits in the case of business failure, a portion of the problem that occurs when a business is forced to cease operations. While the feasibility of either government or private insur-

ance against the risk of bankruptcy and business failure continues to be the subject of the most careful scrutiny—as it should be—all present conclusions are that this is not an insurable risk.

Viewed in this context, and for reasons outlined in the remainder of this statement, NAM believes that enactment of S. 1575 is unnecessary and would be undesirable, because of the rigidities it would introduce, from the viewpoint of those it is ostensibly designed to protect—all present and future retired persons who have the major stake in sound and steadily improving private pension plans.

NAM shares the concern of those seeking to avoid the disappointment and serious social and economic hardship that can flow from a failure to receive anticipated pension benefits. We will continue to be in the forefront in expanding and in supporting all reasonable procedures, measures and practices which can guard against such failure. We cannot, however, subscribe to a remedy which, while having some surface appeal, cannot help but aggravate and ultimately frustrate reasonable private pension plan expectations on the part of many employees. Benefits payable under a pension plan are part of the cost of doing business. Any increase in these costs resulting from unwarranted Federal regulation, including the proposed reinsurance, must ultimately be reflected in lesser pensions than would otherwise be available. Such increased costs, plus the complexity of additional regulation, also would inhibit the start of new plans, thereby depriving many employees of pension coverage.

CURRENT REVIEW OF PRIVATE PENSION PLANS

The sponsor of S. 1575 is to be commended for his interest and role in encouraging the current review of the feasibility of reinsurance of private pension benefit expectations and for urging a more *general* review of all aspects of private pension plans. Such a *general* review has been under way for some time under both private and government auspices.

This review was set in motion largely by the release of the President's Committee Report and encompasses all public and private pension programs. The President's Committee has established an Interagency Task Force to study further all phases of private pension plans, including reinsurance proposals. This group has been meeting with representatives of business, labor, insurance, and other private groups interested in the subject. Representatives of NAM met with the Interagency Task Force on August 17, 1966.

Secretary Wirtz in his August 15 testimony pointed out that "The Department of Labor, in cooperation with the Internal Revenue Service, has undertaken a special study of plan terminations aimed at identifying more closely the reasons for termination and their prevalence." He had earlier emphasized "Such a study is a necessary part of any examination of the desirability of a system of insurance of participants' pension rights as suggested by bills currently before Congress."

The Social Security Administration is also helping to finance a current study by the Pension Research Council of the Wharton School of the University of Pennsylvania on the funding of private pension plans.

The Fiscal Policy Subcommittee of the Joint Economic Committee held public hearings on private pension plans in the Spring of this year and we understand plans full-scale hearings on the subject for early 1967.

S. 1575 is only one of the many focal points being examined carefully in all of these efforts to improve the private pension system. We urge this Committee to defer any further consideration of S. 1575 at least until the results of these many studies are known.

THE STUDEBAKER PLAN

Before commenting on the details of S. 1575, we believe it may be useful to review the factual background of the Studebaker pension plan, since termination of this plan is consistently cited as the major justification for enactment of this legislation.

The Studebaker pension plan was based upon a collectively bargained contract entered into in 1950, which initially provided pension benefits based on years of service (maximum 30 years) and retirement at age 65 or later. By subsequent agreements, these benefits were improved in 1955, 1958 and 1961. Pensions were based on years of service which initially, and under each subsequent agreement, included an employee's service prior to 1950. Thus, each agreement created substantial unfunded obligations which were to be funded after 30 years.

Studebaker's obligation to fund the pension plan terminated after 14 years, due to its inability to remain in business. In accordance with the negotiated termination agreement, life annuities were purchased from an insurance company for those already retired and for those age 60 or over. The remaining funds were dispersed in cash payments to those employees who met the vesting requirements.

A fact of great importance and which seems to have been ignored in this case, as in most other pension plans which are newly installed or improved over the years, is that the years of service to be counted in computing the employee's pension included past service or service prior to the inception or improvement of the plan. Thus, a contingent right is immediately created for the employee with past service, and a corresponding contingent liability arises for the employer.

Such contingent liabilities cannot in all cases be satisfied except over a substantial period of years and under the Studebaker plan this funding process was to take place over a period of 30 years. Until a pension plan is fully funded, it is obvious that the employees' rights cannot be fully protected. It is for this reason that some younger and shorter-service Studebaker employees will not receive pension benefits.

It is interesting to note that the Studebaker pension plan, at the time the company's contributions were terminated, was approximately 50 per cent funded, which is much better than might have been expected after only 14 years of operation and several improvements in benefits. The Studebaker pension plan fully covered the contingency of termination, a fact which must have been understood by the union representatives and which could also have been understood by any employee who reviewed the terms of the plan. The pension plan did, in effect, meet all of its contractual obligations.

Where a pension plan is the subject of collective bargaining, it must be understood that the parties make certain choices in determining the measure of benefits. For example, the number of years over which the funding of prior service can be spread by the company clearly affects the level of benefits that can be provided to the employees. By the same token, the number of years over which a liberalization in benefits can be spread affects the extent to which the benefits can be liberalized.

The actual facts in the Studebaker case do not indicate that the basic problem could be solved by any presently suggested reinsurance program, such as is provided in S. 1575. The real issue in the Studebaker situation was the need for understanding that funding original pension plan promises or increased promises brought about by a liberalization of the plan must be done over a period of time and further—the need for understanding that if the plan terminates before these promises have been fully funded that the benefits may not be paid in full. These are matters of simple arithmetic.

S. 1575 would not improve this need for better understanding of private pension plans; in fact, its enactment would serve to obscure the need for such understanding.

ANALOGY WITH FDIC

Proponents of S. 1575 and similar reinsurance proposals point to the FDIC as an analogous situation. The analogy is incorrect as Professor Merton C. Bernstein said in his book, "The Future of Private Pension Plans":

"Nor does the claimed analogy with Federal Deposit Insurance stand up because the deposit is paid in full by the depositor and owed in full by the bank, whereas the pension benefit due under the plan has not been paid for (not directly, and not indirectly, in the case of past service credits)."

In other words, FDIC insures actual, clearly ascertainable assets in being, not contingent past or future promises.

ACTUARIAL ASSUMPTIONS AND FURTHER FEDERAL CONTROL

Implicit in S. 1575 and other reinsurance suggestions is that standard actuarial assumptions could be developed which would be suitable to determine the liabilities under any pension plan for the purpose of ascertaining the necessary premium. Any such actuarial assumptions, in order to work, would have to take into account a large number of variables such as employee turnover and other characteristics of the group covered. In addition, other "actuarial assumptions" would need to be developed relating to the expected degree, number and frequency of business failures. Of course, to make the "actuarial assumptions" work, government would need ultimately to attempt to impose the most rigid and re-

strictive regulations to insure that businesses did not fail and that all investments were sound.

Secretary Wirtz in his testimony before this Committee, made it clear that if the Federal Government were to undertake insurance of private pension funds, "compliance with certain minimum operating standards would appear to be required." Without such Federal standards with regard to such things as funding and investment practices, he emphasized that "a reinsurance program would have the effect of subsidizing imprudent procedures and inadequate funding." The NAM agrees that this is exactly what would occur. The imposition of Federal standards to guard against such occurrence would seriously inhibit the flexibility which has served so well the needs of all concerned.

LOSS ON INVESTMENTS

With regard to investments, S. 1575 would insure against loss on sales from the holdings of pension funds. While again this proposal has superficial appeal, a more thorough study indicates that it could lead to the very kind of shaky and impudent investment which should be discouraged. Since those responsible for investments in pension funds would be protected against loss from unwise investments, they would be able to show a profit from the "killings" from the few that might be successful. The cost of this would have to be paid for by the provident. In other words, knowing that his failure would be made up by "reinsurance", the improvident plan administrator would be tempted to embark on the riskiest ventures.

UNIFORM PREMIUM RATE

With a uniform premium rate, under S. 1575, for all pension funds for the "investment loss" risk, the primary burden would be placed on the well-administered funds. There would be no effective deterrent to excessive risk taking. Secretary Wirtz pointed out "There is little information available indicating how the risk of loss varies (regarding loss in investments and business failures) for these perils among types of employers and types of plants." These comments underscore precisely the shortcomings of a uniform premium rate and reinsurance proposals in general. The inequities are obvious.

TAX CONSEQUENCES

Finally, we must emphasize the serious tax consequences to be encountered if S. 1575 is enacted. The legislation would restrict the reinsurance of pension benefits to pension funds "qualified" under the appropriate provisions of the Internal Revenue Code and would require funds to carry such insurance in order to maintain their qualified status. To impose such a requirement on the well-funded, soundly-financed pension plans would be inequitable in the extreme. Removal of the tax qualification of such plans, whose administrators might deem Federal insurance undesirable for adequate reasons, would be patently unfair and would penalize those whom S. 1575 purports to protect.

In commenting on the termination of insurance protection provided by S. 1575, Secretary Wirtz emphasized that the "consequences of any such termination . . . would, of course, fall most heavily on the beneficiaries." We submit that the consequences of loss of tax qualification would, in the long run, have the most serious effect on the same "beneficiaries".

During the public hearings on S. 1575, there was substantial discussion of the existing tax treatment of private penison plans. In the current dialogue, there is obviously much misunderstanding as to what this treatment actually involves; how it came into being; and its relation to the tax treatment of other types of income and compensation. In the hope that it will help to complete the record on this important subject, we are including, as part of this statement on S. 1575, a report of the NAM Taxation Committee entitled "Tax Treatment of Private Pension Plans", and ask that it be made part of the hearing record.

CONCLUSION

NAM will continue to support the development and improvement of private pension plans to provide adequate benefits for retired workers, as well as to encourage the establishment and expansion of new plans. S. 1575 would act as a deterrent to these objectives and we urge its rejection.

S. 1575 would lead to additional Federal regulation covering all major areas of private pension plan administration, going well beyond Federal insurance.

thereby impairing the flexibility of the present system, which has been the primary factor enabling the system to meet the needs of widely varying employee groups and their employers.

TAX TREATMENT OF PRIVATE PENSION PLANS—A REPORT OF THE NAM TAXATION COMMITTEE PREPARED BY ITS SUBCOMMITTEE ON GENERAL TAX REVISION

On February 8 and again on August 17, 1965, the NAM Subcommittee on General Tax Revision considered the report on "Public Policy and Private Pension Programs" submitted to the President early this year by a committee headed by the Honorable Willard W. Wirtz, Secretary of Labor.* Because the Penison Report deals with matters beyond the scope of tax policy, as well as matters of mutual interest in the tax aspects of the report, representatives of the Association's Employee Benefits Committee participated in both meetings. The Employee Benefits group has prepared a more comprehensive report dealing with all facets of the public interest in the private pension system. This report is limited to an evaluation of the Pension Report in light of the Association's existing tax policy in the areas as follows:

"Tax law in respect to employee benefit plans should permit the exercise of managerial discretion in determining types, coverage, conditions of eligibility, contributions, and investments, with such safeguards as may be needed to prevent improper discrimination in favor of any special group of employees."

The Pension Report contains conclusions and recommendations for major contraction in the voluntary nature of the private pension system contrary to the objective of our policy. These conclusions and recommendations are largely hinged on the assumption that the tax treatment of private pension plans constitutes a tax subsidy involving a substantial loss of revenue. The implication throughout is that the alleged subsidy justifies greater government involvement and policy determination over the form, scope and other features of the private plans. Other reasons for greater involvement are stated, but the dominant thought seems to be the inter-relation between tax subsidy and control. Regardless of all other aspects of public policy involved, it has seemed to the Subcommittee that its special responsibility is to take a fresh look at the philosophic implications of the tax treatment of private pensions.

Re-examination of the history and nature of the tax treatment of private pensions does not give support to the subsidy concept. Instead, the reasonable conclusion is that the tax law provisions are reasonable and practical in light of the nature of the transactions involved in private pensions, and do not in themselves confer special advantage. Those provisions have tended to impose limitations and restrictions on the development of private pension plans, a far different matter than providing a subsidy to encourage their development.

Actually, this tendency towards limitation is indicated in the Pension Report's discussion of legislative history, as summarized on pages 12–13.

"Payments to retirement funds for *current costs were allowed as deductible expenses for tax purposes before specific legislation was enacted*, provided the amounts represented reasonable compensation. However, in the 1920's statutory action made contributions to such funds for past service costs tax deductible if they were in reasonable amounts and tax exemption was also granted on income of qualified pension trusts.

"*Limits on this tax treatment were enacted as problems appeared.* Thus, the Revenue Act of 1928 stipulated that contributions for funding past service liabilities had to be apportioned over a period of not less than 10 years. Similarly, to prevent tax abuse, the Revenue Act of 1938 established the so-called non-diversion rule which provided that a pension trust had to be irrevocable and the funds had to be used for the benefit of the employees.

"With the impetus to pension plans resulting from the increases in tax rates during the World War II period, the Revenue Act of 1942 set forth more stringent conditions for plans receiving special tax status. The immediate purpose of these conditions was to assure that plans operate for the benefit of a wider group of employees and to prevent pension plans from becoming a wartime tax avoid-

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*"Public Policy and Private Pension Programs: A Report to the President on Private Employee Retirement Plans" by President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs, January 1965. Hereinafter this report is referred to as the *Pension Report*.

ance device. This Act required that pension funds be irrevocably committed to the retirement benefits, that the system not discriminate in favor of highly compensated employees, and that the annual tax deduction for contributions not exceed stated limits. These requirements with subsequent amendments, re-enacted in 1954, today constitute the basic provisions which govern the qualification of pension plans." [Italic supplied.]

We must expect the government from time to time to re-examine all provisions of tax law to consider such abuses or problems as may be alleged or simply to determine whether there are abuses or problems. But the Pension Report does not either point to such factors, or allege their probable existence. Instead, as a whole it attests to the successful operation of the private pension system under tax law and regulation as they exist. With the subsidy allegation being basic to the case made for greater government intervention, an over-all description of the Pension Report is that it embodies a new set of value-judgments of what the private pension system should be. Inevitably, many of the ideas expressed will be examined in other forums, but it seems to us that greater objectivity in viewing such ideas will be achieved if there is an absence of bias regarding the tax treatment of private pensions.

In its assumption of a tax subsidy, sometimes described as a tax incentive, a tax advantage or favored tax treatment or status, there is some implication in the Pension Report that the deduction by the employer of contributions to the retirement fund may be a tax incentive. It is true that the power to allow or disallow such a deduction gives the government its primary control over pension plans.

However, the employer contribution is an irrevocable payment solely for the benefit of employees. In determining the employer's net income subject to tax, it is immaterial to him whether the amount is paid as a pension contribution or as wages. It is an ordinary and necessary business expense, clearly deductible under the income tax law before any special pension rules were enacted. Such deduction clearly is no more a tax incentive than is a tax deduction allowed for a wage payment.

The unqualified claim of subsidy in the Pension Report arises from two facts, first, that the employee does not pay tax until he retires and receives his pension and, second, that the taxation of income earned by pension trusts similarly is deferred until the income is disbursed as pensions.

The attribution of subsidy to these situations apparently derives from a comparison with the tax treatment of other types of income. In regard to wages, for example, it is true that the employers payments are deductible and the employee's income taxable at the same time. But the fact that this is true with respect to wage or other income does not establish that it should be true with respect to pension income.

In the case of wage compensation, the employee receives immediate spendable income in cash. But the employee has no right to income at the time the employer makes a pension contribution. Even with immediate vesting, the employee generally cannot withdraw the vested portion until retirement. Thus, no current tax paying capacity is created; the employee only has a right to future benefits if and when he becomes eligible to receive them. Under many plans, no employer financed benefit accrues to his estate if an employee dies before retirement.

The situation is the same with respect to income from a pension trust. The employee does not immediately receive income, and even if his rights are vested, he has no claim to income until he is actually retired. Even if it were feasible to make allocations of trust income to all the members of every pension plan, would a member be expected to pay a current rate of tax on income which might be taxed to him at a much lower rate, if at all, after he retired? To our knowledge, no one has suggested that there is an equitable means by which income in a pension trust could be taxed as accumulated.

Instead of special privilege, we thus have a situation in which pension income is taxed in accordance with the nature of the transactions involved. These transactions are different from the current receipt of wage payments and other types of income. A tax law which did not take cognizance of the differences would be unrealistic and inequitable.

The recognition in tax law of an established practice, condition, contractual arrangement, or what have you, is far different from use of the tax law to induce or suppress a particular activity. Such recognition merely permits the taxpayer to continue to do that which he had been doing, or that which he

would do except for inhibiting taxation. It is not accurate to describe such permissiveness as constituting an incentive or involving a subsidy.

The fact that the tax treatment of private pensions is consistent with the nature of the pension arrangement is confirmed by tax policy elsewhere. The government's own civil service pension system does not tax employees currently on the employer's contributions. This is also true with respect to the various state retirement systems. Trust fund income likewise is not taxed under these plans until disbursed as pension income.

The social security and railroad retirement systems go further than these plans, and exempt from tax not only employer's contributions and trust fund income, but all retirement payments as well. However, some measure of equality with the social security and railroad beneficiaries is achieved for pensioners under the other plans by use of the retirement income credit.

Another area of similarity in tax treatment is the deferral of tax on interest accumulated on government savings bonds.

Taken together, all of these situations add up to a consistent rule of taxation, instead of a departure justifying an allegation of special privilege. The rule is that the natural time to apply a tax is when income is received, just as the time to deduct an expense is when the expense is incurred. *The forebearance of tax until income is received is a matter of tax timing and not of tax exemption.* It simply is not realistic to consider that any kind of a subsidy results because a tax is not incurred until income is received.

A full evaluation of all the conclusions and recommendations in the Pension Report is more within the competence of the Employee Benefits Committee than our group, and will not be attempted in these pages. However, when the assumption of a tax subsidy is eliminated and the maintenance of the voluntary nature of private pensions is considered an important objective of public policy, a prima facie case is made against many of the judgments reflected in the Pension Report. While leaving the door open to greater in-depth discussion by the Employee Benefits group, we will briefly analyze some of the specific proposals of the Report in light of these considerations.

INTEGRATION WITH SOCIAL SECURITY

The Pension Report would change the rule for integration of private pensions with social security benefits. The present rule measures the potential of discrimination from the value of social security benefits over and above the value financed by the employee contribution. In practical effect, this means that a plan is not discriminatory if a higher-paid employee receives no more in pension value, as a percentage of working income, than a lower-paid employee—eliminating in both cases the value of the pension attributable to his own contributions to the private and social security funds. Because employee contributions are now estimated to account for only 22 percent[1] of the value of social security benefits, a private plan is considered non-discriminatory when employer-financed benefits under the plan do not produce a higher pension-to-compensation relationship than 78 percent of social security benefits. The Pension Report would disregard the actual value of social security benefits financed by individual employee contributions, and place the test for non-discrimination on the fact of equal social security tax rates on employees and employers.

It may be that the 22–78 percent relationship is somewhat out of date. Certainly it should be changed when and if official estimates indicate that it is out of line with experience. To switch over to a 50–50 basis, however, would in effect be to disregard that fact that the average employee under social security does not and will not in the foreseeable future pay for anything like one-half of the cost of his benefits rights. The present integration rule provides an outside limit on allowable freedom for managerial discretion in the development of private plans.

Where this limit permits, an employer is able to provide somewhat higher benefits for higher-paid employees under the present rule than he would be under a 50–50 rule. But, as long as the integration with social security is practical and realistic in the light of the nature of that system, there should be no claim of discrimination. It does seem reasonable to believe that the proposal to go over to a 50–50 rule would not have been made except for the assumption that private plans are tax subsidized.

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[1] In reverse, this means that 78 percent of the value of an individual's benefits under social security derives from contributions by younger employees and employer contributions based on total taxable compensation of all employees.

UPPER LIMIT FOR PENSION BENEFITS

The Pension Report recommends a *dollar limitation on contributions to qualified pension plans* in order to limit resulting benefit payments.

This particular recommendation is specifically related to the alleged "favored tax treatment". Except for the allegation of tax subsidy, however, and as long as the pension plan otherwise meets the non-discriminatory tests provided by law and regulation. there could be no more reason to propose to restrict the size of contributions and benefits than there is reason to restrict the size of salaries on which they are based. Such a restriction would constitute a severe restriction on the voluntary nature of private plans. It may be hoped that arbitrary limitations of this kind will not be advanced in future discussions of public policy with respect to private pension plans.

COVERAGE OF PLANS

The Pension Report recommends that "the option which qualified retirement plans now have to cover only salaried or clerical employees should be eliminated, unless there is a showing of special circumstances," but limits its affirmative explanation to the words:

"The Committee, however, finds no justification for expanding special tax treatment of plans to employers who offer retirement benefit coverage to only a favored group of employees."

However, the Report then "recognizes that there are many situations where it would be wholly impractical but not impossible to avoid differential treatment among groups of employees."

Present rules prohibit discrimination in favor of stockholders, executives or higher paid employees. Except for the sentence associating "special tax treatment" with "a favored group of employees," there is no claim that this rule does not provide adequate protection against favoritism. There is no suggestion of evidence of any trend of discrimination against any class of employees in the development of the private pension system.

The Employee Benefits Committee will deal with the positive advantages of maintaining flexibility with respect to coverage of pension plans, subject to the present rule against discrimination. For the purposes of our report, it seems all too clear that the only basis for the recommendation is the assumption that the alleged "special tax treatment" would justify substituting government judgment for private judgment in determining whether "special circumstances" justified the limited coverage of each affected plan.

LUMP-SUM DISTRIBUTION OF RETIREMENT PLAN BENEFITS

The Pension Report would change the rule with respect to lump-sum distributions under a qualified pension plan. At present, a qualified plan can provide for retirement benefits in a lump-sum payment which would be taxed as long-term capital gains rather than as ordinary income. The Pension Report would substitute income averaging for the capital gains treatment; that is, the income would in effect be spread over a series of years and taxed at applicable income tax rates in those years. However, the justification for special treatment is itself spelled out in the Report:

". . . the Committee recognizes that a lump-sum distribution may sometimes be advisable. Moreover, the Committee recognizes that the taxation of a lump-sum distribution at regular rates can impose a considerably greater tax burden than the taxation of the same amount of benefits received over a number of years."

There is a little more to add. The Pension Report recognizes these types of distributions need special tax treatment, and this treatment is already outlined by the Internal Revenue Code for all forms of capital gains. Alteration of the capital gains tax was not the subject under investigation by the President's Committee.

VESTING

The Pension Report recommends that the tax law be amended to require that a private pension plan, "in order to qualify for favored tax treatment," must provide some reasonable measure of vesting for the protection of affected employees.

Vesting means that participants in a pension plan whose employment is terminated before reaching retirement age retain rights to accrued pension benefits when that age is reached.

As the Pension Report recognizes, the practice of vesting has rapidly expanded in recent years, and is now provided in two out of three private pension plans. The Report also recognizes that an arbitrary requirement for vesting would impinge on the voluntary character of the private pension system.

The cost of vesting must be met by higher employer contributions, or lower benefits. Where a new plan is under consideration, a requirement for vesting might be the factor which tipped the scales against going ahead.

It seems to us unlikely that vesting would have been recommended except for the implication that such a requirement is justified because of the alleged favored tax treatment.

FUNDING

The present tax law provides limited standards for funding. Without production of evidence of the absence of sound funding practices, the Pension Report concludes the present provisions are not adequate. It therefore recommends certain "minimum" funding standards.

The irrelevance of the claim of favored tax treatment for private pension plans is best illustrated in the funding area. In the absence of any funding, a pension plan would be on a pay-as-you-go basis. Under basic tax law, the employer's contribution would be deductible, and the employee's pension income taxable in the same year—just as in the case of wage compensation. However, we believe the proposal in the Pension Report should be considered on its merits, and in its relation to its impingement on the flexibility and voluntary nature of private pension plans, and not disregarded because it could not be founded on a notion of tax subsidy.

It does not seem to us that the Pension Report makes a convincing case for more stringent requirements on funding, but this is an area in which a more conclusive viewpoint will be found in the report of Employee Benefits Committee.

SUMMARY AND CONCLUSIONS

In this report, we have attempted to evaluate the nature of the tax treatment of private pension plans, and draw on that evaluation to appraise some of the specific proposals in the Pension Report. We have not attempted to appraise all public policy aspects of these proposals, nor to examine all of the proposals in the Pension Report involving tax treatment. As a whole, our purpose has been limited to proving the inappropriateness of resting public policy concerning private pension plans on the assumption that the tax treatment afforded involves a subsidy putting the government in the position of he who pays the piper.

With due respect to able and sympathetic discussion of various facets of the private pension system in the Pension Report, we most strongly feel that any further studies or policy deliberations in the area should be conducted without recourse to the tax subsidy argument.

Approved by the NAM Taxation Committee, September 9, 1965.

AMERICAN FOUNDERS LIFE INSURANCE CO.,
Austin, Tex., August 26, 1966.

Hon. RUSSELL B. LONG,
U.S. Senate,
Washington, D.C.

SIR: Senate Bill (S. 1575) is one which provides increasing benefits which I don't believe is to the advantage of employees, or employers to provide. I am against insurance being financed from pension funds to provide benefits lost by (1) "cessation of one or more operations carried on by an Employer," (2) "losses realized on the sale of investments of a fund if a sale is necessary to permit benefits."

Section 4(B)(1) states that "beneficiaries shall receive a monthly retirement or disability benefit, the lesser 50% of his average monthly wage for five years

or $500.00."—this is if a company goes broke. This means that every employee is American would start trying to work for as many companies as possible and trying to break every company for which they worked in order to accumulate benefits under the government insurance program.

I have followed your career closely over the years, and I feel that you want to do what is best for the individual. Senator, I strongly urge you to vote against this Bill.

Very truly yours,

MELVIN D. JONES, C.L.U.,
Executive Vice President.

GRAND RAPIDS, MICH., *August 30, 1966.*

DEAR CHAIRMAN LONG: As a senior citizen 70 years of age I would very much like to see a bill like S. 1575 passed to protect my pension from Gallmeyer & Livingston Co.

Not too many years back a firm known as Hayes-Ionia Co., went out of existence in our city endangering the pensions of their employes, some *were* lost!

I certainly believe a pension earned by a working man should have the same protection given a Federal Reserve Bank!

So I'm asking you to *do* what you can to further passage of this bill and so protect the working man's pension,

Your truly,

JOSEPH A. BRUSKY.

FORD MOTOR CO.,
MANAGING DIRECTOR, WASHINGTON OFFICE,
Washington, D.C., August 31, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This statement is being submitted for the record of the Senate Finance Committee in connection with its recent hearing on Bill S. 1575, calling for a Federal program to insure beneficiaries of covered pension funds against loss of benefits resulting from termination of a business operation of an employer or from a decline in the value of the investment in the fund.

Our Company recognizes the need for a sound private pension plan system. We believe that significant progress is being made toward reaching this goal, both through employer actions and as a result of labor-management negotiations.

We question the advisability of further Federal involvement in the private pension plan area, as is contemplated in the proposed legislation, without careful study of the implications of such action. The proposed reinsurance program raises some serious questions, among them: (1) Can insurance principles be made to apply to such unpredictable risks as a business failure or a decline in the asset value of a pension fund? (2) Would a reinsurance program encourage risky investment and minimum funding since any deficiencies upon plan termination would be covered by insurance? (3) Should well-managed, stable companies and plans in effect be charged with deficiencies created by inept operators who have overreached themselves? (4) most important, would such a reinsurance program discourage the improvement in existing pension plans or the establishment of new pension plans?

During the hearing frequent reference was made to the need for introducing Federal standards in the pension field, most prominently in the areas of vesting, funding, investments and actuarial costs methods. In our judgment, extreme care should be exercised before introducing new requirements in these areas. As was clear at the hearing, there are simply not enough facts at hand to reach a sound judgment on reinsurance and these other matters at the present time. The potential for damage is great, and the need for thorough study and consideration before changes are made in ground rules seems evident.

Sincerely,

R. W. MARKLEY, Jr.

UNITED AIR LINES,
Washington, D.C., August 31, 1966.

Re: S. 1575
Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: Any proposal for insurance of benefits from private pension plans raises so many questions regarding establishment of standards for participating employers, procedures for enforcement of standards, proper measurements of risk and equitable assessment of premiums that legislative action on S. 1575 should not be undertaken until answers have been found for problems inherent in such a program.

Sincerely,

CURTIS BARKES,
Executive Vice President, Finance and Property.

INTERNATIONAL CHEMICAL WORKERS UNION,
Akron, Ohio, September 2, 1966.

Honorable RUSSELL B. LONG,
Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: As President of the International Chemical Workers Union, which represents more than 90,000 workers in the chemical and allied products industries in the United States, I respectfully urge you as a member of the Senate Finance Committee to support Senate Bill 1575 or similar legislation. As you know, this bill would require the participation of private pension plans in a federal re-insurance program to cover loss of employee retirement benefits under two contingencies: cessation of one or more operations carried on by the employer, or losses realized on the sale of investments of a fund if the sale is necessary to provide benefits. Such a measure is of special importance to all of our members who must depend upon the financial soundness of their negotiated private pension plans to guarantee an adequate level of income upon retirement.

As an international union, we are very concerned about the alarming number of business failures and plant shutdowns which result in the termination of a significant number of pension plans involving funds with unfunded liabilities. In such situations, not only do the pension plan participants lose their assurance of retirement income, but our society loses as well. The loss of such expected benefits creates new economic needs on the part of the worker, which must be responded to by the public sector of the economy. Furthermore, the loss of such benefits may in many cases be correlated with disfunctional changes in the mental health of the affected worker, thereby creating the necessity of additional expensive responses by the public sector.

Collective bargaining demands for an adequate pension plan are symbolic of workers' desires to provide in advance for their income needs during retirement. By deferring a significant portion of their potential current income, they hope to achieve an adequate retirement income. In the language of collective bargaining, the workers are "charged" an amount in cents per hour which the actuaries assume as the cost of providing pension benefits. Were there no pension plan, the worker's hourly wage could be expected to be that much higher during his working years.

We believe that such personal responsibility should be encouraged; therefore, one of the major goals of this International Union has been the attainment of adequate private pension plan coverage for all of our members. We have, in turn, concluded that the most economical manner in which adequate retirement income can be provided for most large groups of employees is through the mechanism of a funded pension plan, administered by a non-profit board of trustees. However, such an approach almost invariably entails the acceptance, at least for a time, of an unfunded liability for past service cost.

In a perfectly stable economy, the existence of such an unfunded liability in any particular plan would not be cause for great concern. But such stability is not the case. In fact, the forces of change in our economy constantly challenge the stability of all business enterprises. This dynamic nature of our economy has benefited all who live in our society by being the impetus for the crea-

tion of the highest standard of living in the world. However, at the same time it can have very significant disadvantageous effects on the employees of numerous enterprises which cannot meet the functional requisites of existence in such an economy. In this case, we find the highly inequitable condition of a minority being adveresly affected by a situation which produces substantial benefits for the many. Thus during the period when unfunded liabilities exist, some provision must be made to protect workers' interests.

You have before you the opportunity to deal at least partially with this situation with respect to the loss of pension benefits. In a very real sense you have the opportunity to strengthen our economy. And you have the opportunity to encourage the assumption of personal responsibility for the provision of retirement income needs.

Furthermore, the re-insurance mechanism called for by Senate Bill 1575 would actually be paid for by the beneficiaries of this legislation, in that the cost of such protection will be borne by participating plans. Thus we are simply asking for a self-insured program of protection, which because of the necessity of the pooling of the experience of many plans, can only be administered at a national level. We feel that the economic, social and psychological benefits of such protection will be well worth the cost which we as plan participants must bear out of our deferred wages.

Sincerely yours,

WALTER L. MITCHELL, *President.*

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