PRIVATE PENSION PLAN REFORM

HEARINGS

BEFORE THE

SUBCOMMITTEE ON PRIVATE PENSION PLANS

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-THIRD CONGRESS

FIRST SESSION

MAY 21, 22, 23, 31; AND JUNE 4 AND 12, 1973

PART 1

(MAY 21, 22, AND 23, 1973)

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PRIVATE PENSION PLAN REFORM

MONDAY, MAY 21, 1973

U.S. SENATE,
SUBCOMMITTEE ON PRIVATE PENSION PLANS,
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 1:05 p.m., in room 2221, Dirksen Senate Office Building, Senator Gaylord Nelson (chairman of the subcommittee) presiding.

Present: Senators Long (chairman of the full committee), Nelson, Curtis, Dole, and Roth.

Senator CURTIS. The chairman of the subcommittee, Senator Nelson, had some plane difficulties in Pittsburgh, but he will be here very shortly, we hope. He has asked that we go ahead and start receiving the testimony.

I do want to say to the witnesses who will appear before the chairman gets here, that we regret this necessity that they must testify in the absence of the chairman, but that their tesimony will be carefully considered by the committee and will be scrutinized and digested by the staff for the benefit of the entire committee.

We will print the committee press releases relative to this hearing and the bills involved (S. 4, S. 1179, and S. 1631), and then we will hear from Senator Dole.

[The material referred to follows:]

PRESS RELEASE

FOR IMMEDIATE RELEASE
May 2, 1973

FINANCE SUBCOMMITTEE ON
PRIVATE PENSION PLANS
2227 Dirksen Senate Office Bldg.

FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS ANNOUNCES INITIAL HEARINGS ON PRIVATE PENSION PLAN REFORM

Senator Gaylord Nelson (D., Wis.) has announced that he will chair Senate hearings and panel discussions on qualified private pension and profit sharing plans that very often do not bring the retirement security they promise.

The initial hearings before the Private Pension Plans Subcommittee of the Senate Finance Committee will be at 1:00 p.m. on Monday, May 21, and at 10:00 a.m. on May 22 and 23 in Room 2221 Dirksen Senate Office Building.

In arguing for the need for legislative protection for American workers' pension programs, Nelson said:

> "Experts now maintain that as many as 30 to 35 million people now in jobs with qualified pension plans may never receive a penny of their pension because of shifts to other jobs, company shutdowns or employer bankruptcy."

He pointed out that "some American workers have labored for more than a fourth of a century only to find their pensions do not exist."

Nelson said that it is essential that the private retirement system be strengthened to assure that its promises of retirement security are real and not illusory.

Nelson stated that "the present law is an insult to the American working man and should not be tolerated."

The hearings will include, but will not be limited to, a broad range of issues such as vesting, eligibility requirements (age and service) and portability, funding and termination insurance, fiduciary responsibilities of plan administrators and trustees, deductions in the case of self-employed, closely held corporations, subchapter S corporations and professional corporations, tax treatment of lump sum pension and profit sharing payments and deferred compensation plans of exempt organizations. Comments will be received on the subject of which agency or agencies (or agency to be created) of the Government are best suited to administer the various provisions regulating private pension plans, and whether overlapping regulation by the States should be permitted.

The hearings will be held on Senator Bentsen's bill (S. 1179), Senator Curtis' bill (S. 1631), and also on the principles and policies embodied in S. 4 which has been reported to the Senate by the Senate Labor and Public Welfare Committee.

Requests to Testify . -- Senator Nelson advised that witnesses desiring to testify during this hearing must make their request to testify to Tom Vail, Chief Counsel, Committee on Finance, 2227 Dirksen Senate Office Building, Washington, D. C., not later than Friday, May 11, 1973. Witnesses will be notified as soon as possible after this cutoff date as to when they are scheduled to appear. Once the witness has been advised of the date of his appearance, it will not be possible for this date to be changed. If for some reason the witness is unable to appear on the date scheduled, he may file a written statement for the record of the hearing in lieu of a personal appearance.

Consolidated Testimony . -- Senator Nelson also stated that the Subcommittee urges all witnesses who have a common position or with the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Subcommittee. This procedure will enable the Subcommittee to receive a wider expression of views on the total bill than it might otherwise obtain. Senator Nelson urged very strongly that all witnesses exert a maximum effort, taking into account the limited advance notice, to consolidate and coordinate their statements.

Legislative Reorganization Act . -- In this respect, he observed that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Senator Nelson stated that in light of this statute and in view of the large number of witnesses who desire to appear before the Subcommittee in the limited time available for the hearing, all witnesses who are scheduled to testify must comply with the following rules:

(1) All statements must be filed at least one day in advance of the day on which the witness is to appear. If a witness is scheduled to testify on a Monday or Tuesday, he must file his written statement by the Friday preceding his appearance.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 50 copies must be submitted.

(4) Witnesses are not to read their written statements to the Subcommittee, but are to confine their ten-minute oral presentations to a summary of the points included in the statement.

(5) Not more than ten minutes will be allowed for the oral summary.

Witnesses who fail to comply with these rules will forfeit their privilege to testify. Those who have already requested to testify need not submit a second request.

Written Statements . -- Witnesses who are not scheduled for oral presentation, and others who desire to present a statement to the Subcommittee, are urged to prepare a written position of their views for submission and inclusion in the printed record of the hearings. These written statements should be submitted to Tom Vail, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building not later than Friday, June 1, 1973.

PRESS RELEASE

FOR IMMEDIATE RELEASE
May 21, 1973

FINANCE SUBCOMMITTEE ON
PRIVATE PENSION PLANS
2227 Dirksen Senate Office Bldg.

Finance Subcommittee on Private Pension Plans Announces Panel Discussions on Private Pension Plan Reform

Senator Gaylord Nelson, Chairman of the Finance Subcommittee on Private Pension Plans, announced today that the Subcommittee will hold two days of panel discussions on May 31 and June 4 on selected issues of pension legislation. The panel discussions are designed to present a full and objective review of the pertinent legislative issues involving qualified pension plans and the tax treatment for retirement savings. The panelists, who are recognised experts in the pension plan area, will present a variety of viewpoints in regard to these issues.

The session will begin at 10:00 a.m. on both May 31 and June 4 in Room 2221 Dirksen Senate Office Building. The participants in these panel discussions include only those persons who have been specially invited by the Subcommittee, but the hearing room will be open for anyone who may wish to attend.

Following is a list of the panelists and the subjects to be covered on the particular days.

May 31

This panel will consider, first the question of whether it is better for the vesting, funding and any other similar provisions to be enforced by the Department of Labor, as proposed by S. 4, or whether it would be better for them to be enforced through the Treasury Department, as provided by Senator Bentsen's bill (S. 1179) and Senator Curtis' bill (S. 1631, the Administration proposal). In addition, the administration proposal contains certain provisions relating to limitations with respect to self-employed plans and also makes allowances for those covered by pension plans to provide some coverage on their own behalf. The second question will he should limitations on benefits and contributions be provided for self-employed plans, should they also be provided for professional corporations and closely held corporations, and possibly also for large company plans as well, and if limitations are to be provided, what should they be?

The panelists will be:

PAUL BERGER: Is a member of the Washington, D. C. law firm of Arnold and Porter. He has been involved in the tax aspects of health, welfare and pension plans, particularly those established under collective bargaining agreements. He serves as special tax counsel for the AFL-CIO.

DANIEL HALPERIN: Professor of law at the University of Pennsylvania Law School, teaches courses on taxation and tax policy. He is a consultant to the Treasury Department, and also lectures extensively at tax institutes. From 1969 - 1970 was Deputy Tax Legislative Counsel to the Treasury Department.

CONVERSE MURDOCH: Is President of the Wilmington, Delaware law firm of Murdoch, Longobardi, Schwartz, and Walsh. He is a former Special Attorney for the Interpretive Division, Office of Chief Counsel at the Bureau of Internal Revenue; former Special Assistant to the Chief Counsel, Bureau of Internal Revenue; former member of the legal advisory staff of the Treasury Department. Since 1954, he has been in private practice and is a tax specialist.

JOHN NOLAN: Is a partner in the Washington, D. C. law firm of Miller and Chevalier. He is a former Deputy Assistant Secretary of Treasury for Tax Policy, and was responsible for developing the administration's legislative program for pensions. As an attorney in private practice, he does extensive work in the area of pensions and profit sharing.

CARROLL SAVAGE: Is a partner in the Washington, D. C. law firm of Ivins, Phillips and Barker, specializing in tax and employee benefits.

HAROLD T. SWARTZ: Member of the staff of the Washington, D. C. accounting firm of Coopers and Lybrand. He is a retired Assistant Commissioner (Technical) of Internal Revenue Service, in charge of issuing rulings and technical advice in the area of pension and profit sharing plans. He is the author of several articles on corporate taxes, tax aspects of pension plans and ruling procedures. He is a former Assistant Deputy Commissioner and Director of Tax Rulings Division, and former Acting Commissioner and Acting Deputy Commissioner of the Internal Revenue Service.

JUNE 4

This panel will discuss the vesting and funding provisions in S. 4, S. 1179, and S. 1631, and the provisions in some of those bills for termination insurance, portability, and fiduciary standards.

The panelists are:

MERTON BERNSTEIN: Is a Professor of Law at Ohio State University Law School. He was Counsel to the Labor Subcommittee and Subcommittee on Railroad Retirement. He is a member of the American Pension Conference and the American Risk and Insurance Association. He is the author of The Future of Private Pensions which received Elizar Wright Award for "the most significant contribution to the literature of insurance" in 1965.

HERMAN BIEGEL: Is a partner in the Washington, D. C. law firm of Lee, Toomey and Kent, and formerly with the Chief Counsel's Office of the Internal Revenue Service. He has been in private practice of law since 1937 and a member of the Pension Research Council, Wharton School of Finance. He is legal counsel to the Profit Sharing Council of America.

EDWIN S. COHEN: Is of counsel to the Washington, D. C. law firm of Covington and Burling. He is also Joseph M. Hartfield Professor of Law at the University of Virginia. He was recently Under Secretary for Taxation for the U. S. Treasury Department.

FRANK CUMMINGS: Is a partner in the Washington, D. C. law firm of Gall, Lane, Powell and Kilcullen, and a lecturer at Columbia Law School, Columbia University, New York City. He was formerly minority general counsel of the Senate Labor and Public Welfare Committee. He is also a public member of the U. S. Labor Department's Advisory Council on Employee Welfare and Pension Benefit Plans.

LEONARD LESSER: Is presently general counsel of the Center for Community Change in Washington, D. C. Formerly general counsel and director of social security activities, Industrial Union Department, AFL-CIO and legal counsel to the social security department of the United Auto Workers.

Calendar No. 119

93D CONGRESS
1ST SESSION

S. 4

[Report No. 93–127]

IN THE SENATE OF THE UNITED STATES

JANUARY 4, 1973

Mr. WILLIAMS (for himself, Mr. JAVITS, Mr. ABOUREZK, Mr. BAYH, Mr. BEALL, Mr. BIBLE, Mr. BROOKE, Mr. BURDICK, Mr. CANNON, Mr. CASE, Mr. CHILES, Mr. CLARK, Mr. COOK, Mr. CRANSTON, Mr. DOMENICI, Mr. DOMINICK, Mr. EAGLETON, Mr. GRAVEL, Mr. HART, Mr. HASKELL, Mr. HATHAWAY, Mr. HOLLINGS, Mr. HUGHES, Mr. HUMPHREY, Mr. INOUYE, Mr. JACKSON, Mr. KENNEDY, Mr. MCGEE, Mr. MCGOVERN, Mr. MCINTYRE, Mr. MAGNUSON, Mr. MANSFIELD, Mr. MATHIAS, Mr. MONDALE, Mr. MONTOYA, Mr. MOSS, Mr. MUSKIE, Mr. NELSON, Mr. PASTORE, Mr. PELL, Mr. PERCY, Mr. PROXMIRE, Mr. RANDOLPH, Mr. RIBICOFF, Mr. SCHWEIKER, Mr. SPARKMAN, Mr. STAFFORD, Mr. STEVENSON, Mr. SYMINGTON, Mr. TAFT, Mr. TUNNEY, Mr. WEICKER, and Mr. YOUNG) introduced the following bill; which was read twice and referred to the Committee on Labor and Public Welfare

APRIL 18, 1973

Reported by Mr. WILLIAMS, with an amendment

[Strike out all after the enacting clause and insert the part printed in italic]

A BILL

To strengthen and improve the protections and interests of participants and beneficiaries of employee pension and welfare benefit plans.

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

*S. 4 as reported deleted the original text of the bill and inserted the part printed in italic. The original text is not reproduced here.

That this Act may be cited as the "Retirement Income Security for Employees Act".

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SEC. 2. (a) The Congress finds that private pension and other employee benefit plans and programs in the United States are intrinsically woven into the working and retirement lives of American men and women; that such plans and programs have become firmly rooted into our economic and social structure; that their operational scope and economic impact is interstate and increasingly affecting more than thirty million worker participants throughout the United States; that the pension assets of approximately $150,000,-

000,000 accelerating at more than $10,000,000,000 annually, represent the largest fund of virtually unregulated assets in the United States; that the growth in size, scope, and numbers of employee benefit plans is continuing rapidly and substantially; that Federal authority over the establishment, administration, and operations of these plans is fragmented and ineffective to secure adequate protection of retirement and welfare benefits due to the workers covered and affected; that deficient and inadequate provisions contained in a number of such plans are directly responsible for hardships upon working men and women who are not realizing their expectations of pension benefits upon retirement; that there have been found to be serious consequences to such workers covered by these plans directly attributable to inadequate or nonexistent vesting provisions, lack of portability to permit the transfer of earned credits by employees from one employment to another; that terminations of plans beyond the control of employees, without necessary and adequate funding for benefit payments, has deprived employees and their dependents of earned benefits; that employee participants have not had sufficient information concerning their rights and responsibilities under the plans, resulting in loss of benefits without knowledge of same; that the lack of uniform minimum standards of conduct required of fiduciaries, administrators, and trustees has jeopardized the security of *employee benefits; and that it is therefore desirable, in the interests of employees and their beneficiaries, and in the interest of the free flow of commerce, that minimum standards be prescribed to assure that private pension and employee benefit plans be equitable in character and financially sound and properly administered.*

(b) It is the declared policy of this Act to protect interstate commerce, and the equitable interests of participants in private pension plans and their beneficiaries, by improving the scope, administration, and operation of such plans, by requiring pension plans to vest benefits in employees after equitable periods of service; to meet adequate minimum standards of funding; to promote greater transferability of employees' earned credits resulting from change of, or separation from employment; to protect vested benefits of employees against loss due to plan termination; to require more adequate disclosure and reports to participants and beneficiaries of plan administration and operations, including financial information by the plan to the participant, as may be necessary for the employees to have a comprehensive and better understanding of their rights and obligations to receive benefits from the plans in which they are participants; to establish minimum standards of fiduciary conduct; and to provi^d^e for more appropriate and adequate remedies, sanctions, and ready access to the courts.

DEFINITIONS

Sec. 3. As used in this Act—

(1) "Secretary" means the Secretary of Labor.

(2) "Office" means the Office of Pension and Welfare Plans Administration.

(3) "Assistant Secretary" means the Assistant Secretary of Labor in charge of the Office of Pension and Welfare Plans Administration.

(4) "State" means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, Guam, Wake Island, the Canal Zone, and Outer Continental Shelf lands defined in the Outer Continental Shelf Lands Act (43 U.S.C. 1331–1343).

(5) "Commerce" means trade, traffic, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place outside thereof.

(6) "Industry or activity affecting commerce" means any activity, business, or industry in commerce or in which a labor dispute would hinder or obstruct commerce or the free flow of commerce and includes any activity or industry affecting commerce within the meaning of the Labor-Management Relations Act, 1947, as amended, or the Railway Labor Act, as amended.

(7) "Employer" means any person acting directly as

an employer or indirectly in the interest of an employer in relation to a pension or profit-sharing-retirement plan, and includes a group or association of employers acting for an employer in such capacity.

(8) "Employee" means any individual employed by an employer.

(9) "Participant" means any employee or former employee of an employer or any member or former member of an employee organization who is or may become eligible to receive a benefit of any type from a pension or profit-sharing-retirement plan, or whose beneficiaries may be eligible to receive any such benefit.

(10) "Beneficiary" means a person designated by a participant or by the terms of a pension or profit-sharing-retirement plan who is or may become entitled to a benefit thereunder.

(11) "Person" means an individual, partnership, corporation, mutual company, joint-stock company, trust, unincorporated organization, association, or employee organization.

(12) "Employee organization" means any labor union or any organization of any kind, or any agency or employee representation committee, association, group, or program, in which employees participate and which exists for the purpose in whole or in part, of dealing with employers concern-

ing a pension or profit-sharing-retirement plan, or other matters incidental to employment relationships; or any employees' beneficiary association organized for the purpose, in whole or in part, of establishing or maintaining such a plan.

(13) The term "fund" means a fund of money or other assets maintained pursuant to or in connection with a pension or profit-sharing-retirement plan, and includes employee contributions withheld but not yet paid to the plan by the employer, or a contractual agreement with an insurance carrier. The term does not include any assets of an investment company subject to regulation under the Investment Company Act of 1940.

(14) "Pension plan" means any plan, fund, or program, other than a profit-sharing-retirement plan, which is communicated or its benefits described in writing to employees and which is established or maintained for the purpose of providing for its participants, or their beneficiaries, by the purchase of insurance or annuity contracts or otherwise, retirement benefits.

(15) "Profit-sharing-retirement plan" means a plan established or maintained by an employer to provide for the participation by the employees in the current or accumulated profits, or both the current and accumulated profits of the employer in accordance with a definite predetermined formula for allocating the contributions made to the plan

among the participants and for distributing the funds accumulated under the plan upon retirement or death. Such plan may include provisions permitting the withdrawal or distribution of the funds accumulated upon contingencies other than, and in addition to, retirement and death.

(16) "Registered plan" means a pension plan or profit-sharing-retirement plan registered and certified by the Secretary as a plan established and operated in accordance with title I of this Act.

(17) "Money purchase plan" refers to a pension plan in which contributions of the employer and employee (if any) are accumulated, with interest, or other income, to provide at retirement whatever pension benefits the resulting sum will buy.

(18) The term "administrator" means—

(A) the person specifically so designated by the terms of the pension or profit-sharing-retirement plan, collective bargaining agreement, trust agreement, contract, or other instrument, under which the plan is established or operated; or

(B) in the absence of such designation, (i) the employer in the case of a pension or profit-sharing-retirement plan established or maintained by a single employer, (ii) the employee organization in the case of such plan established or maintained by an employee

organization, or (iii) the association, committee, joint board of trustees, or other similar group of representatives of the parties who have established or maintain such plan, in the case of a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations.

(19) "Initial unfunded liability" means the amount (on the effective date of title II, or the effective date of the establishment of a pension plan or any amendment thereto, whichever is later), by which the assets of the plan are required to be augmented to insure that the plan is and will remain fully funded.

(20) "Unfunded liability" means the amount on the date when such liability is actuarially computed, by which the assets of the plan are required to be augmented to insure that the plan is and will remain fully funded.

(21) "Fully funded" with respect to any pension plan means that such plan at any particular time has assets determined, by a person authorized under section 101(b)(1), to be sufficient to provide for the payment of all pension and other benefits to participants then entitled or who may become entitled under the terms of the plan to an immediate or deferred benefit in respect to service rendered by such participants.

(22) "Experience deficiency" with respect to a pension plan means any actuarial deficit, determined at the time of a review of the plan, that is attributable to factors other than the existence of an initial unfunded liability or the failure of any employer to make any contribution required by the terms of the plan or by section 210, except insofar as such failure to make a required contribution is treated as an experience deficiency under section 217 (a) (1).

(23) "Funding" shall mean payment or transfer of assets into a fund, and shall also include payment to an insurance carrier to secure a contractual right pursuant to an agreement with such carrier.

(24) "Normal service cost" means the annual cost assigned to a pension plan, under the actuarial cost method in use (as of the effective date of title II or the date of establishment of a pension plan after such date), exclusive of any element representing any initial unfunded liability or interest thereon.

(25) "Special payment" means a payment made to a pension plan for the purpose of liquidating an initial unfunded liability or experience deficiency.

(26) "Nonforfeitable right" or "vested right" means a legal claim obtained to that part of an immediate or deferred life annuity which notwithstanding any conditions subsequent which could affect receipt of any benefit flowing from such

right, arises from the participant's covered service under the plan, and is no longer contingent on the participant remaining covered by the plan.

(27) "Covered service" means that period of service performed by a participant for an employer or as a member of an employee organization which is recognized under the terms of the plan or the collective bargaining agreement (subject to the requirements of part A of title II) for purposes of determining a participant's eligibility to receive pension benefits or for determining the amount of such benefits.

(28) "Normal retirement benefit" means that benefit payable under a pension or profit-sharing-retirement plan in the event of retirement at the normal retirement age.

(29) "Normal retirement age" means the normal retirement age, specified under the plan but not later than age 65 or, in the absence of plan provisions specifying the normal retirement age, age 65.

(30) "Pension benefit" means the aggregate, annual, monthly, or other amounts to which a participant will become or has become entitled upon retirement or to which any other person is entitled by virtue of such participant's death.

(31) "Accrued portion of normal retirement benefit" means that amount of benefit which, irrespective of whether the right to such benefit is nonforfeitable, is equal to—

(A) in the case of a profit-sharing-retirement plan or money purchase plan, the total amount (including all interest held in the plan) credited to the account of a participant;

(B) in the case of a unit benefit-type pension plan, the benefit units credited to a participant; or

(C) in the case of other types of pension plans, that portion of the prospective normal retirement benefit of a participant, which under rule or regulation of the Secretary is determined to constitute the participant's accrued portion of the normal retirement benefit under the terms of the appropriate plan.

(32) "Multi-employer plan" means a collectively bargained pension plan to which a substantial number of unaffiliated employers are required to contribute and which covers a substantial portion of the industry in terms of employees or a substantial number of employees in the industry in a particular geographic area.

(33) "Unaffiliated employers" means employers other than those under common ownership or control, or having the relationship of parent-subsidiary, or directly or indirectly controlling or controlled by another employer.

(34) "Qualified insurance carrier" means an insurance carrier subject to regulation and examination by the government of any State, which is determined by rule or regulation

of the Secretary to be suitable for the purchase of the single premium life annuity or the annuity with survivorship operations authorized under section 305(2).

(35) "Vested liabilities" means the present value of the immediate or deferred pension benefits for participants and their beneficiaries which are nonforfeitable and for which all conditions of eligibility have been fulfilled under the provisions of the plan prior to its termination.

(36) "Unfunded vested liabilities" means that amount of vested liabilities that cannot be satisfied by the assets of the plan, at fair market value, as determined by rule or regulation of the Secretary.

TITLE I—ORGANIZATION

PART A—ORGANIZATIONAL STRUCTURE

POWERS AND DUTIES OF THE SECRETARY

SEC. 101. (a) It shall be the duty of the Secretary—

(1) to promote programs and plans for the establishment, administration, and operations of pension, profit-sharing-retirement, and other employee benefit plans in furtherance of the findings and policies set forth in this Act;

(2) to determine, upon application by a pension or profit-sharing-retirement plan, such plan's eligibility for registration with the Secretary under section 105

and, upon qualification, to register such plan and issue appropriate certificates of registration;

(3) to cancel certificates of registration of pension and profit-sharing-retirement plans registered under section 105, upon determination by the Secretary that such plans are not qualified for such registration;

(4)(A) to direct, administer, and enforce the provisions and requirements of this Act and the Welfare and Pension Plans Disclosure Act, except where such provisions are only enforceable by a private party;

(B) to make appropriate and necessary inquires to determine violations of the provisions of this Act, or the Welfare and Pension Plans Disclosure Act, or any rule or regulation issued thereunder: Provided, however, That no periodic examination of the books and records of any plan or fund shall be conducted more than once annually unless the Secretary has reasonable cause to believe there may exist a violation of this Act, or the Welfare and Pension Plans Disclosure Act or any rule or regulation thereunder;

(C) for the purpose of any inquiry provided for in subparagraph (B), the provisions of sections 9 and 10 (relating to the attendance of witnesses and the production of books, papers, and documents) of the Federal Trade Commission Act of September 1, 1914,

are hereby made applicable to the jurisdiction, powers, and duties of the Secretary;

(5) to bring civil actions authorized by this Act and the Welfare and Pension Plan Disclosure Act and in all such proceedings attorneys appointed by the Secretary shall represent the Secretary except for proceedings in the Supreme Court;

(6) to appoint and fix the compensation of such employees as may be necessary for the conduct of his business under this Act in accordance with the provisions of title 5, United States Code, governing appointment in the competitive service, and chapter 51 and subchapter III of chapter 53 of such title relating to classification and General Schedule pay rates, and to obtain the services of experts and consultants as necessary in accordance with section 3109 of title 5, United States Code, at rates for individuals not to exceed the per diem equivalent for GS–18;

(7) to perform such other functions as may be necessary to carry out the purposes of this Act.

(b) The Secretary is authorized to prescribe rules and regulations—

(1) establishing standards and qualifications for persons responsible for performing services under this Act as actuaries and upon application of any such per-

son, to certify whether such person meets the standards and qualifications prescribed;

(2) establishing reasonable fees for the registration of pension and profit-sharing-retirement plans and other services to be performed by him in implementing the provisions of this Act, and all fees collected by the Secretary shall be paid into the general fund of the Treasury;

(3) establishing and maintaining reasonable limitations on actuarial assumptions, including, but not limited to, interest rates, mortality, and turnover rates, which reflect relevant experience;

(4) such as may be necessary or appropriate to carry out the purposes of this Act, including but not limited to definitions of actuarial, accounting, technical, and other trade terms in common use in the subject matter of this Act and the Welfare and Pension Plans Disclosure Act; and

(5) governing the form, detail, and inspection of all required records, reports, and documents, the maintenance of books and records, and the inspection of such books and records, as may be required under this Act.

(c)(1)(A) The Secretary is authorized and directed to undertake appropriate studies relating to pension and profit-sharing-retirement plans including but not limited to

the effects of this Act upon the provisions and costs of pension and profit-sharing-retirement plans, the role of private pensions in meeting retirement security needs of the Nation, the administration and operation of pension plans, including types and levels of benefits, degree of reciprocity or portability, financial characteristics and practices, methods of encouraging the growth of the private pension system, and advisability of additional coverage under this Act, including but not limited to plans of State and local governments exempt under section 104(b)(1).

(B) Without limiting the generality of subsection (c)(1)(A), the Secretary shall undertake a study of the sufficiency of the vesting provisions of this Act as applied to high-mobility employees, and shall recommend such changes in existing law and regulations as may be appropriate to afford to such employees adequate protection against unreasonable forfeiture of pension credits as a result of frequent job changes inherent in the conduct of their professions. In developing such recommendations, the Secretary shall consult with professional societies, industry representatives, and other interested groups with specialized knowledge of the problems of high-mobility workers. The study required by this subsection (c)(1)(B) shall be completed and submitted to the Congress within a year after the enactment of this Act.

(2) The Secretary shall submit annually a report to the Congress covering his activities under this Act during the preceding fiscal year, together with the results of such studies as are conducted pursuant to this Act, or, from time to time, pursuant to other Acts of Congress, and recommendations for such further legislation as may be advisable.

(d) Prior to promulgating rules or regulations, the Secretary shall consult with appropriate departments or agencies of the Federal Government to avoid unnecessary conflicts, duplications, or inconsistency with rules and regulations which may be applicable to such plans under other laws of the United States.

(e) In order to avoid unnecessary expense and duplication of functions among Government agencies, the Secretary may make such arrangements or agreements for cooperation or mutual assistance in the performance of his functions under this Act and the functions of any agency, Federal or State, as he may find to be practicable and consistent with law. The Secretary may utilize on a reimbursable basis the facilities or services of any department, agency, or establishment of the United States, or of any State, including services of any of its employees, with the lawful consent of such department, agency, or establishment; and each department, agency, or establishment of the United States is authorized and directed to cooperate with the Secretary, and to the extent permitted

by law, to provide such information and facilities as the Secretary may request for his assistance in the performance of his functions under this Act.

APPROPRIATIONS

Sec. 102. There are authorized to be appropriated such sums as may be necessary to enable the Secretary to carry out his functions and duties.

OFFICE OF ADMINISTRATION

Sec. 103. (a) There is hereby established within the Department of Labor an office to be known as the Office of Pension and Welfare Plan Administration. Such Office shall be headed by an Assistant Secretary of Labor who shall be appointed by the President, by and with the advice and consent of the Senate.

(b) It shall be the duty of the Assistant Secretary of Labor under the supervision of the Secretary to exercise such power and authority as may be delegated to him by the Secretary for the administration and enforcement of this Act.

(c) Paragraph 20, of section 5315, title 5, United States Code, is amended by striking "(5)" and inserting in lieu thereof "(6)".

(d) Such functions, books, records, and personnel of the Labor Management Services Administration as the Secretary determines are related to the administration of the

Welfare and Pension Plans Disclosure Act are hereby transferred to the Office of Pension and Welfare Plan Administration.

PART B—COVERAGE, EXEMPTIONS, AND REGISTRATION

COVERAGE AND EXEMPTIONS

SEC. 104. (a) Except as provided in subsections (b) and (c), titles II, III, and IV of this Act shall apply to any pension plan and any profit-sharing-retirement plan established or maintained by any employer engaged in interstate commerce or any industry or activity affecting interstate commerce or by any employer together with any employee organization representing employees engaged in commerce or in any industry or activity affecting such commerce or by any employee organization representing employees engaged in commerce or in any industry or activity affecting commerce.

(b) Titles II, III, and IV of this Act shall not apply to any pension plan or any profit-sharing-retirement plan if—

(1) such plan is established or maintained by the Federal Government or by the government of a State or by a political subdivision of the same or by any agency or instrumentality thereof;

(2) such plan is established or maintained by a religious organization described under section 501(c) of

th9 Internal Revenue Code of 1954 which is exempt from taxation under the provisions of section 501(a) of such Code;

(3) such plan is established or maintained for the benefit of self-employed individuals or owner-employees (as defined in section 401(c)(3) of the Internal Revenue Code of 1954);

(4) such plan covers not more than twenty-five participants;

(5) such plan is established or maintained outside the United States primarily for the benefit of employees who are not citizens of the United States and the situs of the employee benefit plan fund established or maintained pursuant to such plan is maintained outside the United States;

(6) such plan is unfunded and is established or maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management employees and is declared by the employer as not intended to meet the requirements of section 401(a) of the Internal Revenue Code; or

(7) such plan is established or maintained by an employee organization and financed solely by contributions from its members.

(c) Title IV and part B of title II shall not apply to profit-sharing-retirement plans or money purchase plans.

(d) Titles V and VI shall apply to any plan covered by the Welfare and Pension Plans Disclosure Act and any pension plan or profit-sharing-retirement plan covered by this Act.

REGISTRATION OF PLANS

SEC. 105. (a) Every administrator of a pension or profit-sharing-retirement plan to which title II, III, or IV apply shall file with the Secretary an application for registration of such plan. Such application shall be in such form and shall be accompanied by such documents as shall be prescribed by regulation of the Secretary. After qualification under subsection (c), the administrator of such plan shall comply with such requirements as may be prescribed by the Secretary to maintain the plan's qualification under this title.

(b) In the case of plans established on or after the effective date of this title, the filing required by subsection (a) shall be made within six months after such plan is established. In the case of plans established prior to the effective date of this title, such filing shall be made within six months after the effective date of regulations promulgated by the Secretary to implement this section but in no event later than twelve months after the date of enactment of this Act.

(c) Upon the filing required by subsection (a), the

Secretary shall determine whether such plan is qualified for registration under this title, and if the Secretary finds it qualified, he shall issue a certificate of registration with respect to such plan.

(d) If at any time the Secretary determines that a plan required to qualify under this title is not qualified or is no longer qualified for registration under this title, he shall notify the administrator, setting forth the deficiency or deficiencies in the plan or in its administration or operations which is the basis for the notification given, and he shall further provide the administrator, the employer of the employees covered by the plan (if not the administrator), and the employee organization representing such employees, if any, a reasonable time within which to remove such deficiency or deficiencies. If the Secretary thereafter determines that the deficiency or deficiencies have been removed, he shall issue or continue in effect the certificate, as the case may be. If he determines that the deficiency or deficiencies have not been removed, he shall enter an order denying or canceling the certificate of registration, and take such further action as may be appropriate under title VI.

(e) A pension or profit-sharing-retirement plan shall be qualified for registration under this section if it conforms to, and is administered in accordance with this Act, the Welfare and Pension Plans Disclosure Act, and in the case

of a pension plan subject to title IV of this Act, applies for and maintains plan termination insurance and pays the required assessments and premiums.

REPORTS ON REGISTERED PLANS

SEC. 106. The Secretary may, by regulations, provide for the filing of a single report satisfying the reporting requirements of this Act, and the Welfare and Pension Plans Disclosure Act.

AMENDMENTS OF REGISTERED PLANS

SEC. 107. Where a pension or profit-sharing-retirement plan filed for registration under this title is amended subsequent to such filing, the administrator shall (pursuant to regulations promulgated by the Secretary) file with the Secretary a copy of the amendment and such additional information and reports as the Secretary by regulation may require, to determine the amount of any initial unfunded liability created by the amendment, if any, and the special payments required to remove such liability.

CERTIFICATE OF RIGHTS

SEC. 108. The Secretary shall, by regulation, require each pension and profit-sharing-retirement plan to furnish or make available, whichever is the most practicable, to each participant, upon termination of service with a vested right to an immediate or a deferred pension benefit or other vested interest, with a certificate setting forth the benefits to *which he is entitled, including, but not limited to, the name and location of the entity responsible for payment, the amount of benefits, and the date when payment shall begin. A copy of each such certificate shalll be filed with the Secretary. Such certificate shall be deemed prima facie evidence of the facts and rights set forth in such certificate.*

TITLE II—VESTING AND FUNDING REQUIREMENTS

PART A—VESTING REQUIREMENTS

ELIGIBILITY

SEC. 201. No pension or profit-sharing-retirement plan filed for registration under this Act shall require as a condition for eligibility to participate in such a plan a period of service longer than one year or an age greater than twenty-five, whichever occurs later: Provided, however, That in the case of any plan which provides for immediate vesting of 100 per centum of earned benefits of participants, such plan may require as a condition for eligibility to participate in the plan, a period of service no longer than three years or an age greater than thirty, whichever occurs later.

VESTING SCHEDULE

SEC. 202. (a) All pension or profit-sharing-retirement plans filed for registration under this Act, except as provided for in paragraphs (2) and (3) herein, shall provide under the terms of the plan with respect to the accrued por-

tion of the normal retirement benefit attributable to covered service both before and after the effective date of the title, that:

(1) a plan participant who has been in covered service under the plan for a period of eight years is entitled upon termination of service prior to attaining normal retirement age—

(A) in the case of a pension plan, to a deferred pension benefit commencing at his normal retirement age; or

(B) in the case of a profit-sharing-retirement plan, to a nonforfeitable right to his interest in such plan

equal to 30 per centum of the accrued portion of the normal retirement benefit as provided by the plan in respect of such service, or of such interest, respectively, and such entitlement shall increase by 10 per centum per year thereafter of covered service until the completion of fifteen years of covered service after which such participant shall be entitled upon termination of service prior to attaining normal retirement age to a deferred pension benefit commencing at his normal retirement age equal to 100 per centum of the accrued portion of the normal retirement benefit as provided by the plan *with respect to such service, or to the full amount of such interest in the profit-sharing-retirement plan;*

(2) in the event a plan is established or amended after the effective date of this title, the requirements of paragraph (1) of this subsection need only apply to service rendered after the date of the plan's establishment or the date of such plan amendment with respect to any improvement in benefits made by such amendment.

(3) if the plan is a class year plan, then such plan shall provide that the participant shall acquire a nonforfeitable right to 100 per centum of the employer's contribution on his behalf with respect to any given year, not later than the end of the fifth year following the year for which such contribution was made. For the purposes of this paragraph, the term "class year plan" means a profit-sharing-retirement plan which provides for the separate vesting of each annual contribution made by the employer on behalf of a participant.

(4) the pension benefits provided under the terms of a pension plan, and the interest in a profit-sharing-retirement plan referred to in subparagraph (B) of paragraph (1) shall not be capable of assignment or alienation and shall not confer upon an employee, personal representative, or dependent, or any other person, any

right or interest in such pension benefits or profit-sharing-retirement plan, capable of being assigned or otherwise alienated; except that where a plan fails to make appropriate provisions therefor, the Secretary shall, by regulation, provide for the final disposition of plan benefits or interests when beneficiaries cannot be located or ascertained within a reasonable time.

(b) Any participant covered under a plan, for the number of years required for a vested right under this section, shall be entitled to such vested right regardless of whether his years of covered service are continuous, except that a plan may provide that—

(1) three of the eight years required to qualify for the 30 per centum vested right under subsection (a) shall be continuous under standards prescribed under subsection (c),

(2) service by a participant prior to the age of twenty-five may be ignored in determining eligibility for a vested right under this section, unless such participant or an employer has contributed to the plan with respect to such service, and

(3) in the event a participant has attained a vested right equal to 100 per centum of the accrued portion of the normal retirement benefit as provided by the plan with respect to such service, or to the full amount of

such interest in a profit-sharing-retirement plan, and such participant has been separated permanently from coverage under the plan and subsequently returns to coverage under the same plan, such participant may be treated as a new participant for purposes of the vesting requirements set forth in section 202(a)(1) without regard to his prior service.

(c) The Secretary shall prescribe standards, consistent with the purposes of this Act, governing the maximum number of working hours, days, weeks, or months, which shall constitute a year of covered service, or a break in service for purposes of this Act. In no case shall a participant's time worked in any period in which he is credited for a period of service for the purposes of this section, be credited to any other period of time unless the plan so provides.

(d) Notwithstanding any other provision of this Act, a pension or profit-sharing-retirement plan may allow for vesting of pension benefits after a lesser period than is required by this section.

(e) Notwithstanding any other provision of this Act, the Secretary may grant a waiver of the requirements of section 202(a)(1) where he determines, upon application for such waiver by the plan administrator, that svch plan contains vesting provisions which assure a degree of vesting protection as equitable as the vesting schedules set forth in

section 202(a)(1). The Secretary shall prescribe the manner in which affected or interested parties shall be notified of such pending application.

PART B—FUNDING

FUNDING REQUIREMENTS

SEC. 210. (a) Unless a waiver is granted pursuant to part C of this title, every pension plan filed for registration under this Act shall provide for funding, in accordance with the provisions of this part, which is adequate to provide for payment of all pension benefits which may be payable under the terms of the plan.

(b) Provisions in the plan for funding shall set forth the obligation of the employer or employers to contribute both in respect of the normal service cost of the plan and in respect of any initial unfunded liability and experience deficiency. The contribution of the employer, including any contributions made by employees, shall consist of the payment into the plan or fund of—

(1) all normal service costs; and

(2) where the plan has an initial unfunded liability, special payments consisting of no less than equal amounts sufficient to amortize such unfunded liabilities over a term not exceeding:

(A) in the case of an initial unfunded liability existing on the effective date of this title, in any

plan established before that date, thirty years from such date;

(B) in the case of an initial unfunded liability resulting from the establishment of a pension plan, or an amendment thereto, on or after the effective date of this title, thirty years from the date of such establishment or amendment, except that in the event that any such amendment after the effective date of this title results in a substantial increase to any unfunded liability of the plan, as determined by the Secretary, such increase shall be regarded as a new plan for purposes of the funding schedule imposed by this subsection and the plan termination insurance requirements imposed by title IV.

(3) special payments, where the plan has an experience deficiency, consisting of no less than equal annual amounts sufficient to remove such experience deficiency over a term not exceeding five years from the date on which the experience deficiency was determined, except where the experience deficiency cannot be removed over a five-year period without the amounts required to remove such deficiency exceeding the allowable limits for a tax deduction under the Internal Revenue Code of 1954 for any particular year during which such payments must be made, the Secretary shall, consistent with the pur-

poses of this subsection, prescribe such additional time as may be necessary to remove such deficiency within allowable tax deduction limitations.

(c) Within six months after the effective date of rules promulgated by the Secretary to implement this title (but in no event more than 12 months after the effective date of this title) or within six months after the date of plan establishment, whichever is later, the plan administrator shall submit a report of an actuary (certified under section 101(b)) stating—

(1) the estimated cost of benefits in respect of service for the first plan year for which such plan is required to register and the formula for computing such cost in subsequent years up to the date of the following report;

(2) the initial unfunded liability, if any, for benefits under the pension plan as of the date on which the plan is required to be registered;

(3) the special payments required to remove such unfunded liability and experience deficiencies in accordance with subsection (b);

(4) the actuarial assumptions used and the basis for using such actuarial assumptions; and

(5) such other pertinent actuarial information required by the Secretary.

(d) The administrator of a registered pension plan shall cause the plan to be reviewed not less than once every five years by a certified actuary and shall submit a report of such actuary stating—

(1) the estimated cost of benefits in respect of service in the next succeeding five-year period and the formula for computing such cost for such subsequent five-year period;

(2) the surplus or the experience deficiency in the pension plan after making allowance for the present value of all special payments required to be made in the future by the employer as determined by previous reports;

(3) the special payments which will remove any such experience deficiency over a term not exceeding five years;

(4) the actuarial assumptions used and the basis for using such actuarial assumptions; and

(5) such other pertinent actuarial information required by the Secretary.

If any such report discloses a surplus in a pension plan, the amount of any future payments required to be made to the fund or plan may be reduced or the amount of benefits may be increased by the amount of such surplus, subject to the *provisions of the Internal Revenue Code of 1954 and regulations promulgated thereunder. The reports under this subsection shall be filed with the Secretary by the administrator as part of the annual report required by section 7 of the Welfare and Pension Plans Disclosure Act, at such time that the report under such section 7 is due with respect to the last year of such five-year period.*

(e) Where an insured pension plan is funded exclusively by the purchase of individual insurance contracts which—

(1) require level annual premium payments to be paid extending not beyond the retirement age for each individual participant in the plan, and commencing with the participant's entry into the plan (or, in the case of an increase in benefits, commencing at the time such increase becomes effective), and

(2) benefits provided by the plan are equal to the benefits provided under each contract, and are guaranteed by the insurance carrier to the extent premiums have been paid,

such plan shall be exempt from the requirements imposed by subsections (b) (2) and (3), (c), and (d) of this section.

(f) The Secretary may exempt any plan, in whole or in part, from the requirement that such reports be filed where the Secretary finds such filing to be unnecessary.

DISCONTINUANCE OF PLANS

Sec. 211. (a) Subject to the authority of the Secretary to provide exemptions or variances where necessary to avoid substantial hardship to participants or beneficiaries, upon complete termination or substantial termination (as determined by the Secretary), of a pension plan, and subject to the provisions of the Internal Revenue Code and regulations promulgated thereunder, relating to limitations applicable to the twenty-five highest paid employees of an employer, all assets of the plan shall be applied under the terms of the plan, as follows—

(1) first, to refund to nonretired participants in the plan the amount of contributions made by them;

(2) second, to participants in the plan who have retired prior to the date of such termination and have been receiving benefits under the plan;

(3) third, to those participants in the plan who, on the date of such termination had the right to retire and receive benefits under the plan;

(4) fourth, to those participants in the plan who had acquired vested rights under the plan prior to termination of the plan but had not reached normal retirement age on the date of such termination; and

(5) fifth, to any other participants in the plan who are entitled to benefits under the plan pursuant to the

requirements of section 401(a)(7) of the Internal Revenue Code of 1954.

(b) Upon complete termination, or substantial termination (as determined by the Secretary), any party obligated to contribute to the plan pursuant to section 210(b), or to contribute on behalf of employees pursuant to a withholding or similar arrangement, shall be liable to pay all amounts that would otherwise have been required to be paid to meet the funding requirements prescribed by section 210 up to the date of such termination to the insurer, trustee, or administrator of the plan or the Pension Benefit Insurance Fund in the circumstances described by section 404(c).

(c) Upon complete termination, or substantial termination (as determined by the Secretary), of a profit-sharing-retirement plan, the interests of all participants in such plan shall fully vest.

(d) In any case, the Secretary may approve payment of survivor benefits with priorities equal to those of the employees or former employees on whose service such benefits are based.

PART C—VARIANCES

DEFERRED APPLICABILITY OF VESTING STANDARDS

SEC. 216. (a) Where, upon application to the Secretary by the plan administrator and notice to affected or interested parties, the Secretary may defer, in whole or in part, *applicability of the requirements of part A of this title for a period not to exceed five years from the effective date of title II, upon a showing that compliance with the requirements of part A on the part of a plan in existence on the date of enactment of this Act would result in increasing the costs of the employer or employers contributing to the plan to such an extent that substantial economic injury would be caused to such employer or employers and to the interests of the participants or beneficiaries in the plan.*

(b) For purposes of subsection (a), the term "substantial economic injury" includes, but is not limited to, a showing that (1) a substantial risk to the capability of voluntarily continuing the plan exists, (2) the plan will be unable to discharge its existing contractual obligations for benefits, (3) a substantial curtailment of pension or other benefit levels or the levels of employees' compensation would result, or (4) there will be an adverse effect on the levels of employment with respect to the work force employed by the employer or employers contributing to the plan.

(c)(1) In the case of any plan established or maintained pursuant to a collective bargaining agreement, no application for the granting of the variance provided for under subsection (a) shall be considered by the Secretary unless it is submitted by the parties to the collective bargaining agreement or their duly authorized representatives.

(2) As to any application for a variance under subsection (a) submitted by the parties to a collective bargaining agreement or their duly authorized representatives, the Secretary shall accord due weight to the experience, technical competence, and specialized knowledge of the parties with respect to the particular circumstances affecting the plan, industry, or other pertinent factors forming the basis for the application.

VARIANCES FROM FUNDING REQUIREMENTS

SEC. 217. (a) Where, upon application to the Secretary by the plan administrator and notice to affected or interested parties, the Secretary determines that—

(1) any employer or employers are unable to make annual contributions to the plan in compliance with the funding requirements of section 210(b) (2) or (3), and he has reason to believe that such required payment for that annual period cannot be made by such employer or employers, the Secretary may waive the annual contribution otherwise required to be paid, and prescribe an additional period of not more than five years for the amortization of such annual funding deficiency, during which period the funding deficiency shall be removed by no less than equal annual payments. Any funding deficiency permitted under this section shall be treated for

the purposes of any actuarial report required under this Act as an experience deficiency under section 210;

(2) no waiver shall be granted unless the Secretary is satisfied after a review of the financial conditions of the plan and other related matters that—

(A) such waiver will not adversely affect the interests of participants or beneficiaries of such plan; or

(B) will not impair the capability of the Pension Benefit Insurance Fund to equitably underwrite vested benefit losses in accordance with title IV; and

(3) waivers granted pursuant to this provision shall not exceed five consecutive annual waivers.

(b) Where a plan has been granted five consecutive waivers pursuant to subsection (a), the Secretary may—

(1) order the merger or consolidation of the deficiently funded plan with such other plan or plans or the contributing employer or employers in a manner that will result in future compliance with the funding requirements of part B of title II of this Act without adversely affecting the interests of participants and beneficiaries in all plans which may be involved;

(2) where necessary to protect the interests of participants or beneficiaries, or to safeguard the capa-

bility of the Pension Benefit Insurance Fund to equitably underwrite vested benefit losses, under title IV, order plan termination in accordance with such conditions as the Secretary may prescribe; or

(3) take such other action as may be necessary to fulfill the purposes of this Act.

(c) No amendments increasing plan benefits shall be permitted during any period in which a funding waiver is in effect.

(d)(1) Notwithstanding the requirements of part B of title II of this Act the Secretary shall by rule or regulation prescribe alternative funding requirements for multiemployer plans which will give reasonable assurances that the plan's benefit commitments will be met.

(2) The period of time provided to fund such multiemployer plans shall be a period which will give reasonable assurances that the plan's benefit commitments will be met and which reflects the particular circumstances affecting the plan, industry, or other pertinent factors, except that no period prescribed by the Secretary shall be less than thirty years.

(3) No multiemployer plan shall increase benefits beyond a level for which the contributions made to the plan would be determined to be adequate unless the contribution rate is commensurately increased.

(e) Upon a showing by the plan administrator of a multiemployer plan that the withdrawal from the plan by any employer or employers has or will result in a significant reduction in the amount of aggregate contributions to the plan, the Secretary may take the following steps:

(1) require the plan fund to be equitably allocated between those participants no longer working in covered service under the plan as a result of their employer's withdrawal, and those participants who remain in covered service under the plan;

(2) treat that portion of the plan fund allocable under (1) to participants no longer in covered service, as a terminated plan for the purposes of the plan termination insurance provisions of title IV; and

(3) treat that portion of the plan fund allocable to participants remaining in covered service as a new plan for purposes of the funding standards imposed by part B of title II of this Act, any variance granted by this section, and the plan termination insurance provisions of title IV.

(f) In considering the experience of multiemployer plans for purposes of establishing new premium rates under section 403(b)(3)(A) the Secretary shall take into account for purposes of prescribing lower premium rates, the withdrawal of

employers from such plans for which the variance provided in subsection (e) was not available.

PART D—PROTECTION OF PENSION RIGHTS UNDER GOVERNMENT CONTRACTS

FINDINGS

SEC. 220. The Congress finds that because of rapid and frequent changes in Federal procurement objectives and policies, professional, scientific, and technical personnel suffer a uniquely high rate of forfeiture of pension benefits under private pension plans, as such employees tend to change employment more frequently than other workers. The Congress declares that it is the policy of the United States to seek to protect professional, scientific, and technical personnel from such forfeitures by making protection against forfeiture of pension credits, otherwise provided, a condition of compliance with Federal procurement regulations.

DEVELOPMENT OF REGULATIONS

SEC. 221. The Secretary shall develop, in consultation with appropriate professional societies, business organizations, and heads of interested Federal departments and procurement agencies, recommendations for modifications of Federal procurement regulations to insure that professional, scientific, and technical personnel and others working in associated occupations employed under Federal procurement, construction, or research contracts or grants shall, *to the extent feasible, be protected against forfeitures of pension ~~or~~ retirement rights or benefits, otherwise provided, as a consequence of job transfers or loss of employment resulting from terminations or modifications of Federal contracts, grants, or procurement policies.*

PUBLICATION

SEC. 222. Recommended changes in regulations governing Federal contracts, grants, or procurement policies shall be developed by the Secretary, as required by section 221, within six months after enactment of this Act, and shall be published in the Federal Register within fifteen days thereafter as proposed regulations subject to comment by interested parties.

RECOMMENDATIONS

SEC. 223. After publication under section 222, receipt of comments, and such modification of the published proposals as the Secretary deems appropriate, the recommended changes in procurement regulations developed under this title shall be adopted by each Federal department and procurement agency within sixty days thereafter unless the head of such department or agency determines that such changes would not be in the national interest or would not be consistent with the primary objectives of such department or agency.

TITLE III—VOLUNTARY PORTABILITY PROGRAM FOR VESTED PENSIONS

PROGRAM ESTABLISHED

SEC. 301. (a) There is hereby established a program to be known as the Voluntary Portability Program for Vested Pensions (hereinafter referred to as the "Portability Program"), which shall be administered by and under the direction of the Secretary. The Portability Program shall facilitate the voluntary transfer of vested credits between registered pension or profit-sharing-retirement plans. Nothing in this title or in the regulations issued by the Secretary hereunder shall be construed to require participation in such Portability Program by a plan as a condition of registration under this Act.

(b) Pursuant to regulations issued by the Secretary, plans registered under this Act may apply for membership in the Portability Program, and, upon approval of such application by the Secretary, shall be issued a certificate of membership in the Portability Program (plans so accepted shall be hereinafter referred to as "member plans").

ACCEPTANCE OF DEPOSITS

SEC. 302. A member plan shall, pursuant to regulations prescribed by the Secretary, pay, upon request of the participant, to the fund established by section 303, a sum of money equal to the current discounted value of the participant's vested rights under the plan, which are in settlement of *such vested rights, when such participant is separated from employment covered by the plan before the time prescribed for payments to be made to him or to his beneficiaries under the plan. The fund is authorized to receive such payments, on such terms as the Secretary may prescribe.*

SPECIAL FUND

SEC. 303. (a) There is hereby created a fund to be known as the Voluntary Portability Program Fund (hereinafter referred to as the "Fund"). The Secretary shall be the trustee of the Fund. Payments made into the Fund in accordance with regulations prescribed by the Secretary under section 302 shall be held and administered in accordance with this title.

(b) With respect to such Fund, it shall be the duty of the Secretary to—

(1) administer the Fund;

(2) report to the Congress not later than the first day of April of each year on the operation and the status of the Fund during the preceding fiscal year and on its expected operation and status during the current fiscal year and the next two fiscal years and review the general policies followed in managing the Fund and recommend changes in such policies, including the necessary changes in the provisions of law which govern the way in which the Fund is to be managed; and

(3) after amounts needed to meet current and anticipated withdrawals are set aside, deposit the surplus in interest-bearing accounts in any bank the deposits of which are insured by the Federal Deposit Insurance Corporation or savings and loan association in which the accounts are insured by the Federal Savings and Loan Insurance Corporation. In no case shall such deposits exceed 10 per centum of the total of such surplus, in any one bank, or savings and loan association.

INDIVIDUAL ACCOUNTS

SEC. 304. The Secretary shall establish and maintain an account in the Fund for each participant for whom the Secretary receives payment under section 302. The amount credited to each account shall be adjusted periodically, as provided by the Secretary pursuant to regulations to reflect changes in the financial condition of the Fund.

PAYMENTS FROM INDIVIDUAL ACCOUNTS

SEC. 305. Amounts credited to the account of any participant under this title shall be paid by the Secretary to—

(1) a member plan, for the purchase of credits having at least an equivalent actuarial value under such plan, on the request of such participant when he becomes a participant in such member plans;

(2) a qualified insurance carrier selected by a participant who has attained the age of sixty-five, for the purchase of a single premium life annuity in an amount

having a present value equivalent to the amount credited to such participant's account, or in the event the participant selects an annuity with survivorship options, an amount determined by the Secretary to be fair and reasonable based on the amount in such participant's account; or

(3) to the designated beneficiary of a participant in accordance with regulations promulgated by the Secretary.

TECHNICAL ASSISTANCE

SEC. 306. The Secretary shall provide technical assistance to employers, employee organizations, trustees, and administrators of pension and profit-sharing-retirement plans in their efforts to provide greater retirement protection for individuals who are separated from employment covered under such plans. Such assistance may include, but is not limited to (1) the development of reciprocity arrangements between plans in the same industry or area, and (2) the development of special arrangements for portability of credits within a particular industry or area.

TITLE IV—PLAN TERMINATION INSURANCE

ESTABLISHMENT AND APPLICABILITY OF PROGRAM

SEC. 401. (a) There is hereby established a program to be known as the Private Pension Plan Termination Insurance Program (hereinafter referred to as the "Insurance

Program"), which shall be administered by and under the direction of the Secretary.

(b) Every plan subject to this title shall obtain and maintain plan termination insurance to cover unfunded vested liabilities incurred prior to enactment of the Act as well as after enactment of the Act.

(c) Upon application by an administrator and the payment of required fees and premiums, the Secretary may provide insurance to cover the unfunded vested liabilities of a plan not otherwise covered by this Act where he determines that such plan conforms with the vesting, funding and all other standards, rules, or regulations required by this Act.

CONDITIONS OF INSURANCE

SEC. 402. (a) The insurance program shall insure participants and beneficiaries of those plans registered under this Act against loss of benefits derived from vested rights which arise from the complete or the substantial termination of such plans, as determined by the Secretary.

(b) The rights of participants and beneficiaries of a registered pension plan shall be insured under the insurance program only to the extent that—

(1) such rights as provided for in the plan do not exceed: (A) in the case of a right to a monthly retirement or disability benefit for the employee himself, the lesser of 50 per centum of the average monthly wage he re-

ceived from the contributing employer in the five-year period after the registration date of the plan for which his earnings were its greatest, or $500 a month; (B) in the case of a right of one or more dependents or members of the participant's family, or in the case of a right to a lump-sum survivor benefit on account of the death of a participant, an amount no greater than the amount determined under clause (A);

(2) the plan is terminated more than three years after the date of its establishment or its initial registration with the Secretary, except that the Secretary may in his discretion authorize insurance payments in such amounts as may be reasonable to any plan terminated in less than three years after the date of its initial registration with the Secretary where (A) such plan has been established and maintained for more than three years prior to its termination, (B) the Secretary is satisfied that during the period the plan was unregistered, it was in substantial compliance with the provisions of this Act, and (C) such payments will not prevent equitable underwriting of losses of vested benefits arising from plan terminations otherwise covered by this title;

(3) such rights were created by a plan amendment

which took effect more than three years immediately preceding termination of such plan; and

(4) such rights do not accrue to the interest of a participant who is the owner of 10 per centum or more of the voting stock of the employer contributing to the plan, or of the same percentage interest in a partnership contributing to the plan.

ASSESSMENTS AND PREMIUMS

SEC. 403. (a) Upon registration with the Secretary, each plan shall pay a uniform assessment to the insurance program as prescribed by the Secretary to cover the administrative costs of the insurance program.

(b)(1) Each registered pension plan shall pay an annual premium for insurance at uniform rates established by the Secretary based upon the amount of unfunded vested liabilities subject to insurance under section 402.

(2) For the three-year period immediately following the effective date of this title such premium shall—

(A) not exceed 0.2 per centum of a plan's unfunded vested liabilities with respect to such unfunded vested liabilities incurred after the date of enactment of this Act;

(B) not exceed 0.2 per centum of a plan's unfunded vested liabilities incurred prior to the date of enactment of this Act, where such plan's median ratio of plan

assets to unfunded vested liabilities was 75 per centum during the five-year period immediately preceding the enactment of this Act, or in the event of a plan established within the five-year period immediately preceding the date of enactment of this Act, where the plan has reduced the amount of such unfunded vested liabilities at the rate of at least 5 per centum each year since the plan's date of establishment;

(C) not exceed 0.4 per centum or be less than 0.2 per centum of a plan's unfunded vested liabilities incurred prior to the date of enactment of this Act where such plan does not meet the standards set forth in subparagraph (B);

(D) not exceed 0.2 per centum of a plan's unfunded vested liabilities regardless of whether such liabilities were incurred prior to or subsequent to the date of enactment of this Act with respect to multiemployer plans.

(3)(A) The Secretary is authorized to prescribe different uniform premium rates-after the initial three-year period based upon experience and other relevant factors.

(B) Any new rates proposed by the Secretary shall be effective at the end of the first period of ninety calendar days of continuous session of the Congress after the date on which the proposed rates are published in the Federal Register.

(C) For the purpose of subparagraph (B)—

(i) continuity of a session is broken only by an adjournment sine die; and

(ii) the days on which either House is not in session because of an adjournment of more than three days to a day certain are excluded in the computation of the ninety-day period.

(c) Assessments and premiums referred to in this section shall be prescribed by the Secretary only after consultation with appropriate Government agencies and private persons with expertise on matters relating to assessment and premium structures in insurance and related matters, and after notice to all interested persons and parties.

PAYMENT OF INSURANCE

SEC. 404. (a) Every plan insured under this title shall provide adequate prior notice to the Secretary of intent to terminate the plan, and in the event such notice is not provided and the plan is terminated, the person or persons responsible for failing to give such notice shall be personally liable for any losses incurred by the Pension Benefit Insurance Fund in connection with any plan termination.

(b) As determined by the Secretary, subject to the conditions specified in section 402, the amount of insurance payable under the insurance program shall be the difference

between the realized value of the plan's assets and the amount of vested liabilities under the plan.

(c) The Secretary shall, by regulation, prescribe the procedures under which the funds of terminated plans shall be wound up and liquidated and the proceeds therefrom applied to payment of the vested benefits of participants and beneficiaries. In implementing this paragraph, the Secretary shall have authority to:

(1) transfer the terminated fund to the Pension Benefit Insurance Fund for purposes of liquidation and payment of benefits to participants and beneficiaries;

(2) purchase single-premium life annuities from qualified insurance carriers from the proceeds of the terminated plan on terms determined by the Secretary to be fair and reasonable; or

(3) take such other action as may be appropriate to assure equitable arrangements for the payment of vested benefits to participants and beneficiaries under the plan.

(d) Any person or persons who terminate a plan insured under this title, with intent to avoid or circumvent the purposes of this Act or in violation of the requirements of this Act or those of the Welfare and Pension Plan Disclosure Act shall be personally liable for any losses incurred by the

Pension Benefit Insurance Fund in connection with such plan termination.

RECOVERY

SEC. 405. (a) Where the employer or employers contributing to the terminatiing plan or who terminated the plan are not insolvent (within the meaning of section 1(19) of the Bankruptcy Act), such employer or employers (or any successor in interest to such employer or employers) shall be liable to reimburse the insurance program for any insurance benefits paid by the program to the beneficiaries of such terminated plan to the extent provided in this section.

(b) An employer, determined by the Secretary to be liable for reimbursement under subsection (a), shall be liable to pay 100 per centum of the terminated plan's unfunded vested liabilities on the date of such termination. In no event however, shall the employer's liability exceed 50 per centum of the net worth of such employer.

(c) The Secretary is authorized to make arrangements with employers, liable under subsection (a), for reimbursement of insurance paid by the Secretary, including arrangements for deferred payment on such terms and for such periods as are deemed equitable and appropriate.

(d)(1) If any employer or employers liable for any amount due under subsection (a) of this section neglects or refuses to pay the same after demand. the amount (including

interest) shall be a lien in favor of the United States upon all property and rights in property, whether real or personal, belonging to such employer or employers.

(2) The lien imposed by paragraph (1) of this subsection shall not be valid as against a lien created under section 6321 of the Internal Revenue Code of 1954.

(3) Notice to the lien imposed by paragraph (1) of this subsection shall be filed in a manner and form prescribed by the Secretary. Such notice shall be valid notwithstanding any other provision of law regarding the form and content of a notice of lien.

(4) The Secretary shall promulgate rules and regulations with regard to the release of any lien imposed by paragraph (1) of this subsection.

PENSION BENEFIT INSURANCE FUND

Sec. 406. (a) There is hereby created a separate fund for pension benefit insurance to be known as the Pension Benefit Insurance Fund (hereafter in this section called the insurance fund) which shall be available to the Secretary without fiscal year limitation for the purposes of this title. The Secretary shall be the trustee of the insurance fund.

(b) All amounts received as premiums, assessments, or fees, and any other moneys, property, or assets derived from operations in connection with this title shall be deposited in the insurance fund.

(c) All claims, expenses, and payments pursuant to operation of the program under this title shall be paid from the insurance fund.

(d) All moneys of the insurance fund may be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States.

(e) With respect to such insurance fund, it shall be the duty of the Secretary to—

(1) administer the insurance fund; and

(2) report to the Congress not later than the first day of April of each year on the operation and the status of the insurance fund during the preceding fiscal year and on its expected operation and status during the current fiscal year and the next two fiscal years and review the general policies followed in managing the insurance fund and recommend changes in such policies, including the necessary changes in the provisions of law which govern the way in which the insurance fund is to be managed.

TITLE V—DISCLOSURE AND FIDUCIARY STANDARDS

SEC. 501. In addition to the filing requirements of the Welfare and Pension Plans Disclosure Act, it shall be a condition of compliance with section 7 of such Act that each annual report hereinafter filed under that section shall be *accompanied by a certificate or certificates in the name of and on behalf of the plan, the administrator, and any employer or employee organization participating in the establishment of the plan, designating the Secretary as agent for service of process on the persons and entities executing such certificate or certificates in any action arising under the Welfare and Pension Plans Disclosure Act or this Act.*

SEC. 502. (a) Section 3 of the Welfare and Pension Plans Disclosure Act (72 Stat. 997) is amended by adding at the end thereof the following new paragraphs:

"(14) The term 'relative' means a spouse, ancestor, descendant, brother, sister, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

"(15) The term 'administrator' means—

"(A) the person specifically so designated by the terms of the plan, collective bargaining agreement, trust agreement, contract, or other instrument, under which the plan is operated; or

"(B) in the absence of such designation (i) the employer in the case of an employee benefit plan established or maintained by a single employer, (ii) the employee organization in the case of a plan established or maintained by an employee organization, or (iii) the association, committee, joint board of trustees, or other

similar group of representatives of the parties who established or maintained the plan, in the case of a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations.

"(16) The term 'employee benefit plan' or 'plan' means an employee welfare benefit plan or an employee pension benefit plan or a plan providing both welfare and pension benefits.

"(17) The term 'employee benefit fund' or 'fund' means a fund of money or other assets maintained pursuant to or in connection with an employee benefit plan and includes employee contributions withheld but not yet paid to the plan by the employer. The term does not include: (A) any assets of an investment company subject to regulation under the Investment Company Act of 1940; (B) premium, subscription charges, or deposits received and retained by an insurance carrier or service or other organization, except for any separate account established or maintained by an insurance carrier.

"(18) The term 'separate account' means an account established or maintained by an insurance company under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against

such account without regard to other income, gains, or losses of the insurance company.

"(19) The term 'adequate consideration' when used in section 15 means either (A) at no more than the price of the security prevailing on a national securities exchange which is registered with the Securities and Exchange Commission, or (B) if the security is not traded on such a national securities exchange, at a price not less favorable to the fund than the offering price for the security as established by the current bid and asked prices quoted by persons independent of the issuer, or (C) if the price of the security is not quoted by persons independent of the issuer, a price determined to be the fair value of the security.

"(20) The term 'nonforfeitable pension benefit' means a legal claim obtained by a participant or his beneficiary to that part of an immediate or deferred pension benefit which, notwithstanding any conditions subsequent which would affect receipt of any benefit flowing from such right, arises from the participant's covered service under the plan and is no longer contingent on the participant remaining covered by the plan.

"(21) The term 'covered service' means that period of service performed by a participant for an employer or as a member of an employee organization which is recognized under the terms of the plan or the collective-bargaining agreement (subject to the requirements of the Retirement Income

Security for Employees Act), for purposes of determining a participant's eligibility to receive pension benefits or for determining the amount of such benefits.

"(22) The term 'pension benefit' means the aggregate, annual, monthly, or other amounts to which a participant has or will become entitled upon retirement or to which any other person is entitled by virtue of such participant's death.

"(23) The term "accrued portion of normal retirement benefit' means that amount of such benefit which, irrespective of whether the right to such benefit is nonforfeitable, is equal to—

"(A) in the case of a profit-sharing-retirement plan or money purchase plan, the total amount credited to the account of a participant;

"(B) in the case of a unit benefit-type pension plan, the benefit units credited to a participant; or

"(C) in the case of other types of pension plans, that portion of the prospective normal retirement benefit of a participant that, pursuant to rule or regulation under the Retirement Income Security for Employees Act, is determined to constitute the participant's accrued portion of the normal retirement benefit under the terms of the appropriate plan.

"(24) The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certifi-

cate of interest or parti̇cipation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in, or, in general, any interest or instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

"(25) The term 'fiduciary' means any person who exercises any power of control, management, or disposition with respect to any moneys or other property of any employee benefit fund, or has authority or responsibility to do so.

"(26) The term 'market value' or 'value' when used in this Act means fair market value where available, and otherwise the fair value as determined pursuant to rule or regulation under this Act."

(b) Paragraph (1) of section 3 of such Act is amended by inserting the words "or maintained" after the word "established", by inserting a comma after the word "unemployment", and by adding the following: "or benefits of the type described or permitted by section 302(c) of the Labor-Management Relations Act".

(c) Paragraph (2) of section 3 of such Act is amended

by inserting the words "or maintained" after the word "established".

(d) Paragraph (3) of section 3 of such Act is amended by striking out the word "plan" the first time it appears and inserting in lieu thereof the word "program".

(e) Paragraphs (3), (4), (6), and (7) of section 3 of such Act are amended by striking out the words "welfare or pension" wherever they appear.

(f) Paragraph (13) of section 3 of such Act is amended to read as follows:

"(13) The term 'party in interest' means as to an employee benefit plan or fund, any administrator, officer, fiduciary, trustee, custodian, counsel, or employee of any employee benefit plan, or a person providing benefit plan services to any such plan, or an employer, any of whose employees are covered by such a plan or any person controlling, controlled by, or under common control with, such employer or officer or employee or agent of such employer or such person, or an employee organization having members covered by such plan, or an officer or employee or agent of such an employee organization, or a relative, partner, or joint venturer or any of the above-described persons. Whenever the term 'party in interest' is used in this Act, it shall mean a person known to be a party in interest. If any moneys or other property of an employee benefit

fund are invested in shares of an investment company registered under the Investment Company Act of 1940, such investment shall not cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a 'fiduciary' or a 'party in interest' as those terms are defined in this Act, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with an employee benefit fund established or maintained pursuant to an employee benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained herein shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other provision of law."

SEC. 503. (a) Section 4(a) of the Welfare and Pension Plans Disclosure Act is amended by striking out the words "welfare or pension", "or employers", and "or organizations" wherever they appear.

(b) Paragraph (3) of section 4(b) of such Act is amended to read as follows:

"(3) Such plan is administered by a religious organization described under section 501(c) of the Internal Revenue Code of 1954 which is exempt from taxation under the provisions of section 501(a) of such Code;"

(c) Paragraph (4) of section 4(b) of such Act is

amended by inserting before the period the following: ", except that participants and beneficiaries of such plan shall be entitled to maintain an action to recover benefits or to clarify their rights to future benefits as provided in section 604 of the Retirement Income Security for Employees Act".

(d) Section 4(b) of such Act is further amended by adding at the end thereof the following new paragraph:

"(5) Such plan is established or maintained outside the United States primarily for the benefit of employees who are not citizens of the United States and the situs of the employee benefit plan fund established or maintained pursuant to such plan is maintained outside the United States."

SEC. 504. (a) Section 5(b) of the Welfare and Pension Plans Disclosure Act is amended to read as follows:

"(b) The Secretary may require the filing of special terminal reports on behalf of an employee benefit plan which is winding up its affairs, so long as moneys or other assets remain in the plan. Such reports may be required to be filed regardless of the number of participants remaining in the plan and shall be in such form and filed in such manner as the Secretary may prescribe."

(b) Section 5 of such Act is further amended by adding at the end thereof the following new subsection:

"(c) The Secretary may by regulation provide for the exemption from all or part of the reporting and disclosure

requirements of this Act of any class or type of employee benefit plans if the Secretary finds that the application of such requirements to such plans is not required in order to implement the purposes of this Act."

Sc. 505. Section 6 of the Welfare and Pension Plans Disclosure Act is amended to read as follows:

"Sec. 6. (a) A description of any employee benefit plan shall be published as required herein within ninety days after the establishment of such plan or when such plan becomes subject to this Act.

"(b) The description of the plan shall be comprehensive and shall include the name and type of administration of the plan; the name and address of the administrator; the names and addresses of any person or persons responsible for the management or investment of plan funds; the schedule of benefits; a description of the provisions providing for vested benefits written in a manner calculated to be understood by the average participant; the source of the financing of the plan and identity of any organization through which benefits are provided; whether records of the plan are kept on a calendar year basis, or on a policy or other fiscal year basis, and if on the latter basis, the date of the end of such policy or fiscal year; the procedures to be followed in presenting claims for benefits under the plan and the remedies avail-

able under the plan for the redress of claims which are denied in whole or in part. Amendments to the plan reflecting changes in the data and information included in the original plan, other than data and information also required to be included in annual reports under section 7, shall be included in the description on and after the effective date of such amendments. Any change in the information required by this subsection shall be reported in accordance with regulations prescribed by the Secretary."

SEC. 506. (a) Subsection (a) of section 7 of the Welfare and Pension Plans Disclosure Act is amended by adding the number "(1)" after the letter "(a)", and by striking out that part of the first sentence which precedes the word "if" the first time it appears and inserting in lieu thereof the words "An annual report shall be published with respect to any employee benefit plan if the plan provides for an employee benefit fund subject to section 15 of this Act or".

(b) Section 7(a)(1) of such Act is further amended by striking out the word "investigation" and inserting in lieu thereof the words "notice and opportunity to be heard", by striking out the words "year (or if" and inserting in lieu thereof the words "policy or fiscal year on which", adding a period after the word "kept", and striking out all the words following the word "kept".

(c) Section 7(a) of such Act is further amended by adding the following paragraphs:

"(2) If some or all of the benefits under the plan are provided by an insurance carrier or service or other organization, such carrier or organization shall certify to; the administrator of such plan, within one hundred and twenty days after the end of each calendar, policy, or other fiscal year, as the case may be, such information as determined by the Secretary to be necessary to enable such administrator to comply with the requirements of this Act.

"(3) The administrator of an employee benefit plan shall cause an audit to be made annually of the employee benefit fund established in connection with or pursuant to the provisions of the plan. Such audit shall be conducted in accordance with generally accepted standards of auditing by an independent certified or licensed public accountant, but nothing herein shall be construed to require such an audit of the books or records of any bank, insurance company, or other institution providing insurance, investment, or related function for the plan, if such books or records are subject to periodic examination by any agency of the Federal Government or the government of any State. The auditor's opinion and comments with respect to the financial information re-

quired to be furnished in the annual report by the plan administrator shall form a part of such report."

(d) Section 7 (b) and (c) of such Act are amended to read as follows:

"(b) A report under this section shall include—

"(1) the amount contributed by each employer; the amount contributed by the employees; the amount of benefits paid or otherwise furnished; the number of employees covered; a statement of assets, liabilities, receipts, and disbursements of the plan; a detailed statement of the salaries and fees and commissions charged to the plan, to whom paid, in what amount, and for what purposes; the name and address of each fiduciary, his official position with respect to the plan, his relationship to the employer of the employees covered by the plan, or the employee organization, and any other office, position, or employment he holds with any party in interest;

"(2) a schedule of all investments of the fund showing as of the end of the fiscal year:

"(A) the aggregate cost and aggregate value of each security, by issuer,

"(B) The aggregate cost and aggregate value, by type or category, of all other investments, and separately identifying (i) each investment, the value

of which exceeds 3 per centum of the value of the fund and (ii) each investment in securities or properties of any person known to be a party in interest;

"(3) a schedule showing the aggregate amount, by type of security, of all purchases, sales, redemptions, and exchanges of securities made during the reporting period; a list of the issuers of such securities; and in addition, a schedule showing, as to each separate transaction with or without respect to securities issued by any person known to be a party in interest, the issuer, the type and class of security, the quantity involved in the transaction, the gross purchase price, and in the case of a sale, redemption, or exchange, the gross and net proceeds (including a description and the value of any consideration other than money) and the net gain or loss, except that such schedule shall not include distribution of stock or other distributions in kind from profit-sharing or similar plans to participants separated from the plan;

"(4) a schedule of purchases, sales, or exchanges during the year covered by the report of investment assets other than securities—

"(A) by type or category of asset the aggregate amount of purchases, sales, and exchanges; the aggregate expenses incurred in connection there-

with; and the aggregate net gain (or loss) on sales, and

"(B) for each transaction involving a person known to be a party in interest and for each transaction involving over 3 per centum of the fund, an indication of each asset purchased, sold, or exchanged (and, in the case of fixed assets such as land, buildings, and leaseholds, the location of the asset); the purchase or selling price; expenses incurred in connection with the purchase, sale, or exchange; the cost of the asset and the net gain (or loss) on each sale; the identity of the seller in the case of a purchase, or the identity of the purchaser in the case of a sale, and his relationship to the plan, the employer, or any employee organization;

"(5) a schedule of all loans made from the fund during the reporting year or outstanding at the end of the year, and a schedule of principal and interest payments received by the fund during the reporting year, aggregated in each case by type of loan, and in addition, a separate schedule showing as to each loan which—

"(A) was made to a party in interest, or

"(B) was in default, or

"(C) was written off during the year as uncollectable, or

"(D) exceeded 3 per centum of the value of the fund,

the original principal amount of the loan, the amount of principal and interest received during the reporting year, the unpaid balance, the identity and address of the loan obligor, a detailed description of the loan (including date of making and maturity, interest rate, the type and value of collateral, and the material terms), the amount of principal and interest overdue (if any) and as to loans written off as uncollectable an explanation thereof;

"(6) a list of all leases with—

"(A) persons other than parties in interest who are in default, and

"(B) any party in interest,

including information as to the type of property leased (and, in the case of fixed assets such as land, buildings, leaseholds, and so forth, the location of the property), the identity of the lessor or lessee from or to whom the plan is leasing, the relationship of such lessors and lessees, if any, to the plan, the employer, employee organization, or any other party in interest, the terms of the lease regarding rent. taxes. insurance, repairs, expenses, and renewal options; if property is leased from persons described in (B) the amount of rental and other expenses paid during the reporting year; and if property *is leased to persons described in (A) or (B), the date the leased property was purchased and its cost, the date the property was leased and its approximate value at such date, the gross rental receipts during the reporting period, the expenses paid for the leased property during the reporting period, the net receipt from the lease, and with respect to any such leases in default, their identity, the amounts in arrears, and a statement as to what steps have been taken to collect amounts due or otherwise remedy the default;*

"(7) a detailed list of purchases, sales, exchanges, or any other transactions with any party in interest made during the year, including information as to the asset involved, the price, any expenses connected with the transaction, the cost of the asset, the proceeds, the net gain or loss, the identity of the other party to the transaction and his relationship to the plan;

"(8) subject to rules of the Secretary designed to preclude the filing of duplicate or unnecessary statements if, some or all of the assets of a plan or plans are held in a common or collective trust maintained by a bank or similar institution or in a separate account maintained by an insurance carrier, the report shall include a statement of assets and liabilities and a statement of receipts and disbursements of such common or collective trust or

separate account and such of the information required under paragraphs (2), (3), (4), (5), (6), and (7) of section 7(b) with respect to such common or collective trust or separate account as the Secretary may determine appropriate by regulation. In such case the bank or similar institution or insurance carrier shall certify to the administrator of such plan or plans, within one hundred and twenty days after the end of each calendar, policy, or other fiscal year, as the case may be, the information determined by the Secretary to be necessary to enable the plan administrator to comply with the requirements of this Act; and

"(9) in addition to reporting the information called for by this subsection, the administrator may elect to furnish other information as to investment or reinvestment of the fund as additional disclosures to the Secretary.

"(c) If the only assets from which claims against an employee benefit plan may be paid are the general assets of the employer or the employee organization, the report shall include (for each of the past five years) the benefits paid and the average number of employees eligible for participation."

(e) Section 7(d) of such Act is amended by striking out the capital "T" in the word "The" the first time it

appears in paragraphs (1) and (2) and inserting in lieu thereof a lowercase "t".

(f) Section 7(e) of such Act is amended to read as follows:

"(e) Every employee pension benefit plan shall include with its annual report (to the extent applicable) the following information:

"(1) the type and basis of funding,

"(2) the number of participants, both retired and nonretired, covered by the plan,

"(3) the amount of all reserves or net assets accumulated under the plan,

"(4) the present value of all liabilities for all nonforfeitable pension benefits and the present value of all other accrued liabilities,

"(5) the ratios of the market value of the reserves and assets described in (3) above to the liabilities described in (4) above,

"(6) a copy of the most recent actuarial report, and

"(A)(i) the actuarial assumptions used in computing the contributions to a trust or payments under an insurance contract, (ii) the actuarial assumptions used in determining the level of benefits, and (iii) the actuarial assumptions used in connection with the other information required to be

furnished under this subsection, insofar as any such actuarial assumptions are not included in the most recent actuarial report,

"(B)(i) if there is no such report, or (ii) if any of the actuarial assumptions employed in the annual report differ from those in the most recent actuarial report, or (iii) if different actuarial assumptions are used for computing contributions or payments than are used for any other purpose, a statement explaining same; and

"(7) such other reasonable information pertinent to disclosure under this subsection as the Secretary may by regulation prescribe."

(g) Section 7 of such Act is further amended by striking out in their entirety subsections (f), (g), and (h).

SEC. 507. (a) Section 8 of the Welfare and Pension Plans Disclosure Act is amended by striking out subsections (a) and (b) in their entirety and by redesignating subsection (c) as subsection (a). The subsection redesignated as subsection (a) is further amended by striking out the words "of plans" after the word "descriptions", striking out the word "the" before the word "annual" and adding the word "plan" before the word "descriptions".

(b) Such section is further amended by adding subsections (b), (c), and (d), to read as follows:

"(b) The administrator of any employee benefit plan subject to this Act shall file with the Secretary a copy of the plan description and each annual report. The administrator shall also furnish to the Secretary, upon request, any documents relating to the employee benefit plan, including but not limited to the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated, and any document so furnished shall be available for public inspection. The Secretary shall make copies of such descriptions and annual reports available for public inspection.

"(c) Publication of the plan descriptions and annual reports required by this Act shall be made to participants and beneficiaries of the particular plan as follows:

"(1) the administrator shall make copies of the plan description (including all amendments or modifications thereto) and the latest annual report and the bargaining agreement, trust agreement, contract, or other instrument under which the plan was established or is operated available for examination by any plan participant or beneficiary in the principal office of the administrator;

"(2) the administrator shall furnish to any plan participant or beneficiary so requesting in writing a fair summary of the latest annual report;

"(3) the administrator shall furnish or make available, whichever is most practicable: (1) to every participant upon his enrollment in the plan and within one hundred and twenty days after each major amendment to the plan, a summary of the plan's important provisions, including the names and addresses of any person or persons responsible for the management or investment of plan funds, and requirements of the amendment, whichever is applicable, written in a manner calculated to be understood by the average participant; such explanation shall include a description of the benefits available to the participant under the plan and circumstances which may result in disqualification or ineligibility, and the requirements of the Welfare and Pension Plans Disclosure Act with respect to the availability of copies of the plan bargaining agreement, trust agreement, contract or other instrument under which the plan is established or operated; and (ii) to every participant every three years (commencing January 1, 1975), a revised up-to-date summary of the plan's important provisions and major amendments thereto, written in a manner calculated to be understood by the average participant; and (iii) to each plan participant or beneficiary so requesting in writing a complete copy of the plan description (including all amendments or modifications thereto) or

a complete copy of the latest annual report, or both. He shall in the same way furnish a complete copy of any bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated. In accordance with regulations of the Secretary, an administrator may make a reasonable charge to cover the cost of furnishing such complete copies.

"(d) In the event a plan is provided a variance with respect to standards of vesting, funding, or both, pursuant to title II of the Retirement Income Security for Employees Act, the administrator shall furnish or make available, whichever is most practicable, notice of such action to each participant in a manner calculated to be understood by the average participant, and in such form and detail and for such periods as may be prescribed by the Secretary."

SEC. 508. (a) Section 9(d) of the Welfare and Pension Plans Disclosure Act is amended to read as follows:

"(d) The Secretary may make appropriate and necessary inquiries to determine violations of the provisions of this Act, or any rule or regulation issued thereunder: Provided, however, That no periodic examination of the books and records of any plan or fund shall be conducted more than once annually unless the Secretary has reasonable cause to believe there may exist a violation of this Act or any rule or regulation issued thereunder."

(b) Subsection (h) of section 9 of such Act is repealed and subsection (i) of such section is redesignated as subsection (h).

Sec. 509. Section 14 of such Act is amended to read as follows:

"Sec. 14. (a)(1) There is hereby established an Advisory Council on Employee Welfare and Pension Benefit Plans (hereinafter referred to as the 'Council') consisting of twenty-one members appointed by the Secretary. Not more than eleven members of the Council shall be members of the same political party.

"(2) Members shall be appointed from among persons recommended by groups or organizations which they shall represent and shall be persons qualified to appraise the programs instituted under this Act and the Retirement Income Security for Employees Act.

"(3) Of the members appointed, five shall be representatives of labor organizations; five shall be representatives of management; one representative each from the fields of insurance, corporate trust, actuarial counseling, investment counseling, and the accounting field; and six representatives shall be appointed from the general public.

"(4) Members shall serve for terms of three years, except that of those first appointed, six shall be appointed for terms of one year, seven shall be appointed for terms of two

years, and eight shall be appointed for terms of three years. A member may be reappointed, and a member appointed to fill a vacancy shall be appointed only for the remainder of such term. A majority of members shall constitute a quorum and action shall be taken only by a majority vote of those present.

"(5) Members shall be paid compensation at the rate of $150 per day when engaged in the actual performance of their duties except that any such member who holds another office or position under the Federal Government shall serve without additional compensation. Any member shall receive travel expenses, including per diem in lieu of subsistence as authorized by section 5703 of title 5, United States Code, for persons in the Government service employed intermittently.

"(b) It shall be the duty of the Council to advise the Secretary with respect to the carrying out of his functions under this Act, and the Retirement Income Security for Employees Act and to submit to the Secretary recommendations with respect thereto. The Council shall meet at least four times each year and at such other times as the Secretary requests. At the beginning of each regular session of the Congress, the Secretary shall transmit to the Senate and House of Representatives each recommendation which he has received from the Council during the preceding calendar year

and a report covering his activities under the Act and the Retirement Income Security for Employees Act for the preceding fiscal year, including full information as to the number of plans and their size, the results of any studies he may have made of such plans and the operation of this Act and the Retirement Income Security for Employees Act and such other information and data as he may deem desirable in connection with employee welfare and pension benefit plans.

"(c) The Secretary shall furnish to the Council an executive secretary and such secretarial, clerical, and other services as are deemed necessary to conduct its business. The Secretary may call upon other agencies of the Government for statistical data, reports, and other information which will assist the Council in the performance of its duties."

SEC. 510. The Welfare and Pension Plans Disclosure Act is further amended by renumbering sections 15, 16, 17, and 18 as sections 16, 17, 18, and 19, respectively, and by inserting the following new section immediately after section 14:

"FIDUCIARY STANDARDS

"SEC. 15. (a) Every employee benefit fund established to provide for the payment of benefits under an employee's benefit plan shall be established or maintained pursuant to a duly executed written document which shall set forth

the purpose or purposes for which such fund is established and the detailed basis on which payments are to be made into and out of such fund. Such fund shall be deemed to be a trust and shall be held for the exclusive purpose of (1) providing benefits to participants in the plan and their beneficiaries and (2) defraying reasonable expenses of administering the plan.

"(b)(1) A fiduciary shall discharge his duties with respect to the fund—

"(A) with the care under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; and

"(B) subject to the standards in subsection (a) and in accordance with the documents and instruments governing the fund insofar as is consistent with this Act, except that (i) any assets of the fund remaining upon dissolution or termination of the fund shall, after complete satisfaction of the rights of all beneficiaries to benefits accrued to the date of dissolution or termination, be distributed ratably to the beneficiaries thereof or, if the trust agreement so provides, to the contributors thereto; (ii) that in the case of a registered pension or profit-sharing-retirement plan, such distribution shall be subject

to the requirements of the Retirement Income Security for Employees Act and (ii) any assets of the fund, attributable to employec contributions, remaining after complete satisfaction of the rights of all beneficiaries accrued to the date of dissolution or termination shall be equitably distributed to the employee contributors according to their rate of contribution.

"(2) Except as permitted hereunder, a fiduciary shall not—

"(A) rent or sell property of the fund to any person known to be a party in interest of the fund;

"(B) rent or purchase on behalf of the fund any property known to be owned by a party in interest of the fund;

"(C) deal with such fund in his own interest or for his own account;

"(D) represent any other party with such fund, or in any way act on behalf of a party adverse to the fund or adverse to the interests of its participants or beneficiaries;

"(E) receive any consideration from any party dealing with such fund in connection with a transaction involving the fund;

"(F) loan money or other assets of the fund to any party in interest of the fund;

"(G) furnish goods, services, or facilities of the fund to any party in interest of the fund;

"(H) permit the transfer of any assets or property of the fund to, or its use by or for the benefit of, any party in interest of the fund; or

"(I) permit any of the assets of the fund to be held, deposited, or invested outside the United States unless the indicia of ownership remain within the jurisdiction of a United States District Court, except as authorized by the Secretary by rule or regulation.

"(3) The Secretary, by rules or regulations or upon application of any fiduciary or party in interest, by order, shall provide for the exemption conditionally or unconditionally of any fiduciary or class of fiduciaries or transactions or class of transactions from all or part of the proscriptions contained in this subsection 15(b)(2) when the Secretary finds that to do so is consistent with the purposes of this Act and is in the interest of the fund or class of funds and the participants and beneficiaries: Provided, however, That any such exemption shall not relieve a fiduciary from any other applicable provisions of this Act.

"(c) Nothing in this section shall be construed to prohibit the fiduciary from—

"(1) receiving any benefit to which he may be

entitled as a participant or beneficiary in the plan under which the fund was established;

"(2) receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the fund, or receiving in a fiduciary capacity proceeds from any transaction involving plan funds, except that no person so serving who already receives full-time pay from an employer or an association of employers whose employees are participants in the plan under which the fund was established, or from an employee organization whose members are participants in such plan shall receive compensation from such fund, except for reimbursement of expenses properly and actually incurred and not otherwise reimbursed;

"(3) serving in such position in addition to being an officer, employee, agent, or other representative of a party in interest;

"(4) engaging in the following transactions:

"(A) holding or purchasing on behalf of the fund any security which has been issued by an employer whose employees are participants in the plan, under which the fund was established or a corporation controlling, controlled by, or under common

control with such employer, except that (i) the purchase of any security is for no more than adequate consideration in money or money's worth, and (ii) that if an employee benefit fund is one which provides primarily for benefits of a stated amount, or an amount determined by an employee's compensation, an employee's period of service, or a combination of both, or money purchase type benefits based on fixed contributions which are not geared to the employer's profits, no investment shall be held or made by a fiduciary of such a fund in securities of such employer or of a corporation controlling, controlled by, or under common control with such employer, if such investment, when added to such securities already held, exceeds 10 per centum of the fair market value of the assets of the fund. Notwithstanding the foregoing, such 10 per centum limitation shall not apply to profit sharing, stock bonus, thrift and savings or other similar plans which explicitly provide that some or all of the plan funds may be invested in securities of such employer or a corporation controlling, controlled by, or under common control with such employer, nor shall said plans be deemed to be limited by any diversification rule as to plan funds which may be invested in *such securities. Profit-sharing, stock bonus, thrift, or other similar plans, which are in existence on the date of enactment and which allow investment in such securities without explicit provision in the plan, shall remain exempt from the 10 per centum limitation until the expiration of one year from the date of enactment of the Retirement Income Security for Employees Act. Nothing contained in this subparagraph shall be construed to relieve profit-sharing, stock bonus, thrift and savings or other similar plans from any other applicable requirements of this section;*

"(B) purchasing on behalf of the fund any security or selling on behalf of the fund any security which is acquired or held by the fund, to or from a party in interest, if (i) at the time of such purchase or sale the security is of a class of securities which is listed on a national securities exchange registered under the Securities Exchange Act of 1934 or which has been listed for more than one month (at the time of such sale or purchase) on an electronic quotation system administered by a national securities association registered under the Securities Exchange Act of 1934, (ii) no brokerage commission, fee (except for customary transfer fees), or other remuneration is

paid in connection with such transaction, (iii) adequate consideration is paid, and (iv) that in the event the security is one described in subparagraph (A), the transaction has received the prior approval of the Secretary;

"(5) making any loan to participants or beneficiaries of the plan under which the fund was established where such loans are available to all participants or beneficiaries on a nondiscriminatory basis and are made in accordance with specific provisions regarding such loans set forth in the plan and are not otherwise inconsistent with the purposes of this Act;

"(6) contracting or making reasonable arrangements with a party in interest for office space and other services necessary for the operation of the plan and paying reasonable compensation therefor;

"(7) following the specific instructions in the trust instrument or other document governing the fund insofar as consistent with the specific prohibitions listed in subsection (b)(2);

"(8) taking action pursuant to an authorization in the trust instrument or other document governing the fund, provided such action is consistent with the provisions of subsection (b).

"(d) Any fiduciary who breaches any of the respon-

sibilities, obligations, or duties imposed upon fiduciaries by this Aot shall be personally liable to such fund for any losses to the fund resulting from such breach, and to pay to such fund any profits which have inured to such fiduciary through use of assets of the fund.

"(e) When two or more fiduciaries undertake jointly the performance of a duty or the exercise of a power, or where two or more fiduciaries are required by an instrument governing the fund to undertake jointly the performance of a duty or the exercise of power, but not otherwise, each of such fiduciaries shall have the duty to prevent any other such cofiduciary from committing a breach of responsibility, obligation, or duty of a fiduciary or to compel such other cofiduciary to redress such a breach, except that no fiduciary shall be liable for any consequence of any act or failure to act as a cofiduciary who is undertaking or is required to undertake jointly any duty or power if he shall object in writing to the specific action and promptly file a copy of his objection with the Secretary.

"(f) No fiduciary may be relieved from any responsibility, obligation, or duty imposed by law, agreement, or otherwise. Nothing herein shall preclude any agreement allocating specific duties or responsibilities among fiduciaries, or bar any agreement of insurance coverage or indemnifi-

cation affecting fiduciaries, unless specifically disapproved by the Secretary.

"(g) A fiduciary shall not be liable for a violation of this Act committed before he became a fiduciary or after he ceased to be a fiduciary.

"(h) No individual who has been convicted of, or has been imprisoned as a result of his conviction of: robbery, bribery, extortion, embezzlement, grand larceny, burglary, arson, violation of narcotics laws, murder, rape, kidnaping, perjury, assault with intent to kill, assault which inflicts grevious bodily injury, any crime described in section 9(a)(1) of the Investment Company Act of 1940, or a violation of any provision of the Welfare and Pension Plans Disclosure Act, or a violation of section 302 of the Labor-Management Relations Act of 1947 (61 Stat. 157, as amended), or a violation of chapter 63 of title 18, United States Code, or a violation of section 874, 1027, 1503, 1505, 1506, 1510, 1951, or 1954 of title 18, United States Code, or a violation of the Labor-Management Reporting and Disclosure Act of 1959 (73 Stat. 519, as amended), or conspiracy to commit any such crimes or attempt to commit any such crimes or a crime in which any of the foregoing crimes is an element, shall serve—

"(1) as an administrator, officer, trustee, custodian, counsel, agent, employee (other than as an employee

performing exclusive clerical or janitorial duties) or other fiduciary position of any employee benefit plan; or

"(2) as a consultant to any employee benefit plan, during or for five years after such conviction or after the end of such imprisonment, unless prior to the end of such five-year period, in the case of a person so convicted or imprisoned, (A) his citizenship rights having been revoked as a result of such conviction, have been fully restored, or (B) the Secretary determines that such person's service in any capacity referred to in clause (1) or (2) would not be contrary to the purposes of this Act. No person shall knowingly permit any other person to serve in any capacity referred to in clause (1) or (2) in violation of this subsection. Any person who willfully violates this subsection shall be fined not more than $10,000 or imprisoned for not more than one year, or both. For the purposes of this subsection, any person shall be deemed to have been 'convicted' and under the disability of 'conviction' from the date of the judgment of the trial court or the date of the final sustaining of such judgment on appeal, whichever is the later event, regardless of whether such conviction occurred before or after the date of enactment of this section. For the purposes of this subsection, the term 'consultant' means any person who, for compensation, advises or represents an

employee benefit plan or who provides other assistance to such plan, concerning the establishment or operation of such plan.

"(i) All investments and deposits of the funds of an employee benefit fund and all loans made out of any such fund shall be made in the name of the fund or its nominee, and no employer or officer or employee thereof, and no labor organization, or officer or employee thereof, shall either directly or indirectly accept or be the beneficiary of any fee, brokerage, commission, gift, or other consideration for or on account of any loan, deposit, purchase, sale, payment, or exchange made by or on behalf of the fund.

"(j) In order to provide for an orderly disposition of any investment, or termination of any service, the retention or continuation of which would be deemed to be prohibited by this Act, and in order to protect the interest of the fund and its participants and its beneficiaries, the fiduciary may in his discretion effect the disposition of such investment or termination of such service within three years after the date of enactment of this Act, or within such additional time as the Secretary may by rule or regulation allow, and such action shall be deemed to be in compliance with this Act.

"(k) In accordance with regulations of the Secretary, every employee benefit plan subject to this Act shall—

"(1) provide adequate notice in writing to any par-

ticipant or beneficiary whose claim for benefits from the plan has been denied, setting forth the specific reasons for such denial, written in a manner calculated to be understood by the participant, and

"(2) afford a reasonable opportunity to any participant whose claim for benefits has been denied for a full and fair review by the plan administrator of the decision denying the claim.

"(l) An employee benefit plan subject to this Act or the Retirement Income Security for Employees Act, which provides an optional death benefit of any kind, or in any form, shall not provide that such option may be waived by default or in any manner other than in a writing signed by the participant, after such participant receives a written explanation of the terms and conditions of the option and the effect of such waiver."

TITLE VI—ENFORCEMENT

SEC. 601. Whenever the Secretary—

(1) determines, in the case of a pension or profit-sharing-retirement plan required to be registered under this Act, that no application for registration has been filed in accordance with section 102, or

(2) issues an order under section 107 denying or canceling the certificate of registration of a pension or profit-sharing-retirement plan, or

(3) determines, in the case of a pension plan subject to title II, that there has been a failure to make required contributions to the plan in accordance with the provisions of this Act or to pay required assessments or to pay such other fees or moneys as may be required under this Act,

the Secretary may petition any district court of the United States having jurisdiction of the parties, or the United States District Court for the District of Columbia, for an order requiring the employer or other person responsible for the administration of such plan to comply with the requirements of this Act as will qualify such plan for registration or compel or recover the payment of required contributions, assessments, premiums, fees, or other moneys.

SEC. 602. Whenever the Secretary ~~has~~ reasonable cause to believe that an employees' benefit fund is being or has been administered in violation of the requirements of the Welfare and Pension Plans Disclosure Act or the documents governing the establishment or operation of the fund, the Secretary may petition any district court of the United States having jurisdiction of the parties or the United States District Court for the District of Columbia for an order (1) requiring return to such fund of assets transferred from such fund in violation of the requirements of such Act· (2) requiring payment of benefits denied to any participant or beneficiary due to violation of the requirements of such

Act, and (3) restraining any conduct in violation of the fiduciary requirements of such Act, and granting such other relief as may be appropriate to effectuate the purposes of this Act, including, but not limited to, removal of a fiduciary who has failed to carry out his duties and the removal of any person who is serving in violation of the requirements of section 15(h) of the Welfare and Pension Plans Disclosure Act.

SEC. 603. Civil actions for appropriate relief, legal or equitable, to redress or restrain a breach of any responsibility, obligation or duty of a fiduciary, including but not limited to, the removal of a fiduciary who has failed to carry out his duties and the removal of any person who is serving in violation of the requirements of section 15(h) of the Welfare and Pension Plans Disclosure Act or against any person who has transferred or received any of the assets of a plan or fund in violation of the fiduciary requirements of the Welfare and Pension Plans Disclosure Act or in violation of the document or documents governing the establishment or operation of the fund, may be brought by any participant or beneficiary of any employeee benefit plan or fund subject to the Welfare and Pension Plans Disclosure Act in any court of competent jurisdiction, State or Federal, or the United States District Court for the District of Columbia, without respect to the amount in controversy and without regard to the citizenship of the parties. Where such action is brought *in a district court of the United States, it may be brought in the district where the plan is administered, where the breach took place, or where a defendant resides or may be found, and process may be served in any other district where a defendant resides or may be found. Such actions may also be brought by a participant or beneficiary as a representative party on behalf of all participants or beneficiaries similarly situated.*

Sec. 604. Suits by a participant or beneficiary for benefits from an employee benefit plan or fund, subject to the Welfare and Pension Plans Disclosure Act, may be brought in any court of competent jurisdiction, State or Federal, or the United States District Court for the District of Columbia, without respect to the amount in controversy and without regard to the citizenship of the parties, against any such plan or fund to recover benefits due him required to be paid from such plan or fund pursuant to the document or documents governing the establishment or operation of the plan or fund, or to clarify his rights to future benefits under the terms of the plan. Where such action is brought in a district court of the United States, it may be brought in the district where the plan is administered, or where a defendant resides or may be found, and process may be served in any other district where a defendant resides or may be found. Such actions may also be brought by a participant or beneficiary as a *representative party on behalf of all participants or beneficiaries similarly situated.*

SEC. 605. (a) In any action brought under section 603 or 604, the court in its discretion may—

(1) allow a reasonable attorney's fee and costs of the action to any party;

(2) require the plaintiff to post security for payment of costs of the action and reasonable attorney's fees.

(b) A copy of the complaint in any action brought under section 603 or 604 shall be served upon the Secretary by certified mail, who shall have the right, in his discretion, to intervene in the action.

(c) Notwithstanding any other law, the Secretary shall have the right to remove an action brought under section 603 or 604 from a State court to a district court of the United States, if the action is one seeking relief of the kind the Secretary is authorized to sue for under this Act. Any such removal shall be prior to the trial of the action and shall be to a district court where the Secretary could have initiated the action.

SEC. 606. The provisions of the Act entitled "An Act to amend the Judicial Code and to define and limit the jurisdiction of courts sitting in equity, and for other pur-

poses", approved March 23, 1932, shall not be applicable with respect to suits brought under this title.

Sec. 607. Suits by an administrator or fiduciary of a pension plan, a profit-sharing-retirement plan, or an employees' benefit fund subject to the Welfare and Pension Plans Disclosure Act, to review a final order of the Secretary, to restrain the Secretary from taking any action contrary to the provisions of this Act, or to compel action required under this Act, may be brought in the name of the plan or fund in the district court of the United States for the district where the fund has its principal office, or in the United States District Court for the District of Columbia.

Sec. 608. Any action, suit, or proceeding based upon a violation of this Act or the Welfare and Pension Plans Disclosure Act shall be commenced within five years after the violation occurs. In the case of fraud or concealment, such action, suit, or proceeding shall be commenced within five years of the date of discovery of such violation.

Sec. 609. (a) It is hereby declared to be the express intent of Congress that, except for actions authorized by section 604 of this title, the provisions of this Act or the Welfare and Pension Plans Disclosure Act shall supersede any and all laws of the States and of political subdivisions thereof insofar as they may now or hereafter relate to the subject matters regulated by this Act or the Welfare and

Pension Plans Disclosure Act, except that nothing herein shall be construed—

(1) to exempt or relieve any employee benefit plan not subject to this Act or the Welfare and Pension Plans Disclosure Act from any law of any State;

(2) to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities or to prohibit a State from requiring that there be filed with a State agency copies of reports required by this Act to be filed with the Secretary; or

(3) to alter, amend, modify, invalidate, impair, or supersede any law of the United States other than the Welfare and Pension Plans Disclosure Act or any rule or regulation issued under any law except as specifically provided in this Act.

(b) Subsection (a) of this section shall not be deemed to prevent any State court from asserting jurisdiction in any action requiring or permitting an accounting by a fiduciary during the operation of an employee benefit fund subject to the Welfare and Pension Plans Disclosure Act or upon the termination thereof or from asserting jurisdiction in any action by a fiduciary requesting instructions from the court or seeking an interpretation of the trust instrument or other document governing the fund. In any such action—

(1) the provisions of this Act and the Welfare and

Pension Plans Disclosure Act shall supersede any and all laws of the State and of political subdivisions thereof, insofar as they may now or hereafter relate to the fiduciary, reporting, and disclosure responsibilities of persons acting for or on behalf of employee benefit plans or on behalf of employee benefit funds subject to the Welfare and Pension Plans Disclosure Act except insofar as they may relate to the amount of benefits due beneficiaries under the terms of the plan;

(2) notwithstanding any other law, the Secretary or, in the absence of action by the Secretary, a participant or beneficiary of the employee benefit plan or fund affected by this subsection, shall have the right to remove such action from a State court to a district court of the United States if the action involves an interpretation of the fiduciary, or reporting, and disclosure responsibilities of persons acting on behalf of employee benefit plans subject to the Welfare and Pension Plans Disclosure Act;

(3) the jurisdiction of the State court shall be conditioned upon—

(A) written notification, sent to the Secretary by registered mail at the time such action is filed, identifying the parties to the action, the nature of the action, and the plan involved; and satisfactory evidence presented to the court that the participants

and beneficiaries have been adequately notified with respect to the action; and

(B) the right of the Secretary or of a participant or beneficiary to intervene in the action as an interested party.

Sec. 610. It shall be unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of the plan, this Act, or the Welfare and Pension Plans Disclosure Act, or for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan, this Act, or the Welfare and Pension Plans Disclosure Act. The provisions of sections 602 and 603 shall be applicable in the enforcement of this section.

Sec. 611. It shall be unlawful for any person through the use of fraud, force, or violence, or threat of the use of force or violence, to restrain, coerce, intimidate, or attempt to restrain, coerce, or intimidate any participant or beneficiary for the purpose of interfering with or preventing the exercise of any right to which he is or may become entitled under the plan, this Act, or the Welfare and Pension Plans Disclosure Act. Any person who willfully violates this section shall be fined $10,000 or imprisoned for not more than one year, or both.

TITLE VII—EFFECTIVE DATES

Sec. 701. (a) Sections 101, 102, 103, and 104, part D of title II, title V, and title VI of this Act shall become effective upon the date of enactment of this Act.

(b) Title II (except part D thereof) of this Act shall become effective three years after the date of enactment of this Act, and titles III and IV of this Act shall become effective one year after the date of enactment of this Act.

93D CONGRESS
1ST SESSION

S. 1179

IN THE SENATE OF THE UNITED STATES

MARCH 13, 1973

Mr. BENTSEN introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To strengthen and improve the private retirement system by establishing minimum standards for participation in and vesting of benefits under pension and profit-sharing-retirement plans; by establishing minimum funding standards; by requiring termination insurance; and by allowing Federal income tax credits to individuals for personal retirement savings.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Comprehensive Private Pension Security Act of 1973".

TITLE I—FINDINGS; PURPOSE

FINDINGS

SEC. 101. (a) The Congress finds that—

(1) the growth in size, scope, and numbers of private retirement plans in recent years has been rapid and substantial;

(2) part of this growth is attributable to the favorable tax treatment offered to these plans;

(3) the continued well-being and security of millions of employees and their dependents are directly affected by these plans;

(4) a significant number of these employee benefit plans have failed to protect adequately the interests of plan participants;

(5) many employees with long years of employment with a company are being denied benefits due to the existence of unreasonable vesting provisions in such plans;

(6) due to inadequate funding of many private retirement plans, such plans have insufficient assets to pay all earned benefits;

(7) due to the termination of plans before requisite funds have been accumulated, employees and their dependents have been deprived of anticipated benefits; and

(8) in order to provide for the uniform treatment of expenditures bearing on the free flow of commerce, to protect the general taxing power of the United States, and to protect the interests of employees and their beneficiaries, it is desirable to amend the Internal Revenue

Code of 1954 to require, as a condition of qualification under section 401 of that Code, minimum vesting, funding, and termination insurance requirements for pension, profit sharing, and deferred compensation plans.

(b) The Congress further finds that, despite the growth of retirement benefit plans, about one-half of the full-time private nonagricultural adult work force is not covered by existing retirement plans and that it is therefore desirable to enact Federal tax incentives to encourage those workers who are not presently participating in employee benefit plans to save independently for their retirement.

PURPOSES

SEC. 102. It is the purpose of this Act—

(1) to protect interstate commerce, the Federal taxing power, and the interests of participants in private pension plans and their beneficiaries by strengthening and improving such plans by requiring them (A) to adopt reasonable vesting standards, (B) to meet minimum standards of funding, and (C) to protect the vested rights of participants against losses due to plan termination through the establishment of pension plan liability insurance; and

(2) to offer a Federal tax incentive to encourage employees to save independently for their own retirement.

TITLE II—OFFICE OF PENSION PLAN ADMINISTRATION

ESTABLISHMENT OF OFFICE

SEC. 201. (a) There is established within the Internal Revenue Service an office to be known as the Office of Pension Plan Administration (hereinafter referred to as the "Office"). The Office shall be under the supervision and direction of an Assistant Commissioner of the Internal Revenue Service.

(b) Section 5109 of title 5, United States Code, is amended by adding at the end thereof the following new subsection:

"(c) The position held by the employee appointed under section 201(a) of the Comprehensive Private Pension Security Act of 1973 is classified at GS–18, and is in addition to the number of positions authorized by section 5108 (a) of this title."

DUTIES; TRANSFER OF FUNCTIONS

SEC. 202. (a) The Office shall carry out all functions of the Internal Revenue Service with respect to pension, profit-sharing, and deferred compensation plans.

(b) All functions of the Secretary of the Treasury which are carried out through the Pension Trust Branch of the Internal Revenue Service are transferred to the Assistant Commissioner of the Internal Revenue Service who is head of the Office.

TITLE III—AMENDMENTS TO THE INTERNAL REVENUE CODE

AMENDMENT OF 1954 CODE

SEC. 301. (a) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this title a reference is made (by way of amendment, repeal, or otherwise) to a section, chapter, or other provision, the reference shall be considered to be made to a section, chapter, or other provision of the Internal Revenue Code of 1954.

(b) TECHNICAL AND CONFORMING CHANGES.—The Secretary of the Treasury or his delegate shall, as soon as practical (but in any event not later than 90 days after the date of enactment of this Act) submit to the Committee on Ways and Means of the House of Representatives a draft of any technical and conforming changes in the Internal Revenue Code of 1954 which are necessary to reflect throughout such Code the changes in the substantive provisions of law made by this title.

Subtitle A—Qualified Trusts

MINIMUM STANDARDS RELATING TO PARTICIPANT ELIGIBILITY

SEC. 321. PERIOD OF SERVICE OR AGE RETIREMENT.—Section 401 (a) (relating to requirements for qualification) is amended by adding at the end thereof the following new paragraph:

"(11) Except in the case of a plan benefiting owner-employees to which subsection (d) applies, a trust shall not constitute a qualified trust under this section if the plan of which such trust is a part requires, as a condition of participation, that an employee—

"(A) have a period of service with the employer in excess of 1 year, or

"(B) have attained an age in excess of 30 years whichever occurs later."

MINIMUM STANDARDS RELATING TO VESTING

SEC. 322. (a) VESTING QUALIFICATION.—Section 401(a) (relating to requirements for qualification) is amended by adding at the end thereof the following:

"(12) (A) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that an employee's rights to at least the percentage specified below of his accrued benefits are nonforfeitable:

"Years of plan participation:	Minimum percentage of accrued benefits that must be nonforfeitable
Less than 5	0
5	25
6	30
7	35
8	40
9	45
10	50
11	55
12	60
13	65
14	70
15	75
16	80
17	85
18	90
19	95
20 and over	100.

For purposes of this subparagraph, service rendered prior to the establishment of a plan may be disregarded in applying the table contained in this paragraph, except that any participant in that plan who has attained 45 years of age on the effective date of this paragraph shall receive credit for accrued benefits attributable to service rendered prior to that date.

"(B) The Secretary or his delegate may defer, with respect to a plan in existence on the date of enactment of the Comprehensive Private Pension Security Act of 1973, in whole or in part, applicability of the requirements of subparagraph (A) for a period not to exceed 5 years from the effective date of this paragraph upon a showing that compliance with the vesting requirements on the part of the plan would result in increasing the cost of the employer or employers contributing to the plan to such an extent that substantial economic injury would be caused to such employer or employers and to the interests of the participants or beneficiaries in the plan. For purposes of this subparagraph the term 'substantial economic injury' includes, but is not limited to, a showing that (i) a substantial risk to the capability of voluntarily continuing the plan exists, (ii) the plan will be unable to discharge its existing contractual obligations for benefits, (iii) a substantial curtailment of pension or other benefit levels or the levels of employees' compensation would result, or (iv) there will be an adverse effect on the levels of employment with respect to the work force employed by the employer or employers contributing to the plan.

"(C) For purposes of applying the schedule in subparagraph (A), the term 'years of plan participation' means all years of participation (whether or not continuous), except that a plan may provide that—

"(i) 2 of the 5 years required to qualify for the 25 percent vested right under subparagraph (A) shall be continuous under standards prescribed by the Secretary or his delegate,

"(ii) service by a participant prior to the age of 30 may be ignored in determining eligibility for a vested right under this section, unless such participant or an employer has contributed to the plan with respect to such service, and

"(iii) if an employee terminates service and then is initially reemployed on a date occurring more than 10 years after the last date on which his service was terminated, each period of service shall be treated separately for purposes of applying the plan's vesting provisions.

"(13) If a plan is a class year plan, then a trust forming part of the plan shall not constitute a qualified trust under this section unless the plan provides that the participant shall acquire a nonforfeitable right to 100 percent of the employer's contribution on his behalf with respect to any given year, not later than the end of the fifth year following the year for which such contribution was made. For the purposes of this paragraph, the term 'class year plan' means a profit-sharing-retirement plan which provides for the separate vesting of each annual contribution made by the employer on behalf of a participant.

"(14) A trust forming part of a plan shall not constitute a qualified trust under this section unless the plan provides that an employee's interest thereunder shall not be capable of assignment or alienation and the plan does not confer upon an employee, personal representative, or dependent, or any other person, any right or interest capable of being assigned or otherwise alienated.

"(15) A trust forming part of a plan shall not constitute a qualified trust under this section unless the plan provides that an employee's nonforfeitable interest in such plan may be distributed commencing no later than the normal retirement age in the same form as retirement benefits payable to employees who remain until normal retirement age. For the purposes of this subparagraph, 'normal retirement age' means the normal retirement age, specified under the plan but not older than age 65, or, in the absence of plan provisions specifying the normal retirement age, such age shall be age 65."

FUNDING REQUIREMENT

SEC. 323. Section 401 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by redesignating subsection (j) as (n) and inserting after subsection (i) the following new subsections:

"(j) (1) FUNDING REQUIREMENTS.—A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part requires that the employer and if applicable, the employees, make annual or more frequent contributions to the plan in amounts which are sufficient—

"(A) to meet all normal service costs;

"(B) in the case of any initial unfunded liability resulting from the establishment or amendment of the plan, to fund such liability, no slower than ratably, over a term not exceeding 30 years from the date of such establishment or amendment; and

"(C) in the case of an experience deficiency, to remove such deficiency, no slower than ratably, over a term not exceeding the average remaining working life of the employees covered by the plan determined as of the date such deficiency was determined.

In the case of a plan which was established prior to the effective date of this paragraph, the 30-year period referred to in subparagraph (B) may, at the option of the employer, be measured from such effective date with respect to any initial unfunded liability existing on such date.

"(2) A plan shall be considered to meet the requirements of paragraph (1) only if, within 6 months after the effective date of regulations promulgated by the Secretary or his delegate to implement this paragraph (but in no event more than 12 months after the effective date of this paragraph or within 6 months after the date of plan establishment, whichever is later), the plan administrator submits a report of an actuary stating—

"(A) the estimated cost of benefits in respect of service for the first plan year following the effective date of this paragraph and the formula for computing such cost in subsequent years up to the date of the following report;

"(B) the initial unfunded liability, if any, for benefits under the plan as of the effective date of this paragraph, or, if later, as of the date such plan is established;

"(C) the payments required to remove such unfunded liability and experience deficiencies in accordance with this paragraph;

"(D) the actuarial assumptions used and the basis for using such actuarial assumptions; and

"(E) such other pertinent actuarial information as may be required by the Secretary or his delegate.

The Secretary or his delegate shall prescribe rules and regulations establishing standards and qualifications for persons responsible for performing actuarial services in connection with this subsection and, upon application of any such person, certify whether such person meets the standards and qualifications prescribed.

"(3) A plan shall not meet the requirements of paragraph (1) unless the administrator of the plan causes it to be reviewed not less than once every 5 years by an actuary certified under paragraph (2) and submits a report to the Secretary or his delegate stating—

"(A) the estimated cost of benefits in respect of service in the next succeeding 5-year period and the formula for computing such cost for such subsequent 5-year period;

"(B) the surplus or the experience deficiency in the plan after making allowance for the present value of all payments required to be made in the future by the employer as determined by previous reports;

"(C) the payments which will remove any such experience deficiency over the term specified in paragraph (1) (C) of this subsection;

"(D) the actuarial assumptions used and the basis for using such actuarial assumptions; and

"(E) such other pertinent actuarial information as the Secretary or his delegate may require.

"(4) Where a plan is funded exclusively by the purchase of individual insurance contracts which require level annual premium payments to be paid extending not beyond the retirement age for each individual participant in the plan and commencing with the participant's entry into the plan (or, in the case of an increase in benefits, commencing at the time such increase becomes effective), and benefits provided by the plan are equal to the benefits provided under each contract, and are guaranteed by the insurance carrier to the extent premiums have been paid, such plan shall be considered to meet the requirements of this subsection.

"(5) The Secretary or his delegate may exempt any plan, in whole or in part, from the requirements of paragraphs (2) and (3) where he finds the filing of the reports required thereunder to be unnecessary.

"(6) Notwithstanding any other provision of this subsection, a multiemployer plan, as defined in regulations prescribed by the Secretary or his delegate, shall be considered to meet the requirements of this subsection if it requires the employers to make contributions according to a funding schedule approved by the Secretary or his delegate. Any such plan must give reasonable assurances that the plan's benefit commitments will be met and must reflect the particular circumstances affecting the plan, industry, or other pertinent factors.

"(7) For the purposes of this subsection, the term 'experience deficiency' with respect to a pension plan means any actuarial deficit, determined at the time of a review of the plan, that is attributable to factors other than the existence of an initial unfunded liability or the failure of any employer to make any contribution required by the terms of the plan or by law.

"(k) WAIVER OF FUNDING REQUIREMENT.—If, upon application and notice to affected or interested parties by the plan administrator, the Secretary or his delegate determines that any employer or employers (and, if appropriate, the employees) are unable to make annual contributions to the plan in compliance with the funding requirements of subsection (j), the Secretary or his delegate may waive the annual contribution otherwise required to be paid, and prescribe an additional period of not more than 5 years for the amortization of such annual funding deficiency. If the funding deficiency is removed on at least a ratable basis over such period, the plan shall be considered to have met the requirement of subsection (j) for such perind. No waiver shall be granted unless the Secretary or his delegate is satisfied after a review of the financial condition of the plan and other related matters that such waiver—

"(1) will not adversely affect the interest of participants or beneficiaries of such plan; and

"(2) will not impair the capability of the Pension Guarantee Corporation equitably to underwrite vested benefit losses.

If any plan has been granted 5 or more consecutive waivers under this subsection, the Secretary or his delegate shall take such action under section 408 as he deems appropriate.

"(l) PLAN TERMINATION.—A trust shall constitute a qualified trust under this section only if the plan of which the trust is a part provides that, upon its complete termination or substantial termination (as determined by the Secretary or his delegate), all assets of the plan will be applied—

"(1) to refund to retired and nonretired participants in the plan the amount of contributions made by them;

"(2) to provide benefits to participants (or their survivors) in the plan who have retired prior to the date of such termination and have been receiving benefits under the plan;

"(3) to provide benefits to those participants (or their survivors) in the plan who, on the date of such termination, had the right to retire and receive benefits under the plan;

"(4) to provide benefits to those participants in the plan who acquired vested rights under the plan prior to termination of the plan but had not reached normal retirement age on the date of such termination; and

"(5) to provide benefits to any other participants in the plan who are entitled to benefits under the plan pursuant to the requirements of subsection (a) (7) of this section.

This subsection shall not apply to assets (including insurance contracts) which have been allocated to specific employees or to assets which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude the discrimination prohibited by subsection (a) (4), may not be used for designated employees in the event of early termination."

ENFORCEMENT OF FUNDING REQUIREMENTS

SEC. 324. Part I of subchapter D of chapter 1 (relating to pension, profit-sharing, stock bonus plans, etc.) is amended by adding at the end thereof the following new section:

"SEC. 408. FAILURE TO MAKE REQUIRED CONTRIBUTIONS.

"Whenever the Secretary or his delegate determines that the employer or other person responsible for the administration of a plan which has elected to be treated as a plan which meets the requirements of section 401 or 404 (a) (2) fails to make the contributions required by section 401 (j) (absent a waiver under section 401 (k)), the Secretary or his delegate may—

"(1) order that the plan be terminated if, after notice and opportunity for a hearing, such action is considered necessary to protect the interests of participants,

"(2) require that any deductions attributable to the maintenance and operation of a qualified pension or profit-sharing plan for the 5 taxable years immediately preceding the year of termination be included in the income of the employer in the year of termination, or

"(3) take such other action as he deems consistent with the purposes of such section."

INSURANCE REQUIREMENTS

SEC. 325. Section 401 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by adding at the end thereof the following new subsection:

"(m) INSURANCE REQUIREMENT.—A trust forming part of a plan shall constitute a qualified trust under this section only so long as the unfunded vested liabilities (whether incurred before the date of enactment of the Comprehensive Private Pension Security Act of 1973 or later) of that trust are insured by the Pension Guarantee Corporation."

CERTAIN TRANSFERS NOT CONSIDERED DISTRIBUTIONS

SEC. 326. Section 402 (a) (relating to taxability of beneficiary of exempt trust) is amended by redesignating paragraphs (3) through (5) as (4) through (6), and by inserting after paragraph (2) the following new paragraph:

"(3) CERTAIN TRANSFERS.—For purposes of this section, a transfer of any amount representing an employee's interest in an employee's trust described in section 401 (a) which is exempt from tax under section 501 (a), or in an individual retirement account described in section 409, shall not be considered a distribution under paragraph (1) if the transfer is made in connection with a change of employment by the employee and the transfer is made from a trust under his former employer, or from his individual retirement account, to—

"(A) a trust under his new employer, or

"(B) to an individual retirement account of the taxpayer."

TECHNICAL AMENDMENTS

SEC. 327. (a) Section 401 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by adding at the end thereof the following new subsection:

"(n) CERTAIN PROVISIONS INAPPLICABLE TO GOVERNMENT PLANS.—The provisions of paragraphs (11) through (15) of subsection (a) and of subsections (j), (k), (l), and (m) shall not apply to any plan operated by the Government of the United States or of any State or political subdivision thereof."

(b) Section 404(a)(2) (relating to employee's annuities) is amended by—

(1) inserting "(12), (13), (14), and (15)," after "section 401(a) (3), (4), (5), (6), (7), and (8),"; and

(2) inserting "(j), (l), and (m)," after "section 401(d) (other than paragraph (1)),".

(c) Section 805(d)(1)(C) (relating to pension plan reserves defined) is amended by striking out "section 401 (a) (3), (4), (5), (6), (7), and (8)" and inserting "section 401(a) (other than paragraphs (1), (2), (9), (10), and (11)), and subsections (j), (l), and (m) of section 401".

EFFECTIVE DATE

SEC. 328. The amendments made by this subtitle shall apply with respect to taxable years beginning more than

3 years after the date of enactment of this Act, except that the amendment made by section 325 shall apply with respect to taxable years beginning more than 1 year after the date of enactment of this Act.

Subtitle B—Retirement Savings Credit

CREDIT ALLOWED

SEC. 341. (a) ALLOWANCE OF CREDIT.—Subpart A of part IV subchapter A of chapter 1 (relating to credits against tax) is amended by redesignating section 42 as 43, and by inserting after section 41 the following new section:

"SEC. 42. RETIREMENT SAVINGS.

"(a) CREDIT ALLOWED.—There shall be allowed, as a credit against the tax imposed by this chapter, amounts paid during the taxable year by an individual (other than as an employer)—

"(1) to a qualified individual retirement account (as defined in section 409 (a)),

"(2) to an employees' trust described in section 401 (a) which is exempt from tax under section 501 (a),

"(3) for the purchase of an annuity contract under a plan which meets the requirements of section 404 (a) (2),

"(4) to or under a qualified bond purchase plan (as defined in section 405), or

"(5) for the purchase of an annuity contract described in section 403 (b).

"(b) LIMITATION.—

"(1) GENERAL RULE.—The amount allowable as a credit under subsection (a) to an individual for any taxable year shall not exceed the lesser of $375 or 25 percent of the amount described in subsection (a) paid during such year.

"(2) REDUCTION ON ACCOUNT OF EMPLOYER OR OWNER-EMPLOYEE CONTRIBUTIONS.—The amount computed under paragraph (1) of this subsection shall be reduced by—

"(A) 25 percent of the amount of any contributions made by the taxpayer as an owner-employee during his taxable year, and

"(B) 25 percent of the amount (determined in accordance with regulations prescribed by the Secretary or his delegate) of any contributions made on behalf of the taxpayer by his employer during the taxpayer's taxable year—

"(i) to an employee's trust described in section 401 (a) which is exempt from tax under section 501 (a),

"(ii) for the purchase of an annuity contract under a plan which meets the requirements of section 404 (a) (2),

"(iii) to or under a qualified bond purchase plan (as defined in section 405), or

"(iv) for the purchase of an annuity contract described in section 403 (b).

In accordance with regulations prescribed by the Secretary or his delegate, the amount of any contributions described in the preceding sentence made on behalf of a taxpayer by his employer during his taxable year may, at the option of the taxpayer, be considered to be 7 percent of his earned income for such taxable year attributable to the performance of personal services for such employer.

"(3) REDUCTION APPLICABLE TO CERTAIN PUBLIC AND OTHER EMPLOYEES.—If a taxpayer has earned income for the taxable year which is not subject to tax under chapter 2, 21, or 22, the amounts which may be taken into account in determining the allowable credit under subsection (a) shall be the amounts described in such subsection reduced by an amount equal to 25 percent of the tax (or the increase in the tax) that would be imposed upon such income under section 3101 for such taxable year if the personal services from the performance of which such income is derived constituted employment (within the meaning of section 3121 (b)).

"(4) MARRIED INDIVIDUALS.—The limitation provided by this subsection in the case of a married individual shall be determined without regard to the earned income of his spouse and without regard to contributions described in paragraph (2) made on behalf of his spouse. For purposes of this subsection, the earned income of a married individual shall be determined without regard to community property laws.

"(5) EARNED INCOME DEFINED.—For puropses of this subsection, the term 'earned income' has the meaning assigned to such term—

"(A) in the case of a self-employed individual, section 401 (c) (2), and

"(B) in the case of an individual who is not a self-employed individual, section 911 (b)."

INDIVIDUAL RETIREMENT ACCOUNTS

SEC. 342. Part I of subchapter D of chapter 1 (relating to pension, profit-sharing, stock bonus plans, etc.) is amended by adding at the end thereof the following new section:

"SEC. 409. INDIVIDUAL RETIREMENT ACCOUNTS.

"(a) REQUIREMENTS FOR QUALIFICATION.—A trust, custodial account, annuity contract, or other similar arrangement created or organized in the United States shall constitute a qualified individual retirement account under this section only if—

"(1) it is maintained for the purpose of distribution to the individual who established it, his spouse, or his beneficiaries, the contributions thereto and the income therefrom;

"(2) except as otherwise provided in subsections (b) (1) and (2), contributions thereto during any taxable year may not exceed the lesser of 20 percent of earned income (as defined in section 42(b) (5)) or $1,500 for such taxable year and may be made only by the individual who established it or his spouse;

"(3) except as otherwise provided in subsection (b) (3), the assets thereof are not commingled with the other property of the individual who established it or his spouse, and the contributions are used to purchase an annuity meeting the requirements of section 401 (g), or the contributions are held in trust by, or in the custody of, a bank (as defined in section 401 (d) (1)), a credit union described in section 501 (c) (14), or any other person who demonstrates to the satisfaction of the Secretary or his delegate that the manner in which he will hold or have custody of such assets will be consistent with the requirements of this paragraph;

"(4) except as otherwise provided in subsection (b) (1), under the plan or the other governing instrument, no benefits may be paid to the individual who established it before he attains the age of 59½ years unless (in accordance with regulations prescribed by the Secretary or his delegate) he, his spouse, or one of his dependents (as defined in section 152) becomes seriously ill and he is required to spend a substantial sum of money in medical bills and this expenditure poses a severe financial hardship;

"(5) under the plan or other governing instrument the entire interest of the individual who established it will be distributed to him not later than his taxable year in which he attains the age of 70½ years, or will be distributed, commencing not later than such taxable year, in accordance with regulations prescribed by the Secretary or his delegate, over—

"(A) the life of such individual or the lives of such individual and his spouse, or

"(B) a period not extending beyond the life expectancy of such individual or the life expectancy of such individual and his spouse; and

"(6) if contributions thereto may be used for the purchase of annuity or similar contracts issued by a life insurance company, under the plan or other governing instrument, any refunds of premiums and any amounts in the nature of a dividend or similar distribution must be held by the issuer of such contract and may be applied only toward the payment of future premiums or to the purchase of additional similar benefits.

"(b) SPECIAL RULES.—

"(1) TRANSFER OF ASSETS.—Subsections (a) (2) and (a) (4) shall not be applied to prevent the contribution of amounts to which section 72 (p) would otherwise apply to qualified individual retirement account for the benefit of the same taxpayer or the same taxpayer and his spouse.

"(2) LIMITATION ON CONTRIBUTIONS.—Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided in paragraphs (2) and (3) of section 401 (e) (relating to excess contributions on behalf of owner-employees) are to apply to contributions to a qualified individual retirement account to the extent necessary to carry out the purposes of this section.

"(3) USE OF COMMON TRUST FUNDS.—Subsection (a) (3) shall not be applied to prevent the investment of the assets of a qualified individual retirement account in a common trust fund.

"(c) TREATMENT AS QUALIFIED TRUST BENEFITING OWNER-EMPLOYEE.—For purposes of subchapter F and subtitle F, a qualified individual retirement account shall be treated as a trust described in section 401 (a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401 (c) (3)), the individual who established such qualified individual retirement account and his spouse shall be treated as owner-employees for whom such contributions or benefits are provided, and the person holding or having custody of the assets of such qualified individual retirement account shall be treated as the trustee of such trust.

"(d) TAXABILITY OF BENEFICIARY OF QUALIFIED INDIVIDUAL RETIREMENT ACCOUNT.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the amount actually distributed or made available to any beneficiary by a qualified individual retirement account shall be taxable to him, in the year in which so distributed or made available, under section 72 (relating to annuities).

"(2) RECONTRIBUTED AMOUNTS.—Paragraph (1) shall not apply to any amount distributed or made available by a qualified individual retirement account to the individual who established such account to the extent that, within 60 days after the day on which such amount is distributed or made available, such amount is contributed to a qualified individual retirement account for the benefit of such individual or such individual and his spouse.

"(3) APPLICABILITY OF SECTION 72 (m).—Under regulations prescribed by the Secretary or his delegate, an individual establishing a qualified individual retirement account shall be treated as an owner-employee for purposes of applying paragraphs (1), (2), (3), and (4) of section 72 (m) (relating to special rules applicable to employee annuities and distributions under employee plans)..

"(e) CAPITAL GAINS TREATMENT AND LIMITATION OF TAX NOT TO APPLY TO DISTRIBUTIONS.—Section 72 (n), section 402 (a) (2), and section 403 (a) (2) shall not apply to any amount distributed or made available by a qualified individual retirement account."

TREATMENT OF DISTRIBUTIONS FROM QUALIFIED INDIVIDUAL RETIREMENT ACCOUNTS

SEC. 343. (a) IN GENERAL.—Section 72 (relating to annuities) is amended by redesignating subsection (p) as subsection (q) and by inserting after subsection (o) the following new subsection:

"(p) PREMATURE DISTRIBUTIONS FROM QUALIFIED INDIVIDUAL RETIREMENT ACCOUNTS.—

"(1) APPLICATION OF SUBSECTION.—This subsection shall apply to—

"(A) distributions from a qualified individual retirement account, and

"(B) amounts which are received from a qualified trust described in section 401 (a) or under a plan described in section 403 (a), but only to the extent attributable under regulations prescribed by the Secretary or his delegate to amounts with respect to which a credit was allowable under section 42 (relating to retirement savings),

which are includable in gross income and which are received by the individual who established such qualified individual retirement account or who was allowed such credit (or the spouse of such individual) before he or his spouse attains the age of 59½ years, for any reason other than his becoming disabled (within the meaning of section 409 (a) (4)), but only to the extent that such amount is not contributed within 60 days after the day on which such amount is distributed or made available to a qualified individual retirement account for the benefit of such individual or such individual and his spouse.

"(2) AMOUNT OF PENALTY.—If an individual is required to include in gross income for the taxable year an amount to which this subsection applies, there shall be imposed an additional tax for such taxable year equal to 30 percent of such amount. Any tax imposed under this paragraph shall not be reduced by any credit under part IV of subchapter A (other than sections 31 and 39 thereof), and shall not be treated as tax imposed by this chapter for purposes of section 56."

(b) INVESTMENT IN THE CONTRACT.—

(1) Subparagraph (A) of section 72(c)(1) (relating to definition of investment in the contract) is amended by inserting after "contract" the following: "for which no credit was allowed under section 42 (relating to retirement savings)".

(2) Section 72(d)(2) (relating to employees' annuities) is amended by striking out "and" at the end of subparagraph (A), by striking out the period at the end of subparagraph (B) and inserting in lieu thereof "; and", and by inserting after subparagraph (B) the following new subparagraph:

"(C) any contribution made with respect to the contract shall not be treated as consideration for the contract contributed by the employee to the extent that a credit was allowed under section 42 (relating to retirement savings) with respect to such contribution."

(c) AMOUNTS RECEIVED BEFORE ANNUITY STARTING DATE.—Section 72 (m) (1) (relating to special rule applicable to amounts received before annuity starting date) is amended to read as follows:

"(1) CERTAIN AMOUNTS RECEIVED BEFORE ANNUITY STARTING DATE.—Any amounts received under an annuity, endowment, or life insurance contract before the annuity starting date which are not received as an annuity (within the meaning of subsection (e) (2)) shall be included in the recipients gross income for the taxable year in which received to the extent that such amounts, plus all amounts theretofore received under the contract and includable in gross income under this paragraph, do not exceed the aggregate premiums or other consideration paid for the contract—

"(A) while the employee was an owner-employee which were allowed as deductions under section 404 for the taxable year and all prior taxable years, or

"(B) with respect to which credits were allowed under section 42 for the taxable year and all prior taxable years, except to the extent that, within 60 days after the day on which such amounts are received, such amounts are contributed to a qualified individual retirement account for the benefit of the recipient or the recipient and his spouse.

Any such amounts so received which are not includable in gross income under this paragraph shall be subject to the provisions of subsection (c)."

TECHNICAL AND CLERICAL AMENDMENTS

SEC. 344. (a) TECHNICAL AMENDMENTS.—

(1) PENSION PLAN RESERVES.—

(A) Section 805(d)(1) (relating to definition of pension plan reserves) is amended by striking out "or" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting in lieu thereof "; or", and by adding at the end thereof the following new subparagraph:

"(E) purchased under contracts entered into with trusts, custodial accounts, or other similar arrangements which (as of the time the contracts were entered into) were deemed to be qualified individual retirement accounts (and defined in section 409 (a))".

(B) Section 801(g)(7) (relating to segregated asset accounts) is amended by striking out "or (D)" and inserting in lieu thereof "(B), or (E)".

(2) AVERAGEABLE INCOME.—Paragraph (2) (A) of section 1302 (a) (relating to definition of averageable income) is amended by striking out "section 72 (m) (5)" and inserting in lieu thereof "section 72 (m) (5) or 72 (p)".

(3) EARNED INCOME.—Section 1348 (b) (1) (relating to definition of earned income) is amended by striking out "72 (n)" and inserting in lieu thereof "72 (n), 72 (p)".

(b) CLERICAL AMENDMENTS.—

(1) The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by striking out the last item and inserting in lieu thereof the following new items:

"Sec. 42. Retirement savings.
"Sec. 43. Overpayments of tax."

(2) The table of sections for part I of subchapter D of chapter 1 is amended by adding at the end thereof the following new items:

"Sec. 408. Failure to make required contributions.
"Sec. 409. Individual retirement accounts."

EFFECTIVE DATE

SEC. 345. The amendments made by this title shall apply with respect to taxable years beginning more than one year after the date of enactment of this Act.

TITLE IV—PENSION INSURANCE

SEC. 401. (a) There is created a Pension Guarantee Corporation (hereinafter referred to as the "corporation") which shall insure, as hereinafter provided, the unfunded vested liabilities of all pension, profit-sharing, stock bonus, and bond purchase plans which otherwise qualify under section 401 or 404 (a) (2) of the Internal Revenue Code of 1954.

(b) The corporation shall not be an agency or establishment of the United States Government.

(c) The corporation shall be a nonprofit membership corporation composed of those plans which purchase insurance from the corporation.

(d) Except as otherwise provided in this title, the corporation shall be subject to, and have all the powers conferred on a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act (D.C. Code, sec. 29-1001).

BOARD OF DIRECTORS

SEC. 402. (a) The corporation shall have a board of directors which, subject to the provisions of this Act, shall determine the policies which shall govern the operations of the corporation.

(b) The board of directors shall consist of—

(1) the Secretary of the Treasury or his designee, ex officio;

(2) the Secretary of Labor or his designee, ex officio; and

(3) five directors appointed by the President as follows:

(A) two from among persons associated with employee organizations,

(B) two from among persons associated with employers, and

(C) one from among members of the general public not eligible for appointment under subparagraphs (A) and (B).

(c) The President shall designate a chairman and vice chairman from among those directors appointed under paragraph (3) of subsection (b).

(d) (1) Except as provided in subparagraphs (A) and (B), each director shall be appointed for a term of three years.

(A) Of the directors first appointed, two shall hold office for a term of one year, two shall hold office for a term of two years, and one shall hold office for a term of three years, as designated by the President at the time of their appointment.

(B) A vacancy in the board shall be filled in the same manner as the original appointment was made. Any director appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed only for the remainder of such term. A director may serve after the expiration of his term until his successor has taken office.

(e) All matters relating to compensation of directors shall be as provided in the bylaws of the corporation.

(f) The board of directors shall meet at the call of its chairman, or as otherwise provided by the bylaws of the corporation.

BYLAWS

SEC. 403. (a) As soon as practicable but not later than forty-five days after the date of enactment of this title, the board of directors shall adopt initial bylaws and rules relating to the conduct of the business of the corporation and the exercise of the rights and powers granted to it by this title, and shall file a copy thereof with the Secretary of the Treasury (hereinafter referred to as the "Secretary"). Thereafter, the board of directors may alter, supplement, or repeal any existing bylaw or rule and may adopt additional bylaws and rules, and in each such case shall file a copy thereof with the Secretary.

(b) Each such bylaw or rule or amendment thereto shall take effect upon the thirtieth day (or such later date as the board of directors may designate) after the filing of the copy thereof with the Secretary or upon such earlier date as the Secretary may determine, unless the Secretary shall by notice to the corporation setting forth the reasons therefor, disapprove the same, in whole or in part, as being contrary to the public interest or contrary to the purposes of this title.

(c) The Secretary may, by such rules or regulations as he determines to be necessary or appropriate in the public interest or to effectuate the purposes of this title, require the adoption, amendment, alteration of, supplement to, or rescission of any bylaw or rule by the corporation whenever adopted.

PENSION GUARANTEE FUNDS

SEC. 404. (a) The corporation shall establish two funds, one of which shall be known as the single-employer fund and the other of which shall be known as the multi-employer fund (hereinafter referred to as the "insurance funds"). All amounts received as premiums, assessments, or fees, and any other moneys, property, or assets derived from the operation by the corporation of the insurance program shall be deposited in the appropriate insurance fund and all claims, expenses, and payments pursuant to the operation of such program shall be paid from the appropriate insurance fund.

(b) All moneys of the insurance funds may be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States.

PROTECTION OF PARTICIPANTS

SEC. 405. (a) Subject to the limitations in subsection (b), upon the termination of a member plan, the corporation shall cause to be paid to each participant in such plan, or to his beneficiary (if such beneficiary would be entitled to receive such benefits), an amount or amounts which (when added to the amounts paid to him by the plan) are necessary to provide him retirement benefits in an amount equal to the retirement benefits with respect to which he had nonforfeitable rights under the plan upon the date of termination of the plan.

(b) The aggregate amount payable to a participant or his beneficiary by the corporation shall not exceed the amount which, in addition to the sum of the amounts paid him by the plan, is necessary to provide a monthly retirement benefit for the life of the participant payable at normal retirement age (or, in the case of a participant who was disabled prior to the termination of the plan, payable at such time as is specified in the plan) equal to the lesser of (1) $1,000 or (2) 50 per centum of his average monthly wage for the five-year period following the date on which the plan became a member of the corporation for which his earnings were their greatest. In the case of a participant (or a beneficiary) who is receiving retirement benefits at the time the plan is terminated, the limitations on the amounts of payments from the corporation shall be determined under regulations issued by the corporation consistent with the principles of this subsection.

(c) Unless otherwise authorized by the corporation, no amount shall be payable by the corporation in the case of a plan which is terminated within five years after it becomes a member of the corporation. The corporation may authorize payments in the case of such a plan only if—

(1) it was maintained as a qualified plan under section 401 of the Internal Revenue Code of 1954 for more than five years prior to its termination;

(2) the corporation is satisfied that during the period the plan was not a member, it was in substantial compliance with the provisions of section 401 (j) of the Internal Revenue Code of 1954 (relating to funding requirements); and

(3) such payments will not prevent equitable underwriting of losses of vested benefits otherwise covered by this title.

(d) No amount shall be payable by the corporation with respect to benefits which were created by a plan amendment which took effect within the three-year period prior to its termination.

(e) No amount shall be payable by the corporation with respect to the interest of a participant who, on the date of the plan's termination, is the owner of 10 per centum or more of the voting stock of the employer, or of a 10 per centum or more interest in the employer where it is an unincorporated trade or business.

(f) The corporation shall, by regulation, prescribe the procedures under which the funds of terminated plans shall be wound up and liquidated and the proceeds therefrom applied to payment of the nonforfeitable benefits of participants and beneficiaries. In implementing this subsection, the corporation shall have authority—

(1) to transfer the funds in the terminated plan to the appropriate insurance fund for purposes of liquidation and payment of benefits to participants and beneficiaries;

(2) to purchase single-premium life annuities with the funds of the terminated plan; or

(3) to take such other action as may be appropriate to assure equitable arrangements for the payment of nonforfeitable benefits to participants and beneficiaries under the plan.

INITIAL ASSESSMENTS

SEC. 406. Each member plan of the corporation shall pay to the corporation, on becoming a member, a uniform assessment as prescribed by the corporation to cover the administrative costs of establishing and maintaining the insurance program.

ANNUAL PREMIUMS

SEC. 407. (a) Each member plan shall pay an annual premium to the corporation determined by applying the premium rate established by the corporation for that year to the plan's unfunded liabilities for nonforfeitable benefits which are protected by the insurance program (referred to herein as "unfunded vested liabilities"). The corporation may establish a uniform premium rate for all member plans, may establish separate uniform premium rates for single-employer plans and for multi-employer plans, or may establish a schedule of premium rates which vary by the likelihood that, and the extent to which, a plan may produce liabilities to the insurance program.

(b) For the three-year period immediately following the effective date of this title, the annual premiums payable pursuant to subsection (a) shall not exceed—

(1) two-tenths of a per centum of a plan's unfunded vested liabilities incurred prior to the date of enactment of this Act, where such plan is a multi-employer plan

or where such plan's median ratio of plan assets to unfunded vested liabilities was 75 per centum during the five-year period immediately preceding the enactment of this Act or, in the event of a plan established within such five-year period, where the plan has reduced the amount of such unfunded vested liabilities at the rate of at least 5 per centum each year since the plan's date of establishment; or

(3) four-tenths of a per centum of a plan's unfunded vested liabilities incurred prior to the date of enactment of this Act where such plan does not meet the standards set forth in paragraph (2) and is not a multiemployer plan.

(c) The corporation is authorized to prescribe different premium rates after the initial three-year period based upon experience and other relevant factors.

(d) The corporation may impose upon its members such special assessments as it may deem necessary and appropriate to provide additional funds to meet obligations of the insurance program. Any assessments so made on a plan for any year shall not exceed the annual premium payable by the plan for that year multiplied by three, and shall be determined in a manner consistent with the methods for determining such annual premium.

(e) In the event that one or both of the insurance funds is or may reasonably appear to be insufficient for the purposes of this Act, the Secretary is authorized to make loans to the corporation. At the time of application for, and as a condition to, any such loan, the corporation shall file with the Secretary a statement with respect to the anticipated use of the proceeds of the loan. A loan shall be made only if the Secretary determines that it is necessary for the protection of participants of member plans and the maintenance of confidence in the private retirement system. The corporation must submit a plan which provides a reasonable assurance of prompt repayment under the circumstances. Such loan shall bear interest at a rate determined by the Secretary taking into consideration the current average market yield on outstanding marketable obligations of the United States of comparable maturities. The Secretary may reduce the interest rate if he determines such reduction to be in the national interest. There are authorized to be appropriated to the Secretary of the Treasury such sums as may be necessary to carry out his duties under this title.

93D CONGRESS
1ST SESSION

S. 1631

IN THE SENATE OF THE UNITED STATES

APRIL 18, 1973

Mr. HANSEN (for Mr. CURTIS) (for himself, Mr. HANSEN, Mr. BENNETT, Mr. DOMINICK, and Mr. FANNIN) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To strengthen and improve the private retirement system by establishing minimum standards for participation in and for vesting of benefits under pension and profit-sharing retirement plans, by allowing deductions to individuals for their contributions to retirement plans, by increasing contribution limitations for self-employed individuals and shareholder-employees of electing small business corporations, by imposing an excise tax on prohibited transactions, and for other purposes.

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

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Retirement Benefits Tax Act".

II

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment is expressed in terms of an amendment to a section or other provision of the Internal Revenue Code of 1954.

SEC. 2. MINIMUM STANDARDS RELATING TO FUNDING, ELIGIBILITY, AND VESTING.

(a) IN GENERAL.—Section 401 (a) (relating to requirements for qualification) is amended:

(1) by inserting at the end of paragraph (7) the following:

"For purposes of this paragraph, a complete discontinuance of contributions under a defined benefit pension plan occurs if the amount contributed to or under the plan for a plan year beginning after December 31, 1973, is less than the minimum funding standard. For this purpose, the minimum funding standard is the excess (if any) of—

"(A) the sum of—

"(i) the normal cost of the plan for such year plus interest on the unfunded liability, computed under the funding method used to determine normal costs,

"(ii) 5 percent of the unfunded liability for nonforfeitable benefits under the plan (computed as the excess of the present value of the then accrued nonforfeitable benefits over the fair market value of the assets), and

"(iii) the total of the amounts determined under clauses (i) and (ii) with respect to the plan for each of the preceding plan years beginning after December 31, 1973, over

"(B) the total of the amounts contributed to or under the plan for each of the preceding plan years beginning after December 31, 1973.

The minimum funding standard determined under the preceding sentence shall not exceed the excess (if any) of the accrued liability under the entry age normal funding method (including the normal cost for the year), over the fair market value of the assets held under the plan. In lieu of the minimum funding standard otherwise provided under this paragraph, the Secretary or his delegate may authorize the use of another minimum funding standard which results in a satisfactory rate of funding.", and

(2) by adding at the end thereof the following new paragraphs:

"(11) A trust shall not constitute a qualified trust under this section if the plan of which such trust is a part requires, as a condition of participation, that an employee—

"(A) have a period of continuous service with the employer (or, in accordance with regulations prescribed by the Secretary or his delegate, a predecessor of the employer) in excess of 3 years,

"(B) have attained an age in excess of 30 years, or

"(C) have not attained an age which is greater than the normal retirement age under the plan reduced by 5 years.

The Secretary or his delegate shall by regulation define the term 'normal retirement age under the plan' for purposes of this paragraph.

"(12) (A) Except as provided in subparagraphs (B) and (C), a trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, an employee's rights in his accrued benefit derived from his own contributions are nonforfeitable (other than by reason of death); his rights in at least 50 percent of his accrued benefit derived from employer contributions become nonforfeitable (other than by reason of death)—

"(i) as of the close of the first plan year in which the sum of his age and the period of his active participation in the plan equals or exceeds 50 years, or "(ii) as of the time he has completed 3 years of continuous service with the employer (or, in accordance with regulations prescribed by the Secretary or his delegate, a predecessor of the employer),

whichever occurs later; and his rights in the remaining percentage of all of his accrued benefit derived from employer contributions become nonforfeitable (other than by reason of death) not less rapidly than ratably over the next succeeding 5 plan years.

"(B) A trust which is a part of a plan to which employees are required to contribute as a condition of participation shall not be disqualified under this paragraph merely because an employee's rights in his accrued benefit derived from employer contributions under the plan are forfeitable if, by reason of his separation from the service or termination of his active participation in the plan, he voluntarily withdraws all or a part of the amount contributed by him.

"(C) This paragraph shall not apply to contributions which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude discrimination prohibited by paragraph (4), may not be used to provide benefits for designated employees in the event of early termination of the plan.

"(D) For purposes of this paragraph and subsection (d) (2) (A), an employee's accrued benefit as of any applicable date is—

"(i) in the case of a defined benefit pension plan, except as provided under subparagraph (F), the annual benefit commencing at normal retirement age to which he would be entitled under the plan as in effect at such time if he continued to earn annually until normal retirement age the same rate of compensation as he earned at such time (based upon his earnings during the 12 preceding months or, if shorter, the actual preceding period of employment) multiplied by a fraction, the numerator of which is the total number of his years of service with the employer (or in accordance with regulations prescribed by the Secretary or his delegate, a predecessor of the employer) performed as of such time, and the denominator of which is the total number of years of service he would have performed as of normal retirement age if he had continued to be employed by the employer until attaining such age, except that the denominator of such fraction shall not be less than 15 nor more than 40, or

"(ii) in the case of a plan other than a defined benefit pension plan, the balance of the account or accounts for such employee as of that time,

For purposes of this subparagraph, the fraction referred to in clause (i) shall be equal to one at normal retirement age and shall never exceed one. In the case of a defined benefit pension plan which permits voluntary employee contributions, the portion of an employee's accrued benefit derived from such contributions shall be treated as an accrued benefit derived from contributions under a plan other than a defined benefit pension plan.

"(E) For purposes of this paragraph, an employee's accrued benefit derived from employer contributions as of any applicable date is the excess of the accrued benefit determined under subparagraph (D) for such employee as of such applicable date over the amount of the accrued benefit derived from contributions made by such employee as of such date. With respect to a plan other than a defined benefit pension plan, the amount of accrued benefit derived from contributions made by an employee is the benefit attributable to the balance of the employee's separate account consisting only of his contributions and the income, gains and losses attributable thereto or, if a separate account is not maintained with respect to an employee's contributions under such a plan, is an amount which bears the same ratio to the total accrued benefit as the total amount of the employee's contributions (less withdrawals) bears to the total amount of such contributions and the contributions made on his behalf by the employer. With respect to a defined benefit pension plan providing an annual benefit in the form of a single life annuity commencing at normal retirement age, the amount of the accrued benefit derived from contributions made by an employee as of any applicable date is the annual benefit equal to the employee's accumulated contributions multiplied by the appropriate conversion factor. For this purpose, the term 'appropriate conversion factor' means the factor necessary to convert an amount equal to the accumulated contributions to a single life annuity commencing at normal retirement age and shall be 10 percent for a normal retirement age of 65 years. For other normal retirement ages the conversion factor shall be determined in accordance with regulations prescribed by the Secretary or his delegate. For purposes of this subparagraph, the term 'accumulated contributions' means the total of:

"(i) all mandatory contributions made by the employee before the end of the last plan year referred to in paragraph (14) (A) (i) or (ii), together with interest (if any) credited thereon under the plan to the end of such plan year (to the extent such contributions and interest are nonforfeitable on the applicable date), and insert compounded annually thereafter at the rate of 5 percent per annum, to the date upon which the employee would attain normal retirement age, and

"(ii) all mandatory contributions made by the employee after the end of the last plan year referred to in paragraph (14) (A) (i) or (ii), together with interest on such contributions compounded annually at the rate of 5 percent per annum to the date upon which the employee would attain normal retirement age.

The accrued benefit derived from contributions made by an employee shall not exceed the accrued benefit determined under subparagraph (D). For purposes of this subparagraph, mandatory contributions made by an employee are the contributions that are required to be made under the plan to receive any benefit derived from employer contributions.

"(F) For purposes of this paragraph, in the case of any defined benefit pension plan, if an employee's accrued benefit is to be determined as an amount other than an annual benefit commencing at normal retirement date, or if the amount of accrued benefit derived from contributions made by an employee is to be determined with respect to a benefit other than an annual benefit in the form of a single life annuity commencing at normal retirement age, the employee's accrued benefit, or the amount of accrued benefit derived from contributions made by an employee, as the case may be, shall be the actuarial equivalent (determined in accordance with regulations prescribed by the Secretary or his delegate) of such benefit or amount d͜etermined under subparagraph (D) or (E).

"(13) (A) Except as provided in subparagraph (B), a trust which is a part of a defined benefit pension plan in existence on December 31, 1972, shall not be disqualified under paragraph (12) merely because the plan of which it is a part provides that an employee's accrued benefit derived from employer contributions for any plan year is forfeitable if—

"(i) for such plan year the sum of the periodic benefit payments to retired participants exceeds the benefit accruals (determined in accordance with regulations prescribed by the Secretary or his delegate) by active participants, and

"(ii) as of the beginning of such plan year, the sum of the present values of accrued plan liabilities to active and retired participants exceeds the fair market value of plan assets.

"(B) Subparagraph (A) shall not apply—

"(i) for any plan year which begins after December 31, 1972, in which the plan is amended to provide additional or increased benefits;

"(ii) for any plan year beginning after the plan year described in clause (i); or

"(iii) for any plan year which begins after December 31, 1972, and which precedes the plan year described in clause (i) by not more than five plan years.

"(14) (A) Except as provided by subparagraph (B), paragraphs (11) and (12) shall not apply in the case of a plan in existence on December 31, 1972, with respect to the eligibility of participants or the benefits accrued under such plan during—

"(i) a plan which begins before January 1, 1975, or

"(ii) if later, a plan year ending before the termination of an agreement, pursuant to which the plan is maintained, which the Secretary or his delegate finds to be a collective-bargaining agreement, between employee representatives and one or more employers, in effect on December 31, 1972.

For purposes of clause (ii), the date on which an agreement terminates shall be determined without regard to any extension thereof agreed to after December 31, 1972.

"(B) Paragraph (12) shall apply to all benefits accrued under the plan unless—

"(i) the conditions of nonforfeitability provided under the plan as in effect on December 31, 1972, remain in effect with respect to benefits accrued during any plan year referred to in subparagraph (A) (i) or (ii), and

"(ii) in the case of a profit sharing, stock bonus, or money purchase pension plan, separate accounts are maintained with respect to the benefits accrued during the plan years referred to in subparagraph (A) (i) or (ii)."

(b) PLANS BENEFITING OWNER-EMPLOYEES.—Section 401 (d) (relating to additional requirements for qualification of trusts and plans benefiting owner-employees) is amended—

(1) VESTING.—By striking out paragraph (2) (A) and inserting in lieu thereof:

"(A) an employee's rights to his accrued benefit derived from his own contributions (within the meaning of subsection (a) (12)) are nonforfeitable (other than by reason of death), and his rights in at least 50 percent of such accrued benefit derived from employer contributions (within the meaning of subsection (a) (12)) are nonforfeitable (other than by reason of death) as of the close of the first plan year in which the sum of his age and the period of his active participation in the plan equals or exceeds 35 years, and his rights in the remaining percentage of all of his accrued benefit derived from employer contributions become nonforfeitable (other than by reason of death) not less rapidly than ratably over the next succeeding 5 plan years; and".

(2) ELIGIBILITY CONDITIONS.—By striking out paragraph (3) and inserting in lieu thereof:

"(3) THE PLAN BENEFITS.—

"(A) each employee who has not attained the age of 30 years and has a period of continuous service with the employer of 3 or more years,

"(B) each employee who has attained the age of 30 years but has not attained the age of 35 years and has a period of continuous service with the employer of 2 or more years, and

"(C) each employee who has attained the age of 35 years and who has a period of continuous service with the employer of 1 or more years.

For purposes of the preceding sentence, the term 'employee' does not include any employee whose customary employment is for not more than 20 hours in any one week or is for not more than 5 months in any calendar year. For purposes of this paragraph, under regulations prescribed by the Secretary or his delegate, the term 'employer' shall include a predecessor of the employer."

(c) CONFORMING AMENDMENTS.—

(1) Section 404 (a) (2) (relating to deduction for contributions of an employer to employees' annuity plan) is amended by striking out "and (8), and, if applicable, the requirements of section 401 (a) (9) and (10) and of section 401 (d) (other than paragraph (1))," and inserting in lieu thereof "(8), (11), (12), and (13), and, if applicable, the requirements of section 401 (a) (9) and (10), section 401 (c) (6), and section 401 (d) (other than paragraph (1)),".

(2) Section 405 (a) (1) (relating to qualified bond purchase plans) is amended by striking out "and (8) and, if applicable, the requirements of section 401 (a) (9) and (10) and of section 401 (d) (other than paragraphs (1), (5) (B), and (8)); and" and inserting

in lieu thereof "(8), and (11), and, if applicable, the requirements of section 401 (a) (9) and (10) and of section 401 (d) (other than paragraphs (1), (2) (A), (5) (B), and (8)); and",

(3) Section 805 (d) (1) (C) (relating to definition of pension plan reserves) is amended by striking out "and (8)" and inserting in lieu thereof "(8), (11), (12), and (13)".

(d) EFFECTIVE DATES.—

(1) GENERAL RULE.—Except as provided by paragraph (2), the amendments made by this section shall be effective after the date of enactment of this Act.

(2) EXCEPTION.—The amendments made by subsection (b) (2) shall not apply for a plan year beginning before January 1, 1975, in the case of a trust or contract which is a part of a plan in existence on December 31, 1972.

SEC. 3. DEDUCTION FOR RETIREMENT SAVINGS.

(a) IN GENERAL.—Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by redesignating section 219 as 220 and inserting after section 218 the following new section:

"SEC. 219. RETIREMENT SAVINGS.

"(a) DEDUCTION ALLOWED.—Subject to the limitations imposed by subsections (b) and (c), in the case of an individual, there shall be allowed as a deduction amounts paid in cash during the taxable year by such individual—

"(1) to or under a qualified individual retirement account described in section 408 (a) which is exempt from tax under section 501 (a), if the individual established such account,

"(2) to an employees' trust described in section 401 (a) which is exempt from tax under section 501 (a), for his benefit,

"(3) for the purchase of an annuity contract for the individual under a plan which meets the requirements of section 404 (a) (2), or

"(4) to or under a qualified bond purchase plan described in section 405 (a), for his benefit.

"(b) LIMITATIONS.—

"(1) GENERAL RULE.—Except as provided in paragraphs (2) and (3), the amount allowable as a deduction under subsection (a) to an individual for any taxable year shall not exceed an amount equal to 20 percent of his earned income paid or accrued for such taxable year, or $1,500, whichever is the lesser. This limitation shall apply to the sum of the amounts paid during the taxable year by the individual to or under all accounts, trusts, and plans described in subsection (a).

"(2) REDUCTION ON ACCOUNT OF EMPLOYER CONTRIBUTIONS TO QUALIFIED PENSION, ETC., PLANS.— The amount of the limitation otherwise determined under this subsection for any taxable year shall be reduced by the amount (determined in accordance with regulations prescribed by the Secretary or his delegate) of contributions paid on behalf of the individual by his employer (including an employer within the meaning of section 401 (c) (4)) for the individual's taxable year—

"(A) to an employees' trust described in section 401 (a) which is exempt from tax under section 501 (a),

"(B) for the purchase of an annuity contract under a plan which meets the requirements of section 404 (a) (2),

"(C) to or under a qualified bond purchase plan described in section 405 (a), or

"(D) for the purchase of an annuity contract described in section 403 (b).

In accordance with regulations prescribed by the Secretary or his delegate, the amount of contributions described in subparagraphs (A), (B), and (C) of the preceding sentence paid on behalf of an individual by his employer for his taxable year may, at the option of the individual, be considered to be 7 percent of his earned income paid or accrued for such taxable year attributable to the performance of personal services for such employer. The previous sentenee shall not apply in the case of a contribution on behalf of an owner-employee within the meaning of section 401 (c) (5).

"(3) Reduction for certain employees.—If an individual has earned income for the taxable year which is not subject to tax under chapter 2, 21, or 22, the amount of the limitation otherwise determined under this subsection for such year shall be reduced by an amount equal to the tax (or the increase in tax) that would have been imposed upon such income under section 3101 for the taxable year had such income constituted wages (as defined in section 3121 (a)) received by him with respect to employment (as defined in section 3121 (b)).

"(4) Contributions made after age 70½ years.—No deduction shall be allowed under this section with respect to any payment described in subsection (a) which is made by an individual who has attained the age of 70½ years.

"(c) Recontributed Amounts.—No deduction shall be allowed under this section with respect to a contribution to which section 72(p)(2)(C), 402(a) (6) or (7), or 403(a) (4) or (5), applies.

"(d) MARRIED INDIVIDUALS.—In the case of a married individual (as defined in section 153), the amount determined under subsection (b)(1) shall be determined without regard to the earned income of his spouse and without regard to contributions described in subsection (b)(2) paid on behalf of his spouse. For purposes of this section, the earned income of a married individual shall be determined without regard to the community property laws of a State.

"(e) EARNED INCOME DEFINED.—For purposes of this section, the term 'earned income' means any income which is earned income within the meaning of section 401 (c)(2) or 911(b).

"(f) TIME CONTRIBUTIONS DEEMED MADE.—For purposes of this section and section 408, an individual shall be deemed to have made a payment during the taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof)."

(b) INDIVIDUAL RETIREMENT ACCOUNTS.—Part I of subchapter D of chapter 1 (relating to pension, etc. plans) is amended by adding at the end thereof the following new section:

"SEC. 408. INDIVIDUAL RETIREMENT ACCOUNTS.

"(a) REQUIREMENTS FOR QUALIFICATION.—A trust created or organized in the United States shall constitute a qualified individual retirement account under this section provided that under a written governing instrument—

"(1) it is maintained for the purpose of distributing the contributions thereto and the income therefrom to the individual who established it or his beneficiaries;

"(2) except in the case of a contribution to which section 72 (p) (2) (C), 402 (a) (6), or 403 (a) (4) applies, contributions thereto during any taxable year may not exceed the excess of—

"(A) the limitation provided by section 219 (b) for such taxable year, over

"(B) the sum of the amounts paid by such individual during such year—

"(i) to an employees' trust described in section 401 (a) which is exempt from tax under section 501 (a), for his benefit,

"(ii) for the purchase of an annuity contract for the individual under a plan which meets the requirements of section 404 (a) (2), or "(iii) to or under a qualified bond purchase plan described in section 405(a), for his benefit,

and may be made only by the individual who established such account;

"(3) the assets thereof may not be commingled with other property except in a common trust fund;

"(4) the assets thereof are required to be held in trust by, or in the custody of, a bank (as defined in section 401(d)(1)) or other person who demonstrates to the satisfaction of the Secretary or his delegate that the manner in which such other person will hold or have custody of such assets will be consistent with the requirements of this section;

"(5) the entire interest of the individual who established it will be distributed to him not later than his taxable year in which he attains the age of 70½ years, or will be distributed, commencing not later than such taxable year, in accordance with regulations prescribed by the Secretary or his delegate, over—

"(A) the life of such individual or the lives of such individual and his spouse, or

"(B) a period not extending beyond the life expectancy of such individual or the life expectancy of such individual and his spouse;

"(6) if the individual who established it dies before his entire interest has been distributed to him, or if distribution has been commenced in accordance with paragraph (5) to his surviving spouse and such surviving spouse dies before the entire interest has been distributed to such surviving spouse, the entire interest (or the remaining part of such interest if distribution thereof has commenced) will, within 5 years after his death (or the death of his surviving spouse) be distributed, or applied to the purchase of an immediate annuity for his beneficiary or beneficiaries (or the beneficiary or beneficiaries of his surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which will be immediately distributed to such beneficiary or beneficiaries; and

"(7) if contributions thereto may be used for the purchase of an annuity or similar contract issued by a life insurance company, any refunds of premiums are applied within the current taxable year or next succeeding taxable year toward the payment of future premiums or the purchase of additional benefits.

For purposes of this title, a custodial account, annuity contract, or other similar arrangement shall be treated as a trust constituting a qualified individual retirement account. For purposes of paragraph (4), if the assets are held in custody, record title to the assets shall be in the name of the custodian or his nominee. Paragraph (6) shall not apply if distribution of the interest of such individual has commenced and such distribution is for a term certain over a period permitted under paragraph (5).

"(b) SPECIAL RULES.—

"(1) EXCESS CONTRIBUTIONS.—To the extent that contributions during any taxable year to a qualified individual retirement account are not deductible under section 219, they shall be treated, under regulations prescribed by the Secretary or his delegate, in the same manner as provided for in paragraphs (2) and (3) of section 401(e) (relating to excess contributions on behalf of owner-employees).

"(2) COMMUNITY PROPERTY LAWS.—This section shall be applied without regard to the community property laws of any State.

"(c) TREATMENT AS QUALIFIED TRUST BENEFITING OWNER-EMPLOYEE.—Solely for purposes of subchapter F, chapter 44, and subtitle F, a qualified individual retirement account shall be treated as a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401 (c) (3)), the individual who established such qualified individual retirement account shall be treated as an owner-employee for whom such contributions or benefits are provided, and the person holding or having custody of the assets of such qualified individual retirement account shall be treated as the trustee of such trust. If section 72 (p) (2) (C), 402 (a) (6), or 403 (a) (4) applies to a contribution to a qualified individual retirement account, chapter 44 shall not be applied to such contribution.

"(d) TAXABILITY OF BENEFICIARY OF QUALIFIED INDIVIDUAL RETIREMENT ACCOUNT.—

"(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amount actually paid, distributed or made available to any payee or distributee by a qualified individual retirement account shall be taxable to him in the year in which actually paid or distributed under section 72 (relating to annuities).

"(2) RECONTRIBUTED AMOUNTS.—Amounts paid or distributed by a qualified individual retirement account, except amounts distributed pursuant to provisions of the governing instrument meeting the requirements of subsection (a) (5), shall not be includible in gross income in the year paid or distributed to the extent that such amounts are not subject to the tax imposed by section 72(p)(3) by reason of the application of section 72(p)(2)(C).

"(3) REPAYMENT OF EXCESS CONTRIBUTIONS.—Amounts paid or distributed under subsection (b)(1) by a qualified individual retirement account shall not be includible in gross income in the year paid or distributed.

"(4) APPLICABILITY OF SECTION 72(m).—Under regulations prescribed by the Secretary or his delegate, an individual who establishes a qualified individual retirement account shall be treated as an employee who is an owner-employee for purposes of applying paragraphs (2) and (4) of section 72(m) (relating to special rules applicable to employee annuities and distributions under employee plans).

"(e) TREATMENT OF NONQUALIFIED OR NONEXEMPT ACCOUNT.—If for the preceding taxable year of a trust it was described in subsection (a) and was exempt from tax under section 501(a) and if for the taxable year such trust is not exempt from tax under section 501(a), the fair market value of the account at the beginning of the taxable year, reduced by any contributions of the individual who established such account which were not deductible under section 219, shall be included in the gross income of the individual who established such account or his beneficiary as if the assets of the trust had been distributed on the first day of the taxable year.

"(f) CROSS REFERENCES.—

"For excise tax on a qualified individual retirement account, see section 4960.

"(2) For additional tax on certain distributions from a qualified individual retirement account, see section 72(p)."

(c) TREATMENT OF DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT ACCOUNTS.—Section 72 (relating to annuities) is amended—

(1) by striking out subsection (m) (1),

(2) by inserting after "section 401 (c) (1)" in subsection (m) (2)", or under section 219",

(3) by striking out at the end of subsection (m) (3) (A) (i) "or",

(4) by striking out at the end of subsection (m) (3) (A) (ii) "participant." and inserting in lieu thereof "participant, or",

(5) by inserting after subsection (m) (3) (A) (ii) the following new clause—

"(iii) purchased by a trust described in section 408 (a) which is exempt from tax under section 501 (a).",

(6) by striking out subsection (m) (3) (B) and inserting in lieu thereof:

"(B) Any contribution to a plan described in subparagraph (A) (i) or a trust described in subparagraph (A) (ii) or (iii), which is allowed as a deduction under section 404 or section 219, and any income of a trust described in subparagraph (A) (ii) or (iii), which is determined in accordance with regulations prescribed by the Secretary or his delegate to have been applied to purchase the life insurance protection under a contract described in subparagraph (A), is includible in the gross income of the participant for the taxable year when so applied.",

(7) by inserting after "501 (a)" in subsection (m) (4) (B) ", a trust described in section 408 (a) which is exempt from tax under section 501 (a),",

(8) by inserting after "501 (a)" in subsection (m) (4) (B) ", a trust described in section 408 (a) which is exempt from tax under section 501 (a),", and

(9) by redesignating subsection (p) as (q) and inserting after subsection (o) the following new subsection:

"(p) Treatment of Certain Premature Distributions.—

"(1) Application of subsection.—This subsection shall apply to amounts paid or distributed—

"(A) by a qualified individual retirement account described in section 408 (a) which is exempt from tax under section 501 (a), or

"(B) by a qualified trust described in section 401 (a) which is exempt from tax under section 501 (a) or under a plan described in section 403 (a), but only to the extent attributable, as determined under regulations prescribed by the Secretary or his delegate, to amounts with respect to which a deduction was allowed under section 219 (relating to retirement savings),

which are includible in the gross income of the distributee or payee and which are received by him before the individual who established such qualified individual retirement account or the individual who was allowed such deduction attains the age of 59½ years.

"(2) LIMITATIONS.—This subsection shall not apply to an amount described in paragraph (1)—

"(A) paid or distributed to such individual on account of his becoming disabled within the meaning of subsection (m) (7),

"(B) includible in gross income under section 72 (m) (3) (B), or

"(C) paid or distributed by a qualified individual retirement account to the individual who established such account if, within 60 days after receipt, such amount is contributed in full to another qualified individual retirement account established by such individual.

Subparagraph (C) shall not apply for a taxable year if during the 3-year period ending on the date such amount is received, this subsection did not apply to an amount previously received by the individual because of subparagraph (C). Subparagraph (C) shall not apply unless the same property received in a payment or distribution is contributed. The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this paragraph.

"(3) AMOUNT OF PENALTY.—If an individual is required to include in gross income for the taxable year an amount to which this subsection applies, there shall be imposed in addition to any other tax imposed by this chapter a tax for such taxable year equal to 30 percent of such amount. The tax imposed under this paragraph shall not be reduced by any credit under part IV of subchapter A (other than sections 13, 39, and 42 thereof), and shall not be treated as a tax imposed by this chapter for purposes of section 56."

(d) EXCISE TAX ON EXCESSIVE ACCUMULATIONS.—Subtitle D (relating to miscellaneous excise taxes) is amended by adding at the end thereof the following new chapter:

"CHAPTER 43.—RETIREMENT PLANS."

"Sec. 4960. Excise tax on individual retirement accounts.

"SEC. 4960. EXCISE TAX ON INDIVIDUAL RETIREMENT ACCOUNTS.

"There is hereby imposed for each taxable year on the assets of a qualified individual retirement account described in section 408 (a) which is exempt from tax under section 501 (a) a tax equal to 10 percent of an amount which bears the same ratio to the fair market value of the total assets in such account at the beginning of the taxable year as the minimum amount required to be distributed during such year under section 408 (a) (5) or (6) (whichever applies) reduced (but not below zero) by the total amount actually distributed during such year by the account to the individual who established such account or his beneficiary bears to the minimum amount required to be distributed during such year under section 408 (a) (5) or (6) (whichever applies). The tax imposed by this section shall apply only for taxable years beginning after the taxable year in which the individual who established such account attains the age of 70½ years. For purposes of this section, the minimum amount required to be distributed during a year under section 408 (a) (5) or (6) shall be determined under regulations prescribed by the Secretary or his delegate."

(e) CONFORMING AMENDMENTS.—

(1) RETIREMENT INCOME.—Section 37(c)(1) (defining retirement income) is amended—

(A) by striking out subparagraph (A) and inserting in lieu thereof the following new subparagraph:

"(A) pensions and annuities including—

"(i) in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1), a distribution by a trust described in section 401(a) which is exempt from tax under section 501(a) to the extent such distribution was not subject to the tax imposed by section 72(p)(3), and

"(ii) distributions from a qualified individual retirement account described in section 408(a) which is exempt from tax under section 501(a) to the extent such distribution was not subject to the tax imposed by section 72 (p)(3),".

(B) by striking out subparagraph (E)

and inserting in lieu thereof the following new subparagraph:

"(E) bonds described in section 405(b)(1) which are received—

"(i) under a qualified bond purchase plan described in section 405(a),

"(ii) in a distribution from a trust described in section 401(a) which is exempt from tax under section 501(a),

"(iii) from a qualified individual retirement account described in section 408(a) which is exempt from tax under section 501(a), or".

(2) ADJUSTED GROSS INCOME.—Section 62 (relating to definition of adjusted gross income) is amended by inserting after paragraph (9) the following new paragraph:

"(10) INDIVIDUAL RETIREMENT SAVINGS.—The deduction allowed by section 219."

(3) TREATMENT OF TOTAL DISTRIBUTIONS.—Section 72(n)(4)(B) (relating to special rule for employees without regard to section 401(c)(1)) is amended by inserting ", and other than a distribution from a qualified individual retirement account described in section 408(a)" after "section 404".

(4) EMPLOYEE DEATH BENEFITS.—Section 101 (b) (2) (B) (relating to nonforfeitable rights) is amended by striking out "or" at the end of clause (ii), by striking out "contract." at the end of clause (iii) and inserting in lieu thereof "contract, or" and by adding at the end thereof the following new clause:

"(iv) by a qualified individual retirement account described in section 408 (a) which is exempt from tax under section 501 (a)."

(5) QUALIFIED BOND PURCHASE PLANS.—Section 405 (d) (relating to taxability of beneficiary) is amended by striking out "or" after "bond purchase plan," in paragraph (1), by inserting "or from a qualified individual retirement account described in section 408 (a) which is exempt from tax under section 501 (a)," after "section 501 (a)," in paragraph (1), and by striking out the portion thereof which follows subparagraph (2) (B) and inserting in lieu thereof the following: "The basis of any bond described in subsection (b) received by a distributee from a trust described in section 401 (a) which is exempt from tax under section 501 (a) or a qualified individual retirement account described in section 408 (a) which is exempt from tax under section 501 (a) shall be determined under regulations prescribed by the Secretary or his delegate."

(6) PENSION PLAN RESERVES.—Section 805 (d) (1) (relating to definition of pension plan reserves) is amended by striking out "or" at the end of subparagraph (C), by striking out "foregoing." at the end of subparagraph (D) and inserting in lieu thereof "foregoing; or", and by adding at the end thereof the following new subparagraph:

"(E) purchased under contracts entered into with trusts which (as of the time the contracts were entered into) were deemed to be qualified individual retirement accounts described in section 408 (a) which are exempt from tax under section 501 (a)."

(7) AVERAGABLE INCOME.—Paragraph (2) (A) of section 1302 (a) (relating to definition of averagable income) is amended by inserting "or 72 (p) (3)" after "section 72 (m) (5)".

(8) EARNED INCOME.—Section 1348 (b) (1) (relating to definition of earned income) is amended by inserting ", 72 (p) (3)" after "72 (m)".

(9) DEFINITION OF WAGES FOR PURPOSES OF FEDERAL INSURANCE CONTRIBUTIONS ACT.—Section 3121 (a) (5) (defining wages) is amended by striking out "or" at the end of subparagraph (B), by striking out "405 (a);" at the end of subparagraph (C) and inserting in lieu thereof "405 (a), or" and by adding at the end thereof the following new subparagraph:

"(D) from or to a qualified individual retirement account described in section 408 (a) which is exempt from tax under section 501 (a) at the time of such payment;".

(10) FEDERAL UNEMPLOYMENT TAX DEFINITION OF WAGES.—Section 3306 (b) (5) (defining wages) is amended by striking out "or" at the end of subparagraphs (A) and (B), by striking out "section 405 (a) ;" at the end of subparagraph (C) and inserting in lieu thereof "section 405 (a), or ", and inserting at the end thereof the following new subparagraph:

"(D) from or to a qualified individual retirement account described in section 408 (a) which is exempt from tax under section 501 (a) at the time of such payment;".

(11) DEFINITION OF WAGES FOR PURPOSES OF COLLECTION OF INCOME TAX AT SOURCE.—Section 3401 (a) (12) (defining wages) is amended by striking out "; or" at the end of subparagraphs (A) and (B) and inserting after subparagraph (C) the following new subparagraph:

"(D) from or to a qualified individual retirement account described in section 408 (a) which is exempt from tax under section 501 (a) at the time of such payment unless such payment is made to an employee of the account as remuneration for services rendered as such employee and not as a beneficiary of the account; or".

(f) Clerical Amendments.—

(1) The table of sections for part VII of subchapter B of chapter 1 is amended by striking out the item relating to section 219 and inserting in lieu thereof the following:

"Sec. 219. Retirement savings.
"Sec. 220. Cross references."

(2) The table of sections for part I of subchapter D of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 408. Individual retirement accounts."

(3) The table of chapters for subtitle D is amended by adding at the end thereof the following new item:

"Chapter 43. Retirement plans."

(g) Effective Date.—The amendments made by this section shall aply to taxable years ending after the date of enactment of this Act.

SEC. 4. CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS AND SHAREHOLDER-EMPLOYEES OF ELECTING SMALL BUSINESS CORPORATIONS.

(a) Contributions on Behalf of Self-Employed Indivduals.—

(1) Special limitations for self-employed individuals.—Section 404 (e) (relating to special limi-

tations for self-employed individuals) is amended by striking out "$2,500, or 10 percent" each place it appears and inserting in lieu thereof "$7,500, or 15 percent".

(2) EXCESS CONTRIBUTIONS ON BEHALF OF OWNER-EMPLOYEES.—

(A) Section 401 (e) (1) (B) (iii) (relating to excess contributions on behalf of owner-employees) is amended by striking out "$2,500 or 10 percent" and inserting in lieu thereof "$7,500 or 15 percent".

(B) Section 401 (e) (1) (B) (iv) (relating to excess contributions on behalf of owner-employees) is amended by striking out "$2,500" and inserting in lieu thereof "$7,500".

(C) Section 401 (e) (3) (relating to contributions for premiums on annuity, etc., contracts) is amended by striking out "$2,500" and inserting in lieu thereof "$7,500".

(3) PENALTIES APPLICABLE TO CERTAIN AMOUNTS RECEIVED BY OWNER-EMPLOYEES.—Section 72 (m) (5) (B) (i) (relating to penalties applicable to certain amounts received by owner-employees) is amended by striking out "$2,500" and inserting in lieu thereof "$7,500".

(b) CONTRIBUTIONS ON BEHALF OF SHAREHOLDER-

EMPLOYEES OF ELECTING SMALL BUSINESS CORPORATIONS.—Section 1379(b)(1) (relating to the taxability of shareholder-employee beneficiaries) is amended—

(1) by striking out in subparagraph (A) "10 percent" and inserting in lieu thereof "15 percent", and

(2) by striking out in subparagraph (B) "$2,500" and inserting in lieu thereof "$7,500".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1972.

SEC. 5. LIMITATION ON APPLICATION OF SECTIONS 402(a) AND 403(a) IN THE CASE OF CERTAIN CONTRIBUTIONS.

(a) AMENDMENT OF SECTION 402.—Section 402(a) (relating to taxability of beneficiary of exempt trust) is amended—

(1) by striking out in the first sentence of paragraph (1) "and (4)" and inserting in lieu thereof ", (4), (6), and (7)", and

(2) by inserting after paragraph (5) the following new paragraphs—

"(6) INDIVIDUAL RETIREMENT ACCOUNTS.—In the case of an employees' trust described in section 401(a), which is exempt from tax under section 501(a), if the total distributions payable with respect to any employee are paid to him within 1 taxable year of the employee on account of his separation from the service other than by reason of his death, the amount of such distribution, to the extent such distribution would be includible in gross income but for the provisions of this paragraph, shall not be includible in gross income in the year paid if, within 60 days after the close of the taxable year in which such amount was paid to him, such amount is contributed by him in full to one or more qualified individual retirement accounts described in section 408 (a). This paragraph shall not apply unless the same property received in the total distribution is contributed. The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this paragraph.

"(7) QUALIFIED PLANS.—

"(A) GENERAL RULE.—In the case of an employees' trust described in section 401 (a), which is exempt from tax under section 501 (a), if the total distributions payable with respect to any employee are paid to him within 1 taxable year of the employee on account of his separation from the service other than by reason of his death, the amount of such distribution, to the extent such distribution would be includible in gross income but for the provisions of this paragraph, shall not be includible in gross income in the year paid if, within 60 days after the close of the taxable year in which such amount was paid to him, such amount is contributed by him in full to another employees' trust described in section 401 (a), which is exempt from tax under section 501 (a), or for the purchase of retirement annuities under an annuity plan which meets the requirements of section 404 (a) (2).

"(B) EXCEPTIONS.—This paragraph shall not apply to a distribution paid to any distributee to the extent such distribution is attributable to contributions made by or on behalf of an employee while he was an employee within the meaning of section 401 (c) (1). This paragraph shall not apply unless the same property received in the total distribution is contributed.

"(C) SPECIAL RULES.—For purposes of this title a contribution made pursuant to subparagraph (A) shall—

"(i) except as provided in clause (ii) be treated as an employer contribution made on the date contributed, and

"(ii) be treated as an employee contribution for purposes of sections 219 (b) (2), 401

(a) (12), 404, 409 (a), and 1379 (b).

"(D) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this paragraph."

(b) AMENDMENT OF SECTION 403.—Section 403 (a) is amended—

(1) by striking out in the first sentence of paragraph (1) "paragraph (2)" and inserting in lieu thereof "paragraphs (2), (4), and (5)", and

(2) by inserting after paragraph (3) the following new paragraphs—

"(4) INDIVIDUAL RETIREMENT ACCOUNTS.—If—

"(A) an annuity contract is purchased by an employer for an employee under a plan described in paragraph (1);

"(B) such plan requires that refunds of contributions with respect to annuity contracts purchased under such plan be used to reduce subsequent premiums on the contracts under the plan; and

"(C) the total amounts payable by reason of an employee's separation from the service other than by reason of death are paid to the payee within one taxable year of the payee,

then the amount of such payments, to the extent such amounts would be includible in gross income but for the provisions of this paragraph, shall not be includible in gross income in the year paid if, within 60 days after the close of the taxable year in which such amounts are paid to him, such amounts are contributed by him in full to one or more qualified individual retirement accounts described in section 408(a). This paragraph shall not apply unless the same property received in such payments is contributed. The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this paragraph.

"(5) QUALIFIED PLANS.—

"(A) GENERAL RULE.—If an annuity contract is purchased by an employer for an employee under a plan described in paragraph (1), such plan requires that refunds of contributions with respect to annuity contracts purchased under such plan be used to reduce subsequent premiums on the contracts under the plan, and the total amounts payable by reason of an employee's separation from the service other than by reason of death are paid to the payee within one taxable year of the payee, then the amount of such payments, to the extent such amounts would be includible in gross income but for the provisions of this paragraph, shall not be includible in gross income in the year paid if, within 60 days after the close of the taxable year in which such amounts are paid to him, such amounts are contributed by him in full to an employees' trust described in section 401 (a), which is exempt from tax under section 501 (a), or for the purchase of retirement annuities under another annuitiy plan which meets the requirements of section 404 (a) (2).

"(B) EXCEPTIONS.—This paragraph shall not apply to a distribution paid to any distributee to the extent such distribution is attributable to contributions made by or on behalf of an employee while he was an employee within the meaning of section 401 (c) (1). This paragraph shall not apply unless the same property received in the total distribution is contributed.

"(C) SPECIAL RULES.—For purposes of this title a contribution made pursuant to subparagraph (A) shall—

"(i) except as provided in clause (ii) be treated as an employer contribution made on the date contributed, and

"(ii) be treated as an employee contribution for purposes of sections 219 (b) (2), 401

(a) (12), 404, 409 (a), and 1379 (b).

"(D) Regulations.—The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this paragraph."

(c) Effective Date.—The amendments made by this section shall apply to taxable years ending after the date enactment of this Act.

SEC. 6. PROHIBITED TRANSACTIONS.

(a) Amendment of Section 503.—Section 503 is amended—

(1) by striking out subsection (a) (1) (B) and by redesignating subsection (a) (1) (C) as (a) (1) (B),

(2) by striking out "or section 401 (a)" in subsections (a) (2) and (c),

(3) by striking out subsections (d), (f), and (g) and redesignating subsection (e) as (d).

(b) Excise Tax on Prohibited Transactions.—Subtitle D (relating to miscellaneous excise taxes) is amended by adding at the end thereof the following new chapter:

"CHAPTER 44.—QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS

"Sec. 4971. Excise tax on prohibited transactions.

"SEC. 4971. EXCISE TAX ON PROHIBITED TRANSACTIONS.

"(a) Imposition of Initial Tax.—There is hereby imposed a tax on each prohibited transaction at the rate of 5 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this paragraph shall be paid by any party in interest who participates in the prohibited transaction.

"(b) ADDITIONAL TAX.—In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction by a party in interest and the transaction is not corrected within the correction period, there is hereby imposed a tax equal to 200 percent of the amount involved. The tax imposed by this paragraph shall be paid by any party in interest who participated in the prohibited transaction.

"(c) SPECIAL RULE.—If more than one person is liable under subsection (a) or (b) with respect to any one prohibited transaction, all such persons shall be jointly and severally liable under such subsection with respect to such transaction.

"(d) PROHIBITED TRANSACTION.—For purposes of this section, the term 'prohibited transaction' means an act which is—

"(1) described in section 14 (b) (2) of the Welfare and Pension Plans Disclosure Act of August 28, 1958, as amended and supplemented (—— Stat. ——, 29

U.S.C. ——), and not permitted under section 14 (c) of such Act, and

"(2) committed by a fiduciary for a trust described in section 401 (a) or 408 (a) which is exempt from tax under section 501 (a).

"(c) OTHER DEFINITIONS.—For purposes of this section—

"(1) PARTY IN INTEREST.—The term 'party in interest' means a person described in section 3 (m) of Welfare and Pension Plans Disclosure Act of August 28, 1958, as amended and supplemented (—— Stat. ——, 29 U.S.C. ——).

"(2) TAXABLE PERIOD.—The term 'taxable period' means with respect to any prohibited transaction, the period beginning with the date on which the prohibited transaction occurs and ending on whichever of the following is the earlier: (A) the date of mailing of a notice of deficiency pursuant to section 6212, with respect to the tax imposed by this section, or (B) the date on which correction of the prohibited transaction is completed.

"(3) AMOUNT INVOLVED.—The term 'amount involved' means, with repsect to a prohibited transaction, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received. For purposes of the preceding sentence, the fair market value—

"(A) in the case of the tax imposed by subsection (a), shall be determined as of the date on which the prohibited transaction occurs; and

"(B) in the case of the tax imposed by subsection (b), shall be the highest fair market value during the correction period.

"(4) CORRECTION.—The terms 'correction' and 'correct' mean, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the trust in a financial position not worse than that in which it would be if the prohibited transaction had not occurred.

"(5) CORRECTION PERIOD.—The term 'correction period' means, with respect to a prohibited transaction the period beginning with the date on which the prohibited transaction occurs and ending 90 days after the date of mailing of a notice of deficiency with respect to the tax imposed by subsection (b) under section 6212, extended by—

"(A) any period in which a deficiency cannot be assessed under section 6213 (a), and

"(B) any other period which the Secretary or his delegate determines is reasonable and necessary to bring about correction of the prohibited transaction.

"(6) FIDUCIARY.—The term 'fiduciary' includes a person described in section 3(w) of the Welfare and Pension Plans Disclosure Act of August 28, 1958, as amended and supplemented, or section 7701(a)(6).

"(f) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this section."

(c) CONFORMING, CLERICAL, ETC. AMENDMENTS.—

(1) The table of chapters for subtitle D is amended by adding at the end thereof the following new item:

"CHAPTER 44. Qualified pension, profit-sharing and stock bonus plans."

(2) Section 6161 (relating to extension of time for paying tax) is amended by striking out "or 42" each place it appears in subsection (b) and inserting in lieu thereof ", 42 or 44".

(3) Section 6201(d) (relating to assessment authority) is amended by striking out "chapter 42" and inserting in lieu thereof "chapter 42 or 44".

(4) Section 6211 (relating to definition of a deficiency) is amended by striking out "chapter 42" each place it appears therein and inserting in lieu thereof "chapter 42 or 44".

(5) Section 6212 (relating to notice of deficiency) is amended—

(i) by striking out "or chapter 42" in subsections (a) and (b) and inserting in lieu thereof "chapter 42, or chapter 44",

(ii) by striking out "chapter 42, and this chapter" in subsection (b) and inserting in lieu thereof "chapter 42, chapter 44, and this chapter", and

(iii) by striking out "except in the case of fraud," and inserting in lieu thereof "or of chapter 44 tax, except in the case of fraud".

(6) Section 6213 (relating to restrictions applicable to deficiences and petition to Tax Court) is amended—

(i) by striking out "or chapter 42" in subsection (a) and inserting in lieu thereof ", chapter 42 or chapter 44",

(ii) by striking out the heading in subsection (e) and inserting in lieu thereof "Suspension Of Filing Period For Certain Chapter 42 or 44 Taxes.—"; by striking out "or 4945 (relating to taxes on taxable expenditures)" in subsection (e) and inserting in lieu thereof "4945 (relating to taxes on taxable expenditures) or 4971 (relating to taxes on prohibited transactions)"; and by striking out "or 4945(h) (2)" in subsection (e) and inserting in lieu thereof ", 4945(h) (2), or 4971 (e) (5)".

(7) Section 6214(c) (relating to determinations by Tax Court) is amended—

(i) by striking out the heading and inserting in lieu thereof "Taxes imposed by section 507, chapter 42, or chapter 44", and

(ii) by striking out "chapter 42" each place it appears therein and inserting in lieu thereof "chapter 42 or 44".

(8) Section 6344(a) (1) (relating to cross references) is amended by striking out "chapter 42" and inserting in lieu thereof "chapter 42 or 44".

(9) Section 6501(c) (3) (relating to limitations on assessment and collection) is amended by striking out "chapter 42" and inserting in lieu thereof "chapter 42 or 44".

(10) Section 6503 (relating to suspension of running of period of limitations) is amended—

(i) by striking out "and chapter 42 taxes)" in subsection (a) (1) and inserting in lieu thereof "chapter 42 taxes and chapter 44 taxes)", and

(ii) by striking out "or section 507" in subsection (h) and inserting in lieu thereof ", section 507, or chapter 44", and by striking out "or 4945 (h) (2)" in subsection (h) and inserting in lieu thereof "4945 (h) (2), or 4971 (c) (5)".

(11) Section 6512 (relating to limitations in case of petition to Tax Court) is amended by striking out "chapter 42" each place it appears therein and inserting in lieu thereof "chapter 42 or 44".

(12) Section 6601 (d) (relating to interest on underpayment, nonpayment, or extensions of time for payment of tax) is amended by striking out "chapter 42" and inserting in lieu thereof "chapter 42 or 44".

(13) Section 6653 (c) (relating to failure to pay tax) is amended by striking out "chapter 42" each place it appears therein and inserting in lieu thereof "chapter 42 or 44".

(14) Section 6659 (b) (relating to applicable rules) is amended by striking out "chapter 42" and inserting in lieu thereof "chapter 42 or 44".

(15) Section 6676 (b) (relating to failure to supply identifying numbers) is amended by striking out "chapter 42" and inserting in lieu thereof "chapter 42 or 44".

(16) Section 6677 (b) (relating to failure to file information returns with respect to certain foreign trusts)

is amended by striking out "chapter 42" and inserting lieu thereof "chapter 42 or 44".

(17) Section 6679(b) (relating to failure to file returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock) is amended by striking out "chapter 42" and inserting in lieu therof "chapter 42 or 44".

(18) Section 7422(g) (relating to civil actions for refund) is amended—

(i) by striking out "chapter 42" in the heading thereof and inserting in lieu thereof "chapter 42 or 44", and

(ii) by striking out "or section 4945(b) (relating to additional taxes on taxable expenditures)" in paragraph (1) and inserting in lieu thereof "section 4945(b) (relating to additional taxes on taxable expenditures), or section 4971 (relating to tax on prohibited transactions)", and

(iii) by striking out "or 4945" in paragraphs (2) and (3) an dinserting in lieu thereof "4945 or 4971".

(d) EFFECTIVE DATE.—The amendments made by this section shall be effective on and after the day after the date of enactment of this Act.

SEC. 7. MISCELLANEOUS PROVISIONS.

(a) PENALTIES APPLICABLE TO FORFEITURES RECEIVED BY OWNER-EMPLOYEES.—Section 72(m)(5)(A)(i) is amended by striking out "while he was an owner-employee," and inserting in lieu thereof ", or forfeitures credited to his account or applied for his benefit, while he was an owner-employee,".

(b) AMENDMENT TO SECTION 401(a)(3)(A).—Section 401(a) (relating to requirements for qualification) is amended by striking out paragraph (3)(A) and inserting in lieu thereof:

"(A) 70 percent or more of all the employees, or 80 percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of all the employees are eligible to benefit under the plan, excluding in each case employees who are included in a unit of employees covered by an agreement which the Secretary or his delegate finds to be a collective-bargaining agreement which does not provide that such employees are to be included, employees who have been employed not more than a minimum period prescribed by the plan, not exceeding 5 years, employees whose customary employment is for not more than 20 hours in any one week, and employees whose customary employment is for not more than 5 months in any calendar year, or".

(c) PLANS BENEFITING SELF-EMPLOYED INDIVIDUALS.—Section 401 (c) (relating to definitions and rules relating to self-employed individuals and owner-employees) is amended by adding at the end thereof the following new paragraph:

"(6) ADDITIONAL REQUIREMENTS FOR QUALIFICATION OF TRUSTS AND PLANS BENEFITING SELF-EMPLOYED INDIVIDUALS. A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are employees within the meaning of paragraph (1) shall constitute a qualified trust only if—

"(A) under the plan, forfeitures attributable to contributions made on behalf of an employee other than an employee within the meaning of paragraph (1) may not inure to the benefit of any individual who, at any time during the period beginning with the taxable year for which the contribution is made and ending with the taxable year during which the forfeiture occurs, is an employee within the meaning of paragraph (1), and

"(B) in the case of a defined benefit pension plan, a separate account is maintained with respect to all participants under the plan who are not employees within the meaning of paragraph (1) and another separate account is maintained with respect to all participants under the plan who are employees within the meaning of paragraph (1)."

(d) TRUSTEE OF A TRUST BENEFITING AN OWNER-EMPLOYEE.—Section 401 (d) (relating to additional requirements for qualification of trusts and plans benefiting owner-employees) is amended by striking out the first sentence of paragraph (1) and inserting in lieu thereof:

"(1) In the case of a trust which is created on or after the date of the enactment of this subsection, or which was created before such date but is not exempt from tax under section 501 (a) as an organization described in subsection (a) on the day before such date, the assets thereof are held in trust by, or in custody of, a bank or other person who demonstrates to the satisfaction of the Secretary or his delegate that the manner in which he will hold or have custody of such assets will be consistent with the requirements of this section. Notwithstanding the requirements of the preceding sentence, a person (including the employer) other than the trustee or custodian so holding plan assets may be granted, under the trust instrument, the power to control the investment of the trust funds either by directing investments (including reinvestments, disposals, and exchanges) or by disapproving proposed investments (including reinvestments, disposals, or exchanges)."

(e) CERTAIN CUSTODIAL ACCOUNTS.—Section 401 (relating to pension, profit-sharing, and stock bonus plans) is amended by striking out subsection (f) and inserting in lieu thereof:

"(f) CERTAIN CUSTODIAL ACCOUNTS.—For purposes of this title, a custodial account shall be treated as a qualified trust under this section provided that—

"(1) such custodial account would, except for the fact that it is not a trust, constitute a qualified trust under this section;

"(2) the custodian is a bank (as defined in subsection (d)(1)) or other person who demonstrates to the satisfaction of the Secretary or his delegate that the manner in which he will have custody of such assets will be consistent with the requirements of this section; and

"(3) the assets of such custodial account are held in the name of the custodian or his nominee.

For purposes of this title, in the case of a custodial account treated as a qualified trust under this section by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof."

(f) EXCESS CONTRIBUTIONS.—Section 401 (e) (1) (B) is amended by striking out clause (ii) and inserting in lieu thereof:

"(ii) with respect to any plan other than a defined benefit plan, the amount of any contribution made by any owner-employee (as an employee) at a rate which exceeds the rate of contributions permitted to be made by employees other than owner-employees;"

(g) AMENDMENTS TO SECTION 404 (a).—Section 404 (a) (relating to deduction for contributions of an employer to an employees' trust, etc.) is amended—

(1) by striking out paragraph (1) (A),

(2) by striking out paragraph (1) (B) and (C) and inserting in lieu thereof:

"(B) the amount necessary to provide with respect to all of the employees under the trust the remaining unfunded cost of their past and current service credits distributed as a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the Secretary or his delegate, but if such remaining unfunded cost with respect to any three individuals is more than 50 percent of such remaining unfunded cost, the amount of such unfunded cost attributable to such individuals shall be distributed over a period of at least 5 taxable years, or

"(C) in lieu of the amount allowable under subparagraph (B), an amount equal to the normal cost of the plan, as determined under regulations prescribed by the Secrotary or his delegate, plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount not in excess of 10 percent 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."

(3) by adding immediately after paragraph (1) (D) the following new sentence:

"The limitations under subparagraphs (B) and (C) shall not apply with respect to the amount of a contribution made to or under a pension plan to the extent such contribution does not exceed the minimum funding standard described in section 401 (a) (7)."

(4) by striking out paragraph (6) and inserting in lieu thereof:

"(6) TIME WHEN CONTRIBUTIONS DEEMED MADE.—For purposes of paragraphs (1), (2), and (3), a taxpayer shall be deemed to have made a payment on the last day of the preceding taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof)."

(5) by striking out subsection (a) (7), and inserting in lieu thereof:

"(7) LIMIT OF DEDUCTION.—If amounts are deductible under paragraphs (1) and (3), or (2) and (3), or (1), (2), and (3), in connection with two or more trusts, or one or more trusts and an annuity plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed the greater of 25 percent of the compensation otherwise paid or accrued during the taxable year to the persons who are the beneficiaries of the trusts or plans, or the amount of contributions made to or under the trusts or plans to the extent such contributions do not exceed the minimum funding standard described in section 401 (a) (7), for the plan year which ends with or within such taxable year. In addition, any amount paid into such trust or under such annuity plans in any taxable year in excess of the amount allowable with respect to such year under the preceding provisions of this paragraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this paragraph shall not exceed the greater of 25 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the trusts or plans, or the amount of contributions made to or under the trusts or plans to the extent such contributions do not exceed the minimum funding standard described in section 401 (a) (7) for the plan year which ends with or within such taxable year. This paragraph shall not have the effect of reducing the amount otherwise deductible under paragraphs (1), (2), and (3), if no employee is a beneficiary under more than one trust, or a trust and an annuity plan",

(h) INCLUSION OF CERTAIN EMPLOYER CONTRIBUTIONS IN GROSS INCOME.—Part I of subchapter D of chapter 1 (relating to pension, etc., plans) as amended by section 3 (b) of this Act is further amended by adding at the end thereof the following new section:

"SEC. 409. INCLUSION OF CERTAIN EMPLOYER CONTRIBUTIONS IN GROSS INCOME.

"(a) INCLUSION OF CONTRIBUTIONS IN GROSS INCOME.—Notwithstanding the provisions of section 402 (relating to taxability of beneficiary of employees' trust), section 403 (relating to taxation of employee annuities), or section 405 (d) (relating to taxability of beneficiaries under qualified bond purchase plans), an individual shall include in gross income, for his taxable year in which or with which the taxable year of his employer ends, the amount equal to the excess of—

"(1) the amount of the contributions made on his behalf by the employer during the taxable year of the employer (including amounts deemed to be paid during such year under section 404 (a) (6)) to or under a money purchase pension plan, over

"(2) 20 percent of such individual's compensation otherwise paid or accrued by him from such employer during the employer's taxable year.

In any taxable year of an individual in which he is covered under two or more money purchase pension plans maintained by an employer, the amount includible in gross income shall be the amount by which the total of such contributions exceeds 20 percent of the compensation received or accrued by such individual during the taxable year of his employer.

"(b) TREATMENT OF AMOUNTS INCLUDED IN GROSS INCOME.—Any amount included in the gross income of an individual under subsection (a) shall be treated as consideration for the contract contributed by the individual for purposes of section 72 (relating to annuities).

"(c) DEDUCTION FOR AMOUNTS NOT RECEIVED AS BENEFITS.—If—

"(1) Amounts are included in the gross income of an individual under subsection (a), and

"(2) the rights of such individual (or his beneficiaries) under the plan terminate before payments under the plan which are excluded from gross income equal the amounts included in gross income under subsection (a),

then there shall be allowed as a deduction, for the taxable year in which such rights terminate, an amount equal to the excess of the amounts included in gross income under subsection (a) over such payments."

(i) CONFORMING AND CLERICAL AMENDMENTS.—

(1) CONFORMING AMENDMENT.—Section 62 (relating to definition of adjusted gross income) as amended by section 3 (e) (2) of this Act is further

amended by adding after paragraph (10) the following new paragraph:

"(11) MONEY PURCHASE PENSION PLANS.—The deduction allowed by section 409 (c)."

(2) CLERICAL AMENDMENT.—The table of sections for Part I of subchapter D of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 409. Inclusion of certain employer contributions in gross income."

(j) EFFECTIVE DATES.—The amendments made by this section (other than the amendment made by subsection (h)) shall be effective on and after the day after the date of enactment of this Act. The amendment made by subsection (h) shall apply with respect to taxable years of an employer beginning after December 31, 1973.

Senator CURTIS. Senator Dole?

Senator DOLE. Mr. Chairman, private pension plans are an extremely important feature of the economic and social fabric of our country today.

More than 30 million Americans are participating in private pension plans. This number represents a sevenfold increase since 1940, and over the same period, the assets held by these plans have grown from $12.1 billion to more than $150 billion. More than a million retired persons now draw benefits from these plans. The outlook for the future indicates that private pension plans will continue to expand in importance as their participants increase and as they serve still more of the rapidly expanding retirement age group.

STIMULATE GROWTH

In view of these important considerations, this subcommittee has been convened to look into the method of stimulating further growth in the private pension system while at the same time assuring each participant of those benefits to which he is legally and equitably entitled.

Growth of the private pension system has been encouraged as an effective means of providing individuals from all walks of life with an adequate source of income after retirement. Putting aside a portion of earnings during a person's most productive years, is in keeping with the most basic American tradition of thrift, self-sufficiency and concern for the future. It was recognized at an early date that many individuals' funds could be combined, managed, and administered effectively with the result that the whole is greater than the sum of its parts. And with the cooperation and participation of employers, a significant system of retirement security has been created by the private sector of the economy. However, approximately one-half of all private, nonagricultural employees are still not covered by these pension plans, and numerous legislative proposals to extend and expand the private pension plan system have been put forward. In the course of our hearings we will be examining these suggestions in search of desirable and practical means of achieving a better and broader understanding of the issues. In addition to provisions designed to encourage the expansion of our private pension system, we will consider additional legislation which would establish minimum standards for vesting and funding of benefits. A system of termination insurance, and a system to provide portability for pension benefits. As we consider these suggestions, each must be thoroughly evaluated in terms of the improvements to be retained, the costs to be incurred and the possible impact of such provisions in causing the termination of existing plans or discouraging the adoption of new plans.

TERMINATING INSURANCE

To take just one of these subjects as an example, the Treasury and Labor Departments recently conducted a joint study of all private pension plans and those which were terminated during 1972. It found that 99.96 percent of all persons covered by these plans are receiving the benefits to which they are entitled. While it is a tragedy of serious dimensions when a single employee loses even a part of his vested benefits, it would appear that the overall system is alive and working quite well.

Admittedly this study covered a short period, but it gives reason to believe that the establishment of a termination insurance measures will have to be very carefully evaluated. The insurance measures thus far proposed would base the assessment of premiums upon the unfunded liabilities of covered pension plans. But such liabilities arise from various sources—for instance, through the liberalization of a plan's benefits in a given year—and the implementation of this insurance financing arrangement would inevitably discourage such liability producing steps. In addition, many eminently sound plans would be called upon to contribute the great bulk of the financing for this insurance system, while the insurance benefits would be paid primarily to individuals covered by smaller, less secure plans. It may be that such a policy would be desirable, perhaps it would not. But we must have a clear view of these ramifications when these proposals are considered.

Aside from matters which bear upon the adequacy of the private pension system, we will also be considering the need for tighter fiduciary and reporting standards to insure the proper management of pension funds.

ADMINISTRATIVE FEATURES

Finally, this subcommittee will be highly concerned with the administration of any new regulatory requirements imposed upon the private pension system. Certain proposals would create an entire new bureaucracy in the Department of Labor to administer these new provisions while retaining the existing regulatory functions of the Internal Revenue Service. A dual system of regulation would be created and, not only would there be a duplication in staffing, but there would be a doubly burdensome system of compliance thrust upon regulated plans. There would also be a difference in plans covered under this proposal and conflicting requirements with respect to qualifications. Lastly, Labor Department administration would require judicially enforced compliance as opposed to the self-enforcing compliance now obtained through IRS administration. These are serious questions, and they deserve detailed consideration and study.

I would hope the deliberations of this subcommittee will lead to recommendations for more efficient administration of a system providing more secure, improved, and expanded benefits for all employed persons.

SELF-EMPLOYED PLANS

I also hope we will be able to achieve similar improvements in the retirement plans which serve self-employed individuals. These plans offer a major source of retirement security to individuals who are in business for themselves. I feel these people should not be discriminated against for the reason that they are not employed by a corporate entity. The individual entrepreneur, professional farmers, or businessman has as much right as an assembly line worker, a corporate officer, or anyone else to a reasonable, secure and sound retirement program. And I believe we must give this area careful scrutiny.

COMPLEX AND TIMELY QUESTIONS

Mr. Chairman, I believe this subcommittee faces an extremely complex, important, and timely challenge. I look forward to participating in these hearings and working with the members of the subcommittee and the full Finance Committee as we come to grips with questions which hold the utmost importance for millions of Americans.

Senator CURTIS. Thank you.

Our first witness will be Mr. William G. Burns, assistant treasurer, American Telephone & Telegraph Co., accompanied by Stanley L. King, Jr., assistant vice president.

Mr. Burns, would you identify any others that you have with you?

Your company has had many years of experience in the private pension plan area and we are pleased that you could be here today. We are delighted you could give us your statement and present us with any information about the problems, as well as the benefits, that we face in this field.

STATEMENT OF WILLIAM G. BURNS, ASSISTANT TREASURER, AMERICAN TELEPHONE & TELEGRAPH CO., ACCOMPANIED BY STANLEY L. KING, JR., ASSISTANT VICE PRESIDENT, AND DONALD HARRINGTON, ACTUARY, A.T. & T.

Mr. BURNS. Thank you. I would like to have Mr. King start off, if that is acceptable, on the general aspects and I will pick up from there.

Senator CURTIS. Would you identify the other gentleman?

Mr. BURNS. This is Mr. Donald Harrington, an actuary on staff at A.T. & T.

Senator CURTIS. And your title, Mr. King?

Mr. KING. Assistant vice president.

Senator CURTIS. Your name is Stanley L. King, Jr.?

Mr. KING. That is correct.

Mr. Chairman, we are pleased to have this opportunity today to present our views, which have been filed in a statement which I believe the committee has.

Our plan, Mr. Chairman, would be that I would make a brief statement followed by another brief summary statement by Mr. Burns, and then we will be most happy to entertain questions in order to clarify anything that seems to need clarification.

Our testimony is directed primarily to the subjects of vesting and compulsory funding. First, I would like to discuss positions that we have taken and still take on other matters, other than vesting, and funding that are certainly a matter of scrutiny to this committee.

We have come, Mr. Chairman, to the conclusion that any regulation of private pension plans should now be at the Federal level of Government. As far as our company is concerned. I am sure you are aware that many of our subsidiary companies operate in a number of States and we would find it untenable that some employees for the same company would be subject to different provisions than other employees of the same company. Furthermore, our employees do move around among the States and it just doesn't seem to make sense to us that this should be an area that would be legislated by the States.

So we do fully support Federal legislation at this time. We further favor IRS administration of the new legislation. There are 30 years of experience in dealing with these matters vested in IRS, and we feel that that experience should not be ignored. And it would be well, we feel, to continue it in this manner rather than to create a new bureaucracy for administering pension regulations.

We do favor fiduciary standards under the prudent man rule. We have gone on record in a number of forums supporting that portion of the legislation.

We also favor a meaningful disclosure to employees. We feel certainly that employees should know their benefits and rights under the pension plans. We do not feel that this disclosure should be unduly burdensome, either to the company or unnecessarily confusing to the employees.

We favor an income tax deduction for personal savings for retirement. We feel that this would certainly be of benefit to many people who today are not covered by private pension plans.

We oppose all portability proposals and we oppose current pension insurance proposals.

Our feeling is with an adequate vesting and funding, these areas will be adequately covered giving protection to employees who are covered under private pension plan systems.

Under vesting, we favor reasonable vesting of well-defined pension benefits payable at age 65. In the legislative proposals, the rule of 50—and in your bill, 1631, we think is one of the most equitable since it does give benefits to those who most need them.

One concern we have under this rule is, it might possibly apply to savings plans and we feel it is not the intention of Congress to apply vesting provisions to such plans, but rather that this rule should be applied only to retirement plans.

So that, then, is a summary of the principal positions that we are taking in the pension area other than the fact we will go into more detail on the funding.

So I would like to ask Mr. Burns now to make that summary for us.

Mr. Burns. Thank you.

In the Bell System, we believe that we have a good pension plan and one that is soundly funded, that is, one that meets the ultimate test of employee security. I mean by that, whether or not the assets would cover vested liability in the event of termination of our plan.

We arrived at this position by having improved benefits over the years as circumstances warranted it. Further, it must be remembered that process was greatly enhanced by being able to spread the cost of such improvements over reasonably long time periods. We were able to increase pensions, therefore, when it was appropriate to do so and, further, to increase funding when it was propitious because we were permitted flexibility. Each time we improved our funding, we did it at a time when it was not unduly financially burdensome to do so.

It is conceivable that our initial benefit plan would never have been established if we had been forced to adopt currently proposed funding procedures at the same time. In drafting any new legislation, we feel Congress should avoid imposing funding rigidity, which might discourage employers from undertaking benefit improvements or perhaps even pressure them into reducing current benefit levels.

There are several crucial criteria for funding which should be incorporated in any legislation if that legislation is to accomplish the dual goals of reasonable benefits and sound funding. Those criteria are: (1) Funding should provide for all benefits when they come due, of course, and I stress "when"; (2) Funding should provide an adequate level of security to employees. Adequacy should be tested by comparing the value of the vested benefits with the pension plan assets; (3) It should include a reasonable period over which to fund all other benefits that are not vested; (4) It should include a stable, rational, systematic plan to take care of so-called "experience deficiencies."

Now "experience deficiency" can be a misleading term. Let me define such occurrences as those situations where actual circumstances vary from those assumed by the actuaries in establishing the accrual rates necessary to adequately fund the plan. Even in a proper funding program, we would expect to go through periods, perhaps even several years, when there are actuarial gains and through other periods when there are actuarial losses. So, in the context of my definition, we did not believe that contributions should be materially altered during temporary periods of such gains or losses.

Regarding the current bill before the Senate and those four criteria, S. 1631 meets all of these criteria. As S. 1179 does not adequately distinguish between vested benefits and accrued benefits. S. 4, due to its handling of experience deficiencies, fails to meet the criteria of a good funding program.

The two attachments to our statement today go to the last criteria enumerated—as to so-called experience deficiencies. We feel strongly that the funding provisions of S. 4, in this respect need dramatic revision. They should not be included in any legislation without dramatic change.

The table attached to our statement shows the impact of S. 4, on stability of funding. The provision in S. 4 requiring special payments to liquidate experience deficiencies within 5 years is, in our judgment, unduly burdensome, since it would result in unstable contributions from year to year, particularly with respect to certain types of plans with more progressive pension benefits. For example, in our plan, pension benefits are based on final average pay. And under this provision, very rapid pay increases in recent years would have caused an experience deficiency resulting in the requirement for experience deficiency contributions of more than $600 million in 1972. The attached table shows the effect of those funding requirements of S. 4, upon contributions under our plan if the provisions of the bill had been in existence during the period of 1963 to 1972.

In this connection, there have been some indications that a similar provision exists in Ontario, Canada, and is working well. We find that such is not accurate. The primary requirement in the law there is solvency and the test in the associated regulations can be met without taking any action on short term aberrations above and below long term actuarial assumptions.

Now, there is one final and troublesome inequity of S. 4 I would like to comment on, and I have a large chart over here to depict the situation. This is identical with the chart attached to our filed statement on the very last page, I believe. Under S. 4, increases in pension liability from plan amendments may be funded over 30 years, a 30-year period. However, when increases in pension liabilities result automatically from unanticipated wage-level changes, the increases must be funded over a 5-year period. Suppose that pension liabilities are $1 million. Ignoring the effect of interest, the annual payment on a 30-year basis is $33,000, a 15-percent increase as shown on the left-hand side of the chart. But if the same 15-percent increase in liabilities resulted from wage increases or other adverse experience, then the funding would undergo $150,000 increase in pension liabilities over the 5 years requiring an additional annual payment of $30,000. This represents 90 percent increase over the 5 years as shown on the right-hand side.

Thus for the same increase in pension liability, the compulsory increase in company contributions resulting from wage increases is six times that resulting from the planned amendment. Such a requirement is, in our judgment, totally inequitable and totally unreasonable.

I believe that summarizes the principal points we wanted to make and thank you for the opportunity.

We welcome any questions you might have.

Senator CURTIS. I wish you would elaborate just a little more on the chart.

Mr. BURNS. Yes, sir.

Senator CURTIS. Not necessarily the drawings but take us through that step-by-step again.

You are calling attention to the fact that an arbitrary or statutory requirement for increase in the contributions to the pension fund does what?

Mr. BURNS. Well, in essence, because this particular change occurs not due to a plan amendment, but rather to a situation in pension liabilities which is the result of a difference from the long term assumptions, built into the accrual rates we must——

Senator CURTIS. Excuse me. But you are saying that the actuarial background upon which you build a pension, already takes into account the seasonal and periodic ups and downs?

Mr. BURNS. Yes, sir.

Senator CURTIS. And that if you interfere with your rate of contributions to the retirement fund, that is, responding to everyone of those, that it not only becomes more costly, but it upsets your actuarial foundation; is that correct?

Mr. BURNS. Yes, although in the long run it would not become more costly, just forgetting the interest assumption in the plan, but it would be funded—well, we would have the flexibility to fund currently over the remaining service life for those actuarial deficiencies, if we can call them that, whereas in the provisions of S. 4, it would state that those changes, no matter how large and no matter where they derive from, would have to be made up in 5 years. In other words, so that in the case of an improvement in pension not deriving from a plan amendment, but rather from improvements in wages where the pension is tied to wage levels, it would have to be picked up in a short period of time—5 years in this case—and the impact would be six times as great as if you could spread that over the remaining service life of the affected employees.

So it would have the tendency to reduce the propensity to improve benefits because of the very restricted period over which you can accrue for those benefit changes. And I mention flexibility at the outset, as one of the things that has allowed us to get where we are today.

Senator CURTIS. What effect, if any, would it have on smaller or medium-sized companies who are yet to setup a pension plan but are interested in doing so?

Mr. BURNS. Proportionately, the impact would be the same.

Senator CURTIS. That is what I would think. It might discourage them?

Mr. BURNS. Yes.

Mr. KING. What we are suggesting here is, this rule in S. 4 tends to require over-reacting in our judgment. The stock market behaves sometimes erratically and one might be seen as not being prudent if one immediately reacts each day to the changes in the stock market, for instances—now that is a simple explanation of it—but, in effect, that is what we are suggesting here, namely, the 5 years for an experience deficiency tends to cause over-reacting in bringing your funds up because a drop in the market value of securities in the fund would be one of the important factors seen as an experience deficiency, if the value were suddenly to drop. In other words——

Senator CURTIS. And so the proposal in S. 4 would require these additional costs regardless of how they came about?

Mr. KING. Yes, sir.

Senator CURTIS. Additional costs to be paid into the fund within a 5-year period would result, is that correct?

Mr. KING. Yes; it would mean that you would have to fund this change which was brought about either by a change in the book value—no; I mean a change in the market value of your assets, a sudden change in your wage rates as a result of a labor or market bargaining situation or a change in the composition of your force and it would suggest that because of those changes, this must be funded in 5 years, whereas all other changes in the plan which provides security to employees to meet the pension promise may be funded over a longer period of time.

So we are suggesting that 5 years is too stringent and it is costly because of the over-reaction that is unnecessary.

Senator CURTIS. Now, do I understood your statement that funding should always be adequate to payoff at any given time all vested benefits?

Mr. BURNS. That is generally correct. That would be a maximum goal.

Senator CURTIS. So if the funding is planned on that basis, then it always will be adequate, will it not?

Mr. BURNS. Except insofar as it may have been unreasonable in an actuarial sense. For instance, to plan on full funding of vested benefits in 1970 or 1971, with a 15-percent improvement in wages, which might result in a like improvement in pension benefits, including the vested portion would be unreasonable. Now, that may be above and beyond what it would have been prudent to envision at the time you began to fund the plan and as you changed it over time.

For a major change like that in a going concern pension costs could be funded over the remaining service life of the employees and the vested portion would tend to be funded much sooner. That would allow you the prerogative to make judgments about benefit improvements so that they could be funded over a much longer period of time; you have a trade off between what it is that it might be reasonable to do by the way of benefits and the period over which you would pay for those benefits, but always testing the plan against the liabilities of those who have vested benefits against the assets in the plan, that is, the result of the funding of the plan, that being the essential test at all periods of time, as to security in case of termination.

But when you make major changes or it appears reasonable to make major changes in benefits, it is better to have a longer period over which to accrue those benefits and to pay for them rather than being forced into a compressed period such as this chart suggests, because a 15-percent improvement in pension benefits funded over a 5-year period is a significant aberration.

Senator CURTIS. What is your rule at the present time with respect to vesting?

Mr. KING. What was the question?

Senator CURTIS. What is your rule now in reference to vesting?

Mr. KING. Vesting? Fifteen years of service at age 40. So one must attain age 40 and have 15 years of service and then you vest. Now that is 100-percent vesting. We do not have graded vesting. You are either vested or you are not vested. Of course, that is pension payable——

Senator CURTIS. Excuse me, but what do you mean by percent vesting? It doesn't mean that they get the same retirement benefits as if they worked the actual length of time?

Mr. KING. No, sir; what it means is that based on the pension formula, we have 1 percent per year of service formula, so that if an employee were to leave the business with 15 years service at age 40, the pension would be 15 percent of the last 5 years average salary. It is that sort of thing. Now, that would·be the pension that would be payable at age 65. Under some vesting provisions, the vesting is graded which would mean, for example, that at 10 years of service one might be 50-percent vested, which would mean that if you left the business with 10 years of service, the formula would be worked at 10 percent, but the payment would be only one-half of the results you otherwise get and then it would be graded up with each year of additional service. This is another approach.

But under our plan, we do not have graded vesting. One is 100-percent vested when vesting cuts in.

Senator CURTIS. So far as the Federal Government is concerned at the present time, it is primarily an Internal Revenue Service matter of regulation?

Mr. KING. With respect to the funding regulations and the financial aspect.

Senator CURTIS. I mean the whole pension plan, though.

Mr. KING. That is correct.

Senator CURTIS. Its foundation is the tax law; the thing that makes private pensions possible is the treatment of current income permitting it to go untaxed into a pension fund and the pension fund thereafter is also free from tax so far as it is concerned and that is what makes private pensions possible, is it not?

Mr. KING. Yes.

Senator CURTIS. How long has A.T. & T. had a pension plan?

Mr. BURNS. We started the plan in 1913. We did not have advance funding. We began advance funding in 1927 and made a number of significant improvements in the funding between 1927 and 1958, at which time we then established programs to remove over a 10-year period all unfunded vested liabilities, in essence, and today we are fully funded.

Senator CURTIS. And at what point was this plan extended to practically all, of what might be termed your permanent employees, or did it start out that way?

Mr. BURNS. It started out that way.

Mr. KING. Yes, sir, all employees participated in the plan from day one, that is to say, all service is credited toward the pension from the day one becomes a regular employee.

Senator CURTIS. How many employees do you have now?

Mr. KING. About 1 million.

Senator CURTIS. And how many beneficiaries do you have in your retirement?

Mr. KING. Right now there are about 145,000 employees on service pensions; retired employees, I mean.

Senator CURTIS. Are some of those retired because of health?

Mr. KING. No; that is a service pension. I have a number here, if you would just give me a second, as to the number of people on disability pension.

Senator CURTIS. I meant disability.

Mr. KING. Yes; that is an additional number. Let me see what this is. Oh, here we have about 9,000 on disability pensions in addition to the number that I mentioned on service pensions. I might say that the disability pension is calculated in the same manner as our service pension. We use the same formula.

Senator CURTIS. Do they operate on two different plans or funds?

Mr. KING. Yes.

Senator CURTIS. If someone retires under a disability plan and they reach the retirement age, are they transferred over to the other plan?

Mr. KING. If one retires with eligibility to a service pension, that is, retired on disability, one goes on service pension right then and there. But if one retires on a disability pension before he is eligible for a service pension, he stays on a disability pension.

Senator CURTIS. Your pension plan does not or does it, have any benefits for survivors or dependents?

Mr. KING. Yes; it has.

Senator CURTIS. Would you explain those?

Mr. KING. Yes; I shall.

We have what is called a survivor option. When an employee is eligible to retire on a service pension, he or she has the option to elect a survivor's annuity. Now, this works on an actuarially discounted basis. If I were to retire and wanted to have a survivor annuity available to my wife, the actuaries would look at my age, my wife's age and a standard—well, there is some kind of table——

Mr. BURNS. A mortality table.

Mr. KING. And the mortality table would reduce my service pension while I am living, to a certain extent, to offset the ultimate cost of the survivor's annuity.

Ordinarily, we find that the service pension is reduced about 10 percent for the employee while living. The amount of pension to the annuitant is one-third of that discounted pension.

Now, this also is an automatic annuity to widows or widowers. If I were to die on the job prior to retirement—I mean, I am eligible to retire now and, if I were to drop dead tomorrow, my wife would automatically receive an annuity, which is calculated on the basis I just mentioned.

Senator CURTIS. It is counted as if you had made such an election?

Mr. KING. Yes, sir, as if I had retired and made that election that day.

Senator CURTIS. Senator Dole?

Senator DOLE. No questions.

Senator CURTIS. Well, we have a long list of witnesses. Is there anything further you would like to mention in light of our discussion so far?

Mr. BURNS. I think we stressed the area of most concern to us in the legislation you are considering today.

Senator CURTIS. Well, your entire statement and all of the charts will be incorporated into the record.

You made a valuable contribution today and we thank you for it.

[The prepared statement of William G. Burns and Stanley King follows:]

PREPARED STATEMENT OF WILLIAM G. BURNS AND STANLEY L. KING, JR., ASSISTANT TREASURER AND ASSISTANT VICE PRESIDENT, AMERICAN TELEPHONE & TELEGRAPH CO.

This statement is submitted on behalf of the American Telephone and Telegraph Company and the 22 Bell System companies, the names of which are attached to this statement.

We appreciate this opportunity to comment on the subject of pension plan legislation. As this Committee is well aware, bills on this subject have been introduced in both the House and the Senate over the last several years. Upon occasion, we have submitted testimony concerning some of these bills and from time to time have consulted with both legislative committee staffs and executive department staffs concerning appropriate legislation.

Although our testimony today will be directed primarily to the subjects of vesting and compulsory advance funding since they have the greatest cost impact on the Bell System, we would like to briefly summarize our position on other major aspects of proposed pension legislation.

If there is to be governmental regulation of private pension plans, it should be at the Federal level of government. Uniformity of approach with respect to any vesting, funding or reinsurance legislation of pension plans is extremely important. This is particularly critical to the Bell System because we operate nationwide. As a nationwide system, our employees are constantly moving from one state to another. An employee, during his or her working career may work in several states. Many of our companies have employees in more than one state. In order to avoid disparity of plans in the Bell System and even within a single Bell company, as well as widespread misunderstanding among our employees, nationwide uniformity of requirements for pension plans is essential to the Bell System.

As for the administration of any new legislation we believe it should be by the Internal Revenue Service which has been developing a body of expertise on pensions and profit sharing plans for more than thirty years. If an existing expert group must continue to enforce both a minimum and a maximum funding requirement, it is a waste of funds and a harassment of plans to establish a second group to go over the same books and enforce a second minimum test.

We support legislation establishing the highest fiduciary standards and incorporating the "prudent man rule" as a primary test of fiduciary activities.

We support relevant and meaningful disclosure. We believe that meaningful disclosure to employees will promote the adequate funding of pension plans.

The listing of who will get what with the existing level of funds will be the greatest stimulus to action by the parties-in-interest—by employees and unions when a security risk is evident. However, we believe that some aspects of the disclosure bills are meaningless, burdensome, and even self defeating in that the intended data cannot reasonably be produced, and the masses of paper which would be forthcoming would obscure the meaningful items.

We endorse the philosophy of providing tax benefits for individual retirement savings, and providing for extension of existing statutory provisions concerning retirement plans of self-employed individuals and their employees. Encouraging the individual to serve the general good by making prudent provision for his own welfare is fundamentally sound, and tends to advance the strength and well-being of communities and of the nation.

We oppose all proposals on portability. We believe that attempting portability is unnecessary when a pension plan has vested benefits that are adequately funded.

We oppose all current proposals on pension insurance.

VESTING OF PENSION PLAN BENEFITS

We support the concept of reasonable vesting, but we recognize that legislation mandating vesting would limit the ability to make the optimum use of available resources. Thus the compulsory standard should be a minimum vesting, that will balance what might be desired for everybody against what companies in the weaker industries can afford. If weaker industries are forced to divert too large a proportion of their resources to the young, short-service employees, they will not be able to provide adequate pensions to the current pensioners and soon to be pensioners.

Of the legislative proposals that have been advanced with *respeot to eligibility for vesting,* we believe that the rule of "50" makes the most equitable allocation of resources since this rule tends to vest older employees more rapidly. This is consistent with a primary goal of pension planning in that those nearest retirement should be assured adequate pensions.

Other rules which are based on service alone, place disproportionate emphasis on giving very small long-deferred benefits to the very young employees. The present value of these benefits is small, and if this is to be done at all severence pay would be more practicable.

There should be no requirement to pay vested pension benefits prior to age 65.

Finally, with *respect to the amount of benefits vested,* we would like to comment that some of the proposals state directly (S. 1631) and others imply (S. 4) that the amount of vested benefits will be determined on the basis of the final years' pay. This is not sound nor is it in accordance with tax regulations which require the use of at least five year average pay. It rewards the departing employee with a more favorable rule than the emptoyees who stay.

ADVANCE FUNDING—BELL SYSTEM HISTORY

The Bell System favors the sound financing of pension plans. A sound funding program is one which makes the most equitable allocation of costs among successive generations of customers and stockholders, while at the same time providing security for employees. We found funding flexibility to be of great value in the past. We believe that many companies continue to need funding flexibility, and we may again need it in the future. Furthermore, we believe that the essential goals of the proposed legislation can be accomplished without imposing harmful funding rigidity. The best way to insure complete flexibility is not to mandate any funding. However, we recognize that the facts may lead Congress to the conclusion that mandatory funding is required, and in that event it is essential that mandatory funding should confine itself to the objective of mandating the funding of vested pension liabilities only. A brief review of Bell System funding history may help demonstrate why this is our position.

In 1913 the Bell System companies adopted formal pension plans. Although the plans have often been improved by amendment, they still are essentially identical between companies.

At the time the plans were established there was no thought of systematic advance funding. The plans were considered to effect a reduction in payroll costs.

However, by the mid 1920's the Bell System recognized that pensions could become a significant item of expense. A 1927 report prepared by a committee of officers contained this statement:

"From the viewpoint of management, a pension plan is primarily a systematic way of providing for a necessary expense in the operation of the business—an expense which, if there were no pension plan, would inevitably be borne by the business through the carrying of under-productive employees on the payroll with resultant adverse reaction upon efficiency and upon the correctness of the distribution of the cost of superannuation."

In other words, from a historical viewpoint, pensions were not viewed as a gift, or deferred compensation, but rather as a business expense that had to be borne if the industry was to remain competitive.

As a result, a thorough reappraisal of the funding question was made; trust funds were established in 1927 and advance funding initiated. The rate of advance funding was increased in 1928, though not to a level adequate to support the plans indefinitely. In the late 1930's with a partial recovery from the depression the System companies began strengthening the advance funding. By 1941 all companies had adopted advance funding programs, that in principle, were adequate to support the pension plans for the foreseeable future. These same programs froze the unfunded costs, i.e., paid interest only on the unfunded costs, at the levels then in effect. All so-called experience deficiencies or surpluses were automatically incorporated into the future contributions and thereby amortized over the future service lifetime of the employees.

Starting in 1946, increases in costs resulting from improved pension benefits, were also automatically spread over the future service lifetime of the employees. Thus plan amendments had no effect on the frozen unfunded costs.

In 1959 the Bell System companies adopted programs to amortize the remaining frozen unfunded costs. All but one of these programs has now been completed and the one remaining program will be completed in 1978.

PRESENT BELL SYSTEM FUNDING

Our present funding is a complete funding program called the "aggregate" method, wherein the cost effects of all plan changes, changes in assumptions, and wage level changes or other factors causing experience deficiencies or surpluses, are included in determining current rates of contribution. The method is designed to produce a contribution rate, expressed as a percentage of payroll, that will have provided on the day the last current employee retirees exactly enough funds (counting principle and investment earnings) to pay all benefits to current pensioners, current active employees, and vested former employees.

Contrary to the general popular notion that employees have separate individual accounts, no attempt is made to allocate this contribution among groups of employees or pensioners or among benefits that might be said to be attributable to various periods of service.

Although our funding program was not specifically designed to provide any given level of security for active employees, we believe it has provided and will continue to provide a high level of security for active employees. Expensive plan amendments were made in 1963, 1967, 1969 and 1971 each of which greatly increased the value of vested benefits. Even so, all companies except one still have enough money to cover these benefits.

Not only has the value of vested benefits increased very rapidly from plan amendments but it has also increased very rapidly as a result of the inflationary pay increases of recent years. If inflation is brought under control, the degree of employee security as measured by the relationship between the available assets and the value of vested benefits should improve.

NEED FOR FLEXIBILITY

While we are currently at what we believe to be the most equitable level of funding possible we cannot ignore the evolutionary history of our funding program. At first we had no real funding program. Through a succession of gradual steps we improved our funding until we reached our current levels. Each time we improved our funding, we did it at a time when it was not unduly financially burdensome to do so. We were able to increase pensions when it was propitious and increase funding when it was propitious because we were permitted flexibility. It is conceivable that our initial plan would never have been established if we had been forced to adopt current funding procedures at the same time. In drafting any new legislation Congress should avoid imposing funding rigidity which might discourage employers from undertaking benefit improvements or perhaps even pressure them into reducing current benefit levels.

FUNDING REQUIREMENTS IN SENATE BILLS

In regard to the various Senate Bills, we believe that if a bill is to contain a compulsory funding requirement, then that requirement should be limited to the funding of the vested pension benefits as defined by the plan. It does not seem reasonable to force an employer to make provision *now* for benefits that will not be earned until some time in the *future*. Further we believe it is essential that any funding program should be stable, rational and systematic.

Benefits Funded

The bills before this Committee contemplate the mandatory funding of *nonvested benefits*. These proposals, namely, (S.1179) and (S.1631) as well as (S.4) require the payment of normal cost and make some provision for the unfunded amounts attributable to either the initial unfunded or that resulting from plan amendments. This provision for the unfunded consists of either a thirty year amortization program (S.1179 and S.4) or the payment of interest on such unfunded (S.1631). The latter already being part of the tax law. One should be aware that payment of interest on the unfunded amounts under a level cost funding approach is generally more than adequate when the ration of the pension payments to current payrolls is small. "So-called" minimal funding in this instance, will generally be more than sufficient to cover the vested benefits earned to date. In the situation where the vested benefits are not covered by the pension fund assets, (S.1631) requires that an additional contribution be made to amortize the unfunded vested benefits.

Nature of Funding

The funding provisions of both (S. 1179) and (S. 1631) are stable, rational and systematic but the funding provision of (S. 4) is inherently unstable. Of the other two, we prefer (S. 1631) since this funding program meets a dual objective. This dual objective consists of a minimum funding program designed to meet the benefits when they become due (corresponding to the current IRS requirement) and adds to this goal an additional objective that the annual funding requirement be supplemented when the nonforfeitable benefits earned to date are not covered by funds on hand.

Both (S. 1179) and (S. 4) deal with amortization of experience deficiencies. (S. 1179) would amortize such deficiencies over the average remaining working life of the employees covered by the plan. We feel that this requirement, in most cases, is stable, rational and systematic.

The provision in (S. 4) requiring special payments to liquidate "experience deficiencies" within five years is in our judgment unduly burdensome since it would result in unstable contributions from year to year, particularly with respect to certain types of plans with more progressive pension benefits. For example, in our plan pension benefits are based in final average pay and under this provision very rapid pay increases in recent years would have caused experience deficiency (actuarial loss) contributions of more than $600 million for 1972. See the attached Table which shows the effect of the funding requirements of S. 4 upon contributions under the Plan as in existence during the period 1963 to 1972.

In a proper funding program we would expect to go through periods, perhaps several years, when there are actuarial gains and through other periods when there are actuarial losses. We do not believe that contributions should be materially decreased during temporary periods of gains or materially increased during temporary periods of losses. This would be the effect of experience deficiency provisions of (S. 4). When a program has in prospect periods up to half a century until the retirement of the youngest employees, several years can indeed be viewed as temporary or short-term.

Funding, should be on a more stable, longer range basis. When actuarial losses occur for several years funding should be adjusted accordingly over the long range and likewise when actuarial gains occur for several years the long range funding should be adjusted. *The provision dealing with experience deficiencies in (S. 1179) does this.*

We have indicated that the experience deficiency clause affects plans with more progressive pension benefits more adversely than others. Pension liabilities increase when pension levels are raised. Pension levels are raised by increases in wages where the pension formula is based on final pay but in some plans pension levels are increased only by plan amendments.

Under S. 4, increases in pension liabilities from plan amendments may be funded over a 30-year period. However, when increases in pension liabilities result automatically from unanticipated wage level changes, the increases must be funded over a 5-year period.

To illustrate, suppose pension liabilities are $1,000,000. Ignoring the effect of interest, the annual payment on a 30-year basis is $33,333. A plan amendment increasing pension liabilities to $1,150,000 calls for an additional payment on the same 30-year basis of $5,000 each year. Thus the annual payment increases from $33,333 to $38,333, a 15% increase.

Suppose the same 15% increase in liabilities resulted from wage increases or other adverse experience. Funding of the $150,000 increase in pension liabilities over 5 years would require an additional annual payment of $30,000 per year. The original annual payment of $33,333 is increased by $30,000 and becomes $63,333, a 90% increase. Thus for the same increase in pension liability the compulsory increase in company contributions resulting from wage increases is six times that resulting from a plan amendment. Such a requirement is totally inequitably, totally unreasonable, and can be financially disastrous.

A chart entitled "Discriminatory Impact of S. 4" is enclosed. This chart shows the percentage impact of the above illustration.

It may be suggested that if a plan's regular funding program contains an allowance for wage level increases, then the wage level changes that occur will not cause significant "experience deficiencies". In fact such allowances for wage level changes would not appreciably relieve the problem. The actuaries may properly use only a long term estimate which at the present time could probably not exceed an allowance for more than a 5% annual increase in wage levels. It is unlikely that the Internal Revenue Service would permit any higher allowance. Thus large experience deficiencies will necessarily arise when, as in recent years, annual wage level changes have greatly exceeded 5%, sometimes reaching the 15% range.

In order to avoid this problem, employers probably would stop improving pension plans to provide pensions based on final pay. Plans already having more liberal provisions might be forced to amend their plans and retrench. One possibility would be to link pensions to career-average pay, improving the pension levels by amendments from time to time.

OTHER PROBLEMS WITH COMPULSORY FUNDING

There have been examples of individual companies and even of whole industries that have gone through a long period of growth, then of maturity, and then of decline. The time for the funding of pension plans is during the periods of growth and maturity not the period of decline. It then is often too late to obtain the necessary resources to finance a pension plan. It may well do harm in such cases to force plans to divert resources away from current payment of pensions into greater advance funding.

Sometimes a declining company or industry is able to arrest its decline in terms of profitability while still declining in terms of personnel. The bituminous coal industry is one such example. In such a situation there will be a point in time when the rate of pension payments reaches a maximum and then starts to decline. If the industry or company is able to afford to pay these pensions on a "pay as you go" basis they will be able to maintain the plan indefinitely and start to accumulate assets for future pensioners as the pension role declines. Any legislation that is passed should allow the use of the available resources to pay adequate pensions to present pensioners instead of forcing their accumulation behalf of the relatively few young employees who will not need them for perhaps thirty, forty, or fifty years. As a simplified example of this situation suppose that an actuarial projection shows:

Years in future:	*Number of pensioners*
0 to 5	1,000.
5 to 10	900.
10 to 15	800.
15 to 20	700.
20 to 25	600.
25 to 30	500.
30 to 35	400 plus some new hires.

Now if the available resources are $100,000 per month the company can afford to pay $100 a month pension without accumulating any reserves for the first five years. During the second five years it can continue the $100 pension while accumulating-$10,000 a month reserve. During the third five years its reserve accumulation can be increased to $20,000 a month and so on. In all probability the $100 a month pension could be increased within 15 or 20 years. In contrast, any type of proposed mandatory funding would in effect be saying you must accumulate reserves at some rate, say $50,000 a month. Therefore, you can only pay $50,000 a month in pensions, a maximum pension of $50 per month per person.

It is difficult to envision how a statutory mandate can accommodate the variety of special circumstances, of which this is one illustration. It must be recognized that all present and prospective pensioners are not best served by the concepts embodied in a law which meets the needs of most. Some provision is required to handle the exceptions. We have not studied this question carefully, but situations like the bituminous coal industry strongly suggest that the need for handling exceptions be met.

We believe the proper allocation of available resources is best accomplished by design of individual programs to adapt to the particular needs and circumstances of each plan. Possibly, the most useful procedure to promote this objective would be legislation to require the meaningful annual financial disclosures to participants enumerated earlier in our testimony under disclosure requirements.

The listing of who will get what with the existing level of funds, in case of termination, will be the greatest stimulus to action by the parties-in-interest—by employers because the degree of security is exposed, and by employees and unions when a security risk is evident.

Another useful approach toward increasing the level of funding would be to amend the Internal Revenue Code so as to allow larger contributions on a tax deductible basis. Many employers would fund more if they could do so when financial conditions were favorable.

BELL SYSTEM COMPANIES

American Telephone & Telegraph Co.
The Bell Telephone Co. of Pennsylvania
Bell Telephone Laboratories, Inc.
The Chesapeake & Potomac Telephone Cos.
Cincinnati Bell Inc.
Illinois Bell Telephone Co.
Indiana Bell Telephone Co., Inc.
Michigan Bell Telephone Co.
The Mountain States Telephone & Telegraph Co.
New England Telephone & Telegraph Co.
New Jersey Bell Telephone Co.
New York Telephone Co.
Northwestern Bell Telephone Co.
The Ohio Bell Telephone Co.
Pacific Northwest Bell Telephone Co.
The Pacific Telephone & Telegraph Co.
South Central Bell Telephone Co.
Southern Bell Telephone & Telegraph Co.
The Southern New England Telephone Co.
Southwestern Bell Telephone Co.
Western Electric Company, Inc.
Wisconsin Telephone Co.

AMERICAN TELEPHONE & TELEGRAPH CO. AND ALL SUBSIDIARIES: SERVICE PENSION ACCRUALS

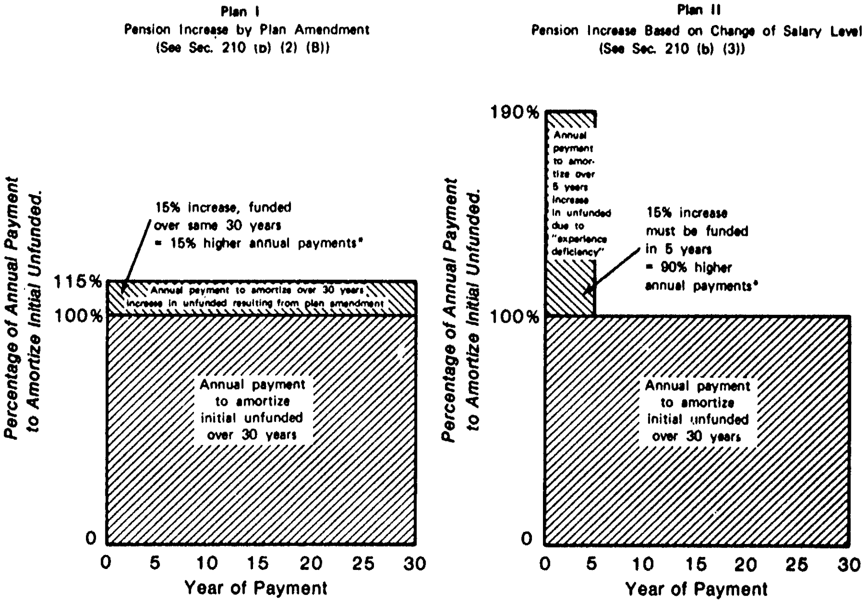
[In millions of dollars]

Year	Actual company contributions	Minimum contributions under bill similar to S. 4					
			Amortization of—				
		Entry age normal	Initial unfunded	Plan amendments	Experience deficiency	Total	Increase over actual contributions
1963	$282	$158	$68			$226	($56)
1964	353	180	68	$31	$32	311	(42)
1965	411	199	68	31	72	370	(41)
1966	414	210	68	31	179	488	74
1967	476	236	68	52	196	552	76
1968	482	246	68	52	229	595	113
1969	635	310	68	130	315	823	188
1970	801	382	68	130	370	950	149
1971	903	442	68	130	394	1,034	131
1972	1,148	536	68	225	679	1,508	360
1963–72	5,905					6,857	952
Percent increase over actual							16
1968–72	3,969					4,910	941
Percent increase over actual							24

Note: Parentheses denote decrease.

Discriminatory Impact of S.4

On funding of 2 plans, each with 15% increase of unfunded pension cost



Plan I
Pension Increase by Plan Amendment
(See Sec. 210 (b) (2) (B))

Plan II
Pension Increase Based on Change of Salary Level
(See Sec. 210 (b) (3))

*Effect of interest ignored.

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Senator CURTIS. Mr. Preston C. Bassett?

Mr. Bassett, if you will give your name to the reporter and for the record tell us who you are appearing for, and, also, please identify the gentleman with you.

STATEMENT OF PRESTON C. BASSETT, VICE PRESIDENT AND ACTUARY, TOWERS, PERRIN, FORSTER & CROSBY, INC., ACCOMPANIED BY JOHN W. FISHER, VICE PRESIDENT

Mr. BASSETT. I am Preston C. Bassett, and with me is John Fisher. John Fisher will tell you about the company and why we are here.

Mr. FISHER. Mr. Chairman, my name is John Fisher and I am the vice president and manager of the Washington, D.C. office of Towers, Perrin, Forster & Crosby, Inc.

Mr. Bassett is the vice president and director and chief actuary of TPFC. TPFC has been providing actuarial and consulting services in the pension area for over 55 years. On our staff we have some 56 actuaries and over 100 professionals working in this area.

We provide our service from 10 offices here in the United States and 6 overseas offices as well.

Today we have more than 1,200 clients for which we provide our services and many of these clients are among the top 100 industrial companies in the United States.

In the development of our position, we have had a committee of very senior TPFC professionals and actuaries work on this. The average length of service of these people in our committee has been in excess of 20 years.

There are certain basic beliefs that this committee has developed. (1) We feel that the continuation of the private pension system should be strongly encouraged; (2) in the majority of cases, pension plans in our judgment are financially and socially responsible; finally, we feel that abuses and shortcomings are the exception. We feel that the current bills are much improved over prior bills and yet there are some important changes which, in our judgment, still need to be made.

I would like at this point, to ask Mr. Bassett, who is the chief actuary of our firm, to comment on some of these technical aspects.

Mr. BASSETT. I would like to take a few minutes to run through the major provisions of all of the bills.

On disclosure and fiduciary responsibility, we don't have any detailed comments we want to make at this time. Details are in the written testimony. One comment I would like to make is that I hope that the bill that is finally decided upon is not so detailed that it will be almost impossible to administer. There is a real problem of collecting a lot of statistics and data in depth and then not being able to adequately review them and use what is followed.

Let's hope that we file what we can use and not more than that. On the topic of vesting, I think the bill that I would like to see is kind of a combination of the bills that are now being considered by this committee. For example, we believe that vesting should cover prior service as does the Williams-Javits bill. We believe vesting should include the service prior to the date of the act.

On the other hand, as far as eligibility——

Senator CURTIS. May I interrupt? What do you mean by prior service?

Mr. BASSETT. Benefits vested with an employee and that benefit includes credits for service prior to the effective date of the act. This is included in the Williams-Javits bill. Service includes the benefits credited for service prior to the effective date of the act. The other bills, I believe, are future services only.

In regard to the eligibility, we prefer the administration bill where eligibility is when the age plus the service is equal to 50. We feel that is strongly that given a certain number of dollars being available to improve pensions—and this is really what we are talking about because vesting is going to cost something—and so, if it is going to cost a fixed number of dollars, we feel it is more important to concentrate those dollars at the older ages. People who are age 30 or 35 that terminate, they will reach 50 or reach 40, with 10 years of service and then just let them get their vesting. I think the money ought to be concentrated at the older ages. I think a rule of 50 does a better job.

In line with Senator Bentsen's bill, I think anyone with less than 5 years of service ought to be excluded. I think a person ought to work 5 years before they get any benefits.

Funding and plan termination insurance, I would like to talk about both of those together. These are probably the most controversial of the issues now before our committee. I think the two should be tied together. We have set forth certain criteria in regard to considering these two factors. One, we don't think you should try to solve all of past and potential and future problems at this time. We think you should move a little slower. We don't believe you should jeopardize the existing security to employees.

Some proposals would allocate assets in a way that might jeopardize the benefits to present employees. You certainly shouldn't discourage the formulation of new plans. You should do what you can to protect this against abuse. I will come back to that in a few minutes.

You shouldn't affect the plans that are now being soundly funded with adequate assets. That is my major point.

We believe that the emphasis should be on funding rather than on insurance. We think you should require companies to put in the contributions that are necessary to fund the plan, but in this regard, I would like to submit for your consideration the fact that maybe what we ought to be looking to is funding and insurance of future service benefits and not past service benefits. A plan can be amended today and increase past service benefits significantly; should we have an insurance bill and if that plan goes out of business, you will now pick up or someone picks up benefits for those employees for past service that was not earned while they were working. If consideration to perhaps this insurance and funding should be on the future services only.

For example, it would not be inconceivable to require that every plan put in the contribution necessary to pay for the current benefits. Now, if that is in there the plan is funded for those benefits and each year it would be required to put in the money to fund the current benefits and maintain the fund sufficient for those current benefits.

And then the insurance will only be necessary in the event the market dropped or something unusual happened, because the funding would be adequate to meet the benefits guaranteed to the employees. It is only when you try to insure and fund past benefits that you get into the problems that we are having in adopting a reasonable funding and insurance program.

Finally, on portability, we don't think it is necessary. We think vesting takes care of it. We are in favor of tax deductible employee contributions as provided in the administration bill, although we do not believe it is clear and equitable to have an offset for employees who are participating in employer plans. For example, if the employee terminates prior to vesting, he has had a reduction in the benefits being provided himself and he gets nothing from the employer.

So we do not believe there should be an offset of employee reduction when he has a qualified plan.

And, in conclusion, we feel we should have legislation and should have it now. We probably should have had it a few years ago. And if there is a real hangup on insurance and funding, we thing you should put through a bill on disclosure and fiduciary responsibility, and for vesting as well.

I thank you.

Senator CURTIS. Does that complete your presentation?

Mr. BASSETT. Yes, sir.

Senator CURTIS. Chairman Long?

The CHAIRMAN. No questions.

Senator CURTIS. Senator Roth?

Senator ROTH. No questions.

Senator CURTIS. Senator Dole?

Senator DOLE. No questions.

Senator CURTIS. Well, I would like to ask a question or two.

Who should be the judge of the adequacy of the funding?

Mr. BASSETT. I think the only people today that are qualified to determine the liability, which is the main part of the adequacy of the funding, are the actuaries. I think the responsibility should be left to the actuaries.

Senator CURTIS. Do you think that authority should be vested in any branch of the Government?

Mr. BASSETT. I presume it most logically comes under the Treasury Department because they are involved with the funding, the contributions of the plan and so on.

Senator CURTIS. What powers do they have now?

Mr. BASSETT. They do require a minimum contribution, which is equal to the cost of the current benefits being credited plus the interest requirements on any funded prior service benefits.

Senator CURTIS. Do you think the way that is being done now is satisfactory?

Mr. BASSETT. In most situations it is. There are situations where I think more funding would be required, but it is awfully hard to get it into the law in an equitable and fair manner. There are plans, I think, which are underfunded, yes.

Senator CURTIS. Have there been many private pension plans that have failed to pay the expected retirement benefits?

Mr. BASSETT. Well, first, we have to say what is expected. That is a tough question.

Senator CURTIS. Well, what was committed?

Mr. BASSETT. So far as what was committed, the answer was there have been very, very few that haven't because the commitment in most plans is limited to the assets in the fund. So I don't want to duck the issue, but——

Senator CURTIS. But purely from a practical standpoint, I would like to know from you people how big a problem do we have in the country of retirement plans failing because they haven't adequate funding?

Mr. BASSETT. I understand that the Treasury Department has just completed an extensive study of terminated plans during the last 7 months. And I presume that you will have their figures here for your review. That is the best study of anything of its kind I have seen on it.

Senator CURTIS. Well, is it a problem of consequence? Surely in the business you are in, you come in contact and receive the information of pension plans that fail. How big a problem is it or is it a problem?

Mr. BASSETT. We have had very few. Nationwide, as I understand, it is very few but to the individuals that are affected it is very important.

Senator CURTIS. It is 100 percent important to them?

Mr. BASSETT. Yes; so you come down to the fact that although it doesn't look like it is an expensive item, it doesn't look like it is a major item, but you can argue both ways that, well, if it is not expensive and not major, we might as well put it in there and go ahead with it, because it doesn't cost too much or you can look at it from the other side; that, well we have more important issues than this issue so why spend so much time with this issue.

So, you are getting into a real major problem here because you are changing the whole concepts of the pension plans as they are constituted. Companies put in pension plans with the expectation of paying benefits. Now, we have changed the concept to where companies are putting in pension plans where they are going to have to pay the benefits and some of the plans put a liability on the company to meet that benefit. So if I were a corporation and knew that the corporate liability might be attached because of the requirements of an insurance program, I might think twice whether I wanted to put in that program. You may be discouraging companies from putting in plans.

Snator CURTIS. Well, now, as to that, assuming that the problem is small, percentagewise, of retirement plans failing and you didn't pay the benefits and that it was of no consequence to the firm, do you think that insurance such as proposed here is the right angle to approach that problem?

Mr. BASSETT. In my earlier testimony, as you know, I felt you wouldn't need the insurance if you probably fund the plan so that you can do it on a future service in a realistic manner. It is when you set up a bill that if past service is increased by any amount, that you are going to insure it, it is when you do that that you create an opportunity for people to abuse the system.

Senator CURTIS. That is to rely on the insurance?

Mr. BASSETT. That is right.

Senator CURTIS. Rather than on their own careful handling of the funds?

Mr. BASSETT. That is right.

Senator CURTIS. So your answer is that proper requirements for funding universally applied will make unnecessary in the foreseeable future at least any insurance plan?

Mr. BASSETT. Well, I limited that to my recommendation that it be applied to future service only and not to past services and in that event, of course, that would cover.

Senator CURTIS. Would you change the system we have now where the control is in the Treasury Department and shift it to any other department of Government?

Mr. BASSETT. I think most of the provisions of these bills like vesting, funding and the insurance, should remain with the Treasury Department. They have the machinery set up. They are familiar with the plans and familiar with the problems. I think that would be the most efficient place for that.

Disclosure naturally falls in the Welfare and Pension Plan Disclosure Act—No, in the area, and I think the Labor Department has more experience in that. Fiduciary might flop either way.

Senator CURTIS. Senator Dole?

Senator DOLE. My information is that a joint study by the Labor and Treasury Departments indicates that—of all of the private pension plans in existence had terminated in 1972—99.96 of the persons covered were receiving the benefits to which they were entitled.

Mr. BASSETT. I didn't know it was that large but it could be.

Senator DOLE. It is better than I would have expected.

Mr. BASSETT. I know that their study concluded it was not a major problem, sir, nationwide.

Senator CURTIS. Well, we thank you very much for your appearance.

Mr. BASSETT. It has been a pleasure.

Senator CURTIS. Your statement in full, of course, will be printed in the record.

[The prepared statement of Mr. Bassett follows:]

PREPARED STATEMENT BY PRESTON C. BASSETT, VICE PRESIDENT AND ACTUARY, AND JOHN W. FISHER, VICE PRESIDENT AND MANAGER, WASHINGTON, D.C., OFFICE, TOWERS, PERRIN, FORSTER & CROSBY

For over 50 years, Towers, Perrin, Forster & Crosby has been consultants to the management of both large and small organizations in the United States, Canada, and Europe. Currently, we are consultants to over 1,200 firms, including major corporations, non-profit organizations, and state and local governments. We recognize that proposed pension legislation is controversial and that there are many valid, yet varying, points of view about it. Nonetheless, we believe it important, as responsible consultants and actuaries, to take a position on this subject.

We do not want to recite all the well-known facts that confirm the success of the private pension system. However, we cannot help but emphasize the fact that almost 6-million retired persons are currently receiving about $7-billion in benefits under this system and that the private pension system is responsible for providing pensions to a significant portion of the total retired population. Plan sponsors have contributed about $10-billion to private retirement funds on behalf of 35-million covered employees last year. This money has been irrevocably set aside for the benefit of employees.

Our basic position is that any legislation should be directed toward strengthening the private pension system. This system has existed for over 50 years with the most significant growth occurring during the last two decades. We believe the system is sound and in the vast majority of cases has proven to be both financially and socially responsible.

This outstanding achievement has been unfavorably pictured as a result of some distortion by the news media, and what we might term—biased observers. The stressing of dramatic and isolated situations leads readers, listeners, and the general public to believe that such unusual occurrences are the rule, and not as our experience leads us to believe, rare exceptions.

So much for the background. Because of our 50 years of experience, knowledge, and expertise on pension and profit sharing plans, we believe we are well qualified to comment on the provisions under consideration in current legislative proposals.

We believe some of the bills introduced in Congress come much closer to providing a realistic solution to solving problems that have become apparent in the private pension system than bills introduced in previous sessions of Congress. And we would, therefore, like to compliment many of the drafters of the proposed legislation on taking a more practical than utopian viewpoint into trying to find proper solutions in this important area. However, there are still certain practical and technical corrections that still need to be made. You will be glad to know that we have positive suggestions to be made in the areas of disclosure, fiduciary responsibility, vesting, funding, and plan termination insurance. We will comment on each of these areas in order.

1. DISCLOSURE AND FIDUCIARY RESPONSIBILITY

We support amending the Welfare and Pension Plans Disclosure Act in a manner which:

(a) assures that administrators and trustees of pension plans and funds observe the highest standards of fiduciary responsibility.

(b) relies on the "prudent man" rules as a sufficient standard for the investment of funds;

(c) provides for forthright, positive, continuing disclosure of essential provisions and operations to employees and government authorities; and

(d) simplifies and standardizes the forms and information required by various government agencies.

2. DISCLOSURE

Our specific recommendations on disclosure follow:

(a) Disclosure to *employees terminating* with vested benefits:

A requirement that a statement be given to every terminated vested employee describing his rights, the amount of the vested benefit, when payable, by whom, under what circumstances, and what further action will be required of him in order to receive such vested benefits. In addition, the employer must make a bona fide attempt to advise the vested terminated employee of his rights six months prior to the date on which he would be first eligible for benefits. If the employer is unable to locate the employee, the employer would be required to notify the Social Security Administration so that Social Security can inform the former employee to advise his former employer of his address.

(b) Disclosure to all *active employees* who are covered by the plan:

A requirement that an employer publish annually a brief statement summarizing:

(1) The eligibility requirements for normal retirement benefits, early retirement benefits, vesting of benefits, and for any other benefits provided by the plan.

(2) The benefit formulas.

(3) The options available and any notice period required.

(4) Any substantive changes in the plan during the prior year.

(5) Where the employee can get full details of the plan.

(c) Disclosure to all *active and retired employees* who are covered by the plan:

A requirement that the employer disclose annually:

(1) Information as to who is responsible for investing the fund, and who are the trustees, custodians and/or insurors of the fund.

(2) A summary balance sheet as of the close of the last plan year showing the value of investments by major categories as used for cost purposes.

(3) A summary of the income and oūtgo of the fund during the prior plan year showing:

Income

Employee contributions.
Employer contributions.
Interest and dividend income.
Net realized gain or loss in sale of assets.

Outgo

Benefits paid to retired employees and beneficiaries.
Fees, commissions, and other expenses paid and to whom.

(4) A statement of:

Market value of the fund as of the beginning and end of the plan year.

Present value of benefits* payable and the number of retired participants and their beneficiaries.

Present value of benefits* accrued by and the number of active participants eligible for retirement.

Present value of vested benefits* and the number of vested active and terminated participants.

(d) Disclosure to the *Labor Department*:

The present Act should be amended to simplify the filing requirements so as to cover essentially the following:

(1) Initial disclosure and disclosure following a substantive plan amendment:

Identification of the plan and those responsible for its administration.

Documents—plan, trust agreement, union agreements, etc.

(2) Annual reports:

Copies of disclosure to active and retired employees as described in (2) and (3) above.

Details regarding all transactions involving parties of interest, including investments under pension plans in company securities, and leasebacks, etc.

Statements from the auditor and actuary concerning the fund and plan liabilities.

Details regarding expenses charged to the fund for administering the plan or fund.

(3) A copy of all material filed with the Labor Department to be available for inspection at locations reasonably available to all employees.

3. FIDUCIARY RESPONSIBILITY

TPF/C believe that after a reasonable period of service, employees should be entitled to vested rights to their credited pension benefits even though service with their employer is terminated. While we recognize that many employers currently provide reasonable vesting and that there is a trend for more companies to provide more liberal vested benefits, we still believe some legislative minimums are desirable.

(a) Investments to be according to the prudent man rule.

(b) Limit for pension plans (not profit sharing type plans) of 20% of total fund assets that may be invested in securities or assets of the employer, with an appropriate transition period for existing plans.

(c) Prohibition against certain persons acting as fiduciaries or trustees.

(d) Fund is for exclusive use of plan participants.

(e) Listing of certain prohibited transactions.

4. VESTING

However, our recommendations in this area are slightly different than those of S: 4, S. 1179 or S. 1631. We believe our proposals will be easier to understand and administer than those of the proposed bills. Also, our proposals will more completely satisfy the real needs of the plan participants in that we recommend faster vesting (five years) for employees at the older ages (45 and over).

*The benefits above are to be determined on a single premium basis as though the plan were terminated, and the interest rate, mortality basis and any provision for expenses used to determine the above present values shall be stated.

NOTE.—These requirements may have to be modified in certain cases, e.g., for certain insured contracts.

We recommend that legislated vesting provide the following minimum vesting requirement:

(a) Participants would be immediately and fully vested for 100% of their own plan contributions, plus interest (if any) at the rate and under the conditions provided by the plan.

(b) For employer contributions in a money purchase or profit sharing type plan, or for pensions accrued under a unit credit or final pay type plan, participants would vest for pension credits as follows:

50% when age plus service equals 50, plus 10% for each complete year thereafter until 100% vesting is reached five years later, but with a requirement of:

a minimum of five years of service before the vesting schedule applies, and

compliance by all existing plans within three years of the effective date of Act.

Mandated vesting requirements would apply to pension benefits only, with the pension benefits payable on a life-only basis and payable at the normal retirement age specified in the plan, but no later than age 65. There would be no mandated vesting with respect to ancillary plan benefits (e.g., death, disability, or other incidental benefits) or to special rights available to active plan participants (e.g., early retirement based on special factors). We recommend that in pension plans which required or require employee contributions, legislated vesting be conditional on the agreement by the participant to leave his own contributions in the plan.

5. FUNDING AND PLAN TERMINATION INSURANCE

(a) We see some serious problems in the funding and insurance provisions set forth in S. 4, S. 1179 and S. 1631. For example:

(1) Some of the provisions (e.g., S. 4, Sec. 210(b)(3)) may be in conflict with current Internal Revenue Service Rules and such required contribution might not be tax deductible.

(2) We believe all plans (state, municipal, multi-employer, etc.) should be included. We recommend that Sec. 323(j)(6) of S. 1179 be omitted. Satisfactory relief, if necessary, for multi-employer plans is available through Sec. 323(k).

(b) Before making our recommendations, we would like to set our criteria for both Funding and Plan Termination Insurance:

(1) Proposals in these areas should not attempt to solve immediately all the past problems and *all* the potential problems which may develop because of existing funding inadequacies. Instead, they should focus on preventing the expansion of such inadequacies and the continuance of inadequate funding for basic pension benefit promises made to employees.

(2) The proposals should not jeopardize existing asset allocation provisions with respect to accrued benefits. This jeopardy can be avoided if mandated funding and insurance apply only to future benefit accruals for which the employer or his employees have made necessary plan contributions.

(3) Funding and Plan Termination Insurance should be limited so they do not discourage further liberalization of benefits provided under the private system.

(4) Proposals in these areas should be coordinated so that they assure responsible funding for *basic* benefit promises and do not encourage reliance on a Federal insurance program to "bail out" employers or unions who have made benefit promises which are unrealistic in terms of plan assets and future contributions.

(5) Legislated proposals should have "teeth" in them so that conformance will be assured.

(6) Government intrusion into the private pension system should be kept within reasonable parameters so that new layers of bureaucratic control are not added to those which are now operative.

(7) Proposals in these areas should have no impact on the overwhelming majority of pension plans which have been and continue to be soundly funded.

5. FUNDING

Keeping to the above criteria, our proposals for funding are:

(a) Employer must fund each year at least the "minimum credited benefit" for each participant. The "minimum credited benefit" for each year of plan participation after the effective date of the legislated funding requirement provisions of the Act would equal the greater of (1) or (2) below:

(1) For money purchase plans, the lesser of (1) employer contributions made on the participant's behalf in such year, or (2) 3% of such participant's wages subject to Social Security Tax for such year; or

For fixed benefit type plans, the lesser of (1) the increase in the participants accrued pension credit in such year, or (2) .75% of the participants wages received in such year which are subject to Social Security Tax;

(2) The benefits which can be provided by the participant's plan contributions. tions.

The minimum funding requirements under (1) above could be waived for employee groups which typically experience high turnover; e.g., employees who are under age 25 or have completed less than one year of service.

(b) The employer would be required to contribute each year the sum of:

(1) Any excess of the present value of the "minimum credited benefits" accrued to date over the market value of the funds, and

(2) The present value of "minimum credited benefits" expected to be credited during the ensuing year offset by the value of any contributions by participants; *Provided, however,* That for this purpose no contribution need be made for any year to the extent the market value of fund at the beginning of that year exceeds 100% of the single premium liability for all estimated accrued benefits under the plan as of the end of such year.

(c) Failure to meet the minimum funding requirement would result in a plan termination, unless the company promptly contributes the deficiency or adopts an amortization schedule acceptable to the IRS to fund such deficiency. In the event of such plan termination, a lien shall be made against the company's assets for the outstanding minimum funding contribution as constituting unpaid wages.

6. PLAN TERMINATION INSURANCE

Although we are aware of the myriad problems involved in designing an equitable and practicable insurance program to cover the loss due to plan termination of vested basic pension credits, and recognize the very limited need for such insurance in view of the general adequacy of private pension plan reserves, we do acknowledge that the total loss of previously vested pension credits for which apparently adequate contributions had been made can create severe economic problems for affected employees. Therefore, we are now recommending a limited program of Plan Termination Insurance which we believe would be equitable and can be practicable if it is adopted in conjunction with the legislated funding requirements which we propose above.

(a) Plan Termination Insurance would cover the portion of each participant's "minimum credited benefits" which has been vested in accordance with the legislatively required vesting provisions.

(b) In the event of plan termination, plan assets would be allocated in accordance with the following priority to provide pension benefits:

(1) The pension which can be provided for each participant based on the accumulation of his own contributions to the plan plus any interests credited under the plan;

(2) Any excess of each participant's vested "minimum credited benefits" over the provision provided in (1);

(3) Any excess of the benefits for each active participant at or over normal retirement age and for retired participants and their beneficiaries over the pension provided in (1) and (2);

(4) Any excess of the benefits for each participant eligible to retire early over the pension provided in (1) and (2);

(5) Any excess of the vested benefits for each participants over the pension provided in (1) and (2); and

(6) Any excess of the benefits for each participant over the benefits provided in (1), (2) and (5).

(c) The amount of "insurance" in any year would equal the excess, if any, of the single premium liability for the benefits in (b)(1) and (2) above, over the market value of plan assets.

For this purpose, the single premium liability would be based on unit purchase rates guaranteed by an insurance company or as promulgated periodically by the Treasury Department.

(d) The program would be a loss assessment rather than a prepaid premium insurance program with assessments to be made only as needed to cover insurance for actual plan terminations. The cost of insurance is to be provided by assessing pension plans in an appropriate manner, such as on the basis of number of pension plan participants.

7. PORTABILITY

Legislated vesting proposals would seem to us to remove the need for any legislated portability. Portability schemes will be an unnecessary and expensive additional complication.

8. TAX DEDUCTIBLE EMPLOYEE CONTRIBUTIONS

TPF/C supports the deductibility of employee contributions either to an employer-sponsored plan or to an individual-regulated savings/retirement plan up to an amount each year equal to the lesser of 10% of basic earnings or $1,500. In order to achieve equity and simplicity, this deduction should be granted regardless of participation in a qualified pension or profit sharing plans.

9. STATE LAWS

Federal laws should supersede all state laws pertaining to pension plans.

10. CONCLUSION

We agree with many legislators and others that legislation is needed *now* in the private pension plan area. The proposals we have made above would apply uniformly to all qualified plans and plans for states and municipal employees, except that plans covering fewer than 25 employees would continue to be exempted from Federal disclosure requirements. As outlined above, the Funding and Plan Termination Insurance proposals do not apply to profit sharing plans.

We recognize that the proposal for tax deductible employee contributions could result in loss of substantial tax revenue to the Federal government, and are willing to concede that this may not be a propitious time for this legislation. However, legislation covering at least the areas of Disclosure, Fiduciary Responsibility, and Vesting should be enacted promptly. We also favor early enactment of the Funding and Plan Termination Insurance proposals set forth above.

Senator CURTIS. Mr. Bernard Greenberg, if you will give your full name to the reporter and tell us who you represent and please identify the gentleman with you.

STATEMENT OF BERNARD GREENBERG, PENSION DEPARTMENT, UNITED STEELWORKERS OF AMERICA, ACCOMPANIED BY JOHN SHEEHAN, DIRECTOR, LEGISLATIVE DEPARTMENT, WASHINGTON, D.C.

Mr. GREENBERG. Yes, sir, Mr. Chairman. My name is Bernard Greenberg, and I am assistant director of the Insurance Pension and Unemployment Benefits Department of the United Steelworkers of America, Pittsburgh, Pa.

I am accompanied by John Sheehan, who is the director of our legislative department in Washington, D.C.

I am appearing today to offer testimony on what my union believes should be the basic principles of legislation to protect and advance the private pension system. At one time, after the debate over pension protection legislation had continued for a period of time, these basic principles began to appear to be self-evident. As with the proverbial broth which was spoiled by too many cooks, too many people with no interest, or at best peripheral interest, in private pensions have lately joined the discussion with proposals which have only muddied the essential problem areas. Proposals and panaceas have been proposed which may have some relationship to the income people receive, but bear no relationship to the real problem of our Nation's private pension system.

It would not be amiss to recall how the protection of the private pension system became a major legislative issue. Until 1948, the right of unions to negotiate with respect to pensions was not a recognized right. When the Inland Steel Co., after World War II, refused to negotiate with the United Steelworkers of America with respect to the unilaterally established compulsory retirement rule, and the content and level of benefits included in the company's pension plans, our union brought suit against the company under the Taft-Hartley law. In 1948, the Supreme Court decided in favor of the United Steelworkers of America and pensions became a major issue in collective bargaining, which is, of course, not only for the steelworkers but for the workers generally.

The CHAIRMAN. Could I ask you a question on this point that has bothered me for quite a while?

I am asking you now because I might not be here when you have concluded your statement.

Mr. GREENBERG. Yes.

The CHAIRMAN. It is fine with me for you people to bargain about pensions as well as a lot of other things. I think that this is an appropriate area for negotiation. I wonder if you can answer this question for the steelworkers. When you have an impasse between management and labor, I was wondering whether it might be appropriate for us to amend the law so that in situations where you are getting ready to have a strike, one side or the other would be allowed to say they are willing to bargain entirely in terms of dollars.

What I have in mind is this: If you can't agree with management and they can't agree with you, and if you have several issues upon which you can't agree, management would say to you, "Look, it is all right with us for you to take whatever we are going to pay you and put it into whatever you want. If you want to use it on pensions, that is okay, you can put it into pensions; if you want to use it for something else, put it into that; but in order to try to resolve this negotiation we would like to bargain on the basis of one common denominator. We want to insist on negotiating strictly in terms of dollars. As far as we are concerned, you can spend it on whatever you want to. You can use it on pensions, or you can use it on hiring a lawyer or setting up a trust fund, or you can use it on anything that you wish, but we want to bargain in terms of dollars because otherwise this impasse might go on forever."

Would you have any objection to legislation that would say that either party could insist that negotiation be in terms of dollars?

Mr. GREENBERG. Oh, I think probably we would. First, I would like to point out that under the Taft-Hartley law no employer could simply turn money over to a union and for just that that money be used for pension purposes. Any fund——

The CHAIRMAN. We are talking about amending the law, not what is permitted under present law.

Mr. GREENBERG. Well, I would just point out that the law was introduced and I think passed by a very substantial majority, because it was felt that it would be wrong to provide for the expenditure of company funds exclusively by unions.

The law, after all, says that these moneys, these trusts, they must be administered jointly by representatives of the company and the union in order to maintain a check over these funds, and for the use of an impartial chairman in the event that there is a dispute that can't be broken. But the fact is, to a degree, that is already occurring. It is not infrequent at the present time for pension plans to be established on the basis of the company contributing a specified number of cents per hour for the development of a pension plan. Now, frankly, we feel that that is in many situations not the best possible approach. For example, I don't think it is an approach that could be used in the basic steel industry. It is an approach that has validity in a number of smaller companies but the main reason I would say that that has no validity in the basic steel industry is that I could not conceive of a situation where, for example, the United States Steel Corp. would agree that the union was to take over full responsibility for the $2.3 billion fund, which has been accumulating in that corporation for the provision of pensions. Furthermore, I can't speak for the corporation but I think I know them well enough to say that they rather think the administration of these funds, as a managerial responsibility, and would take a very dim view of their being joint administration much less exclusive administration by the union.

But, in those situations where it does happen, we do provide for such arrangements. The Industrial Union Department of the AFL–CIO has a pool plan, which is based exclusively on that arrangement and——

The CHAIRMAN. Excuse me, but I look at this the way a Senator sitting on the Finance Committee would look at things. When somebody comes in with a good idea—and most of them are, if you can afford them—I find myself asking two questions: (1) What is the idea going to cost; and, (2) Who is going to pay for it?

Now, it would seem to me that when you negotiate on these various matters, it would be a sad thing if you have to go out on strike and shut down the economy when management and labor are not really at loggerheads at all with regard to differences in terms of cost; you are only arguing about what the money would be spent for.

It would seem to me that if you could persuade your members that it would be better to put a given amount of money into a pension fund than it would be to put that same money into a higher pay check, then I think that management would find some appeal to saying, "well, we would like to negotiate just in terms of dollars and then if you want to put more of it into the pension fund and less of it into wages, that is all right with us."

Why don't you think about that and then give us a memo on it?

Mr. GREENBERG. I would be very happy to do that.*

*Included as a communication in volume 3 of these hearings. Refer to contents, volume 3.

Mr. CHAIRMAN. I might have brought up something that you had not anticipated being asked.

Mr. GREENBERG. I must say that this is not a new or novel approach. As I said, this has been suggested to us many times.

I would like to make a couple of suggestions to you for your consideration that I think are important.

First, there is no such thing as a negotiation that does not take into account the cost of a pension component of the negotiations. When we negotiate, we have grand total of cost, which may consist of wages and pensions but, also, with arrangements with respect to holidays and vacations and insurance and unemployment benefits and what have you. So that these are matters that already are subject to a cost limitation. I might say that both the industries that we deal with, and ourselves, use actuaries, so that these costs can be reasonably determined, but I think I should point out that the question of pensions is a two-headed one; while there is a matter of cost, there is also a matter of relationship to existing income. No pension plan is negotiated in a vacuum. It is negotiated in relationship to what the man was getting as an active employee. And I would say that that is a basic component of every pension plan including pension plans in the Government and, that is, the relationship of a man's earnings to his pension is determined by such matters as what you will use as the base for determining the average. It will be determined by the number of service years the employee has. So that weight is given both the length of employment as well as earnings prior to retirement.

Finally, I would like to make this comment, which I think is a difficult one but, nevertheless, an important one. Pensions are a cost, but they are not cost, in quite the same way that, let us say, wages are cost because in calculating pension costs, we have to take into account such variables as the age of the employees involved, the probabilities of retirement and death and disability, withdrawal, the interest that the moneys will earn and so on. This is a complex kind of calculation. Regrettably, occasionally, using a simple cents per hour approach has the result of confusing people as to whether what we are talking about is something that personally belongs to the employee, because we said we were going to allocate 10 or 20 or 50 cents an hour for pensions, when, in fact, what we are doing is, not allocating these moneys on the basis of so many cents per hour but, actually, in terms of the characteristics of the ages and the service of the employees and the types of benefits that we are negotiating, so does it belong to him or not?

I am afraid that, as with many other problem complexities, there are side effects, let me put it that way, there are side effects that need to be taken into account.

The CHAIRMAN. Well, thank you very much. I apologize for bringing you into this area. I thought we might simplify this but I am afraid it is not that simple.

I would appreciate a memo on that area. That would help me because I don't want to complicate these areas any more than they are already. So if you can simplify that, fine.

Senator NELSON. On the question of a strike and how the money might be spent, you represent the one major union in this country that has agreed on arbitration of disputes between labor and management.

Mr. GREENBERG. With respect to the steel industry, yes. Unfortunately, it does not cover more than half of our membership.

Senator NELSON. Basically, steel industry has this agreement?

Mr. GREENBERG. Oh, yes.

Senator NELSON. Go ahead.

Mr. GREENBERG. From that time forward, the tremendous expansion of the private pension system took place. Regrettably, the bargaining right recognized by the Supreme Court did not become meaningful until the steelworkers struck the steel industry in late 1949 in support of the recommendation of the Fact-Finding Board appointed by President Harry S Truman, and chaired by Prof. Carol R. Daugherty.

Senator Long, I think it might be of passing interest that the Presidential Fact-Finding Board in 1949 recommended that 6 cents an hour be expended for pensions, but after the parties bargained on the subject, they decided that it was the better part of wisdom to drop the 6 cents and agreed on a benefit program.

From this brief outline of the early events in the history of the start of our present private pension system, we can see why pensions, the same as wages and working conditions, have an important issue on the legislative agenda.

The first pension problem before the Congress is whether the ground rules by which pension rights and benefits are established will be left to industrial conflict, or whether Congress will enact the legislation to mandate the minimum basic standards that all private pension plans must adhere to. We believe that the basic principles of sound private pension plans are not matters of opinion, but axioms drawn from generations of experience. As such, it is clear that no private pension plan can endure which does not adhere to these principles. If these basic principles are not mandated by law, they assuredly will have to be established at great cost to the Nation and its workers through industrial strife.

The Congress has maintained a continuing interest in legislation affecting pension plans since the enactment of the Taft-Hartley law. The exposure of a number of scandals involving the mishandling of pension funds resulted in the passage, during the late 1950's, of the Welfare and Pension Plan Disclosure and the Landrum-Griffin Acts. But these measures failed to deal with the more serious evolving problem of protecting participants from the loss of benefits from improperly drawn and inadequately funded pension plans.

Since the early congressional enactments, great strides have been made in the development of new and improved pension plans, and a new dimension of well-being has been added to the standard of living of the American worker. It is difficult to recall that as short as 40 years ago, retirement on pension was practically unknown. A worker continued to work until he was no longer able to do so. As short as only 25 years ago, meager social security benefits of less than $50 a month were the sole retirement income of most workers. The right to retirement on a public and private pension is now so widely accepted that when, for some reason, a private pension plan fails to deliver a promised benefit, the loss is properly greeted by a sense of outrage. When a pension benefit is lost, a fundamental right and a just reward of work have been violated.

The current pension protection issues arise because the fate of millions of workers and billions of dollars are now involved in the private pension system. Even the general economy is affected by the growth and pervasiveness of this vast new social phenomenon. The question before Congress is not whether additional pension legislation is required to monitor this vast system, but what the nature and the scope of such legislation should be.

Aside from the issues of minimum standards of managerial and fiduciary probity, on which there appears to be unanimous agreement, we believe there are four basic issues on which consensus must be reached before meaningful legislative action can be taken. We believe these four issues are interrelated and inseparable. If only part of the pension protection problem is resolved by legislation, the remaining issues will still have to be acted on, because any single major defect in a private pension plan can result in the failure of the purpose of the entire plan.

Issue No. 1 we want to deal with is pensions as deferred income. The first issue concerns the principle that a pension is deferred payment for services rendered. Of course, there are major significant differences between wages paid for work performed and pension benefits paid after work ceases. Wages represent a share of current production; pensions represent an obligation to the worker after he no longer is able to or has earned the right not to toil. It is the fact that pensions are paid to people who are no longer producing which creates the necessity for accumulating the means to pay for pensions before retirement occurs. Furthermore, unlike wages, pension costs are related to age. The closer a man is to retirement, the more costly is each unit of pension benefit.

When the principle of retirement on pension as a payment for working is accepted, several consequences follow:

No worker who has earned a pension right should be deprived of that right because his employment with a particular employer terminates prior to the date of his pension eligibility.

Senator NELSON. Mr. Greenberg, my plane was late and held up in Pittsburgh——

Mr. GREENBERG. Very unusual, sir.

Senator NELSON. I got here after you started, and I don't know if you were informed about the ground rules. We have seven more witnesses, and everybody was notified to summarize their statement in 10 minutes. You have 3 minutes left to you, I am told.

Mr. GREENBERG. I see.

Senator NELSON. The time doesn't run against you when we ask questions.

Mr. GREENBERG. May I talk to a question then which I think is one that is of great concern, and, that is, the question of jurisdiction.

Senator NELSON. Your statement will be printed in full in the hearing record.

Mr. GREENBERG. I understand, sir. I want to talk to the problem of pension protection enforcement because we feel very strongly that pension protection enforcement should not be in the Internal Revenue Service, but should be located in the Department of Labor. I must say that in addition to my statement, which I think will speak for itself, that I can speak from some experience: experience, I might say, which unfortunately I ran into just several days ago. Just several days ago, a problem arose as to the propriety of a termination clause in a pension plan that was being negotiated. I would say, without going into the details, that there was no question that the proposed termination clause was contrary to all accepted principles of pension drafting. I was immediately stopped when I started the discussion by the statement that "that can't be so because the clause had been presented to the IRS, and the IRS had not found anything to be critical of." It is difficult to tell someone that the presentation of a document to IRS is not any judgment as to whether or not that is a sound clause, and one that is designed to protect the participants but, it exclusively, has been examined as to whether or not it protects the Government because the IRS, their interest in these matters is to protect the Federal Treasury and not to protect pension participants.

The IRS is concerned with whether or not a pension plan is a bona fide plan. If they think that this is merely a scheme for the avoidance of taxes, they will put a stop to it. But if it meets their criteria of not cheating Uncle Sam of taxes, they have met the charge that they are responsible for it.

Now, we think that is not sufficient. That is not the basis on which pension plans can be protected. We believe that the rules, the same as for banking and for insurance, where the reserves play the same role as they do in pensions, must be mandated by law.

Senator NELSON. You support the provision of S. 4 that would provide for certain aspects of the administration of the pension plans to be in the Labor Department?

Mr. GREENBERG. Wholeheartedly.

Senator NELSON. Thank you.

Mr. GREENBERG. Thank you.

[The prepared statement of Bernard Greenberg follows:]

PREPARED STATEMENT OF BERNARD GREENBERG, ASSISTANT DIRECTOR, INSURANCE, PENSIONS AND UNEMPLOYMENT BENEFITS DEPARTMENT, UNITED STEELWORKERS OF AMERICA

Mr. Chairman, my name is Bernard Greenberg. I am Assistant Director of the Insurance, Pensions and Unemployment Benefits Department of the United Steelworkers of America, Pittsburgh, Pennsylvania. I am appearing today to offer testimony on what my Union believes should be the basic principles of legislation to protect and advance the private pension system. At one time, after the debate over pension protection legislation had continued for a period of time, these basic principles began to appear to be self-evident. As with the proverbial broth which was spoiled by too many cooks, too many people with no interest, or at best peripheral interest, in private pensions have lately joined the discussion with proposals which have only muddied the essential problem areas. Proposals and panaceas have been proposed which may have some relationship to the income people receive, but bear no relationship to the real problems of our nation's private pension system.

It would not be amiss to recall how the protection of the private pension system became a major legislative issue. Until 1948, the right of Unions to negotiate with respect to pensions was not a recognized right. When the Inland Steel Company, after World War II, refused to negotiate with the United Steelworkers of America with respect to the unilaterally established compulsory retirement rule, and the content and level of benefits included in the Company's pension plan, our Union brought suit against the Company under the Taft-Hartley law. In 1948, the Supreme Court decided in favor of the United Steelworkers of America and pensions became a major issue in collective bargaining. From that time forward, the tremendous expansion of the private pension system took place. Regrettably, the bargaining right recognized by the Supreme Court did not become meaningful until the Steelworkers struck the Steel Industry in late 1949 in support of the recommendations of the Fact Finding Board appointed by President Harry S Truman, and chaired by Professor Carol R. Daugherty. From this brief outline of the early events in the history of the start of our present private pension system, we can see why pensions, the same as wages and working conditions, have become an important issue on the legislative agenda.

The first pension problem before the Congress is whether the ground rules by which pension rights and benefits are established will be left to industrial conflict, or whether Congress will enact the legislation to mandate the minimum basic standards that all private pension plans must adhere to. We believe that the basic principles of sound private pension plans are not matters of opinion, but axioms drawn from generations of experience. As such, it is clear that no private pension plan can endure which does not adhere to these principles. If these basic principles are not mandated by law, they assuredly will have to be established at great cost to the nation and its workers through industrial strife.

The Congress has maintained a continuing interest in legislation affecting pension plans since the enactment of the Taft-Hartley law. The exposure to a number of scandals involving the mishandling of pension funds resulted in the passage, during the late 1950's of the Welfare and Pension Plan Disclosure and the Landrum-Griffin Acts. But these measures failed to deal with the more serious evolving problem of protecting participants from the loss of benefits from improperly drawn and inadequately funded pension plans.

Since the early Congressional enactments, great strides have been made in the development of new and improved pension plans, and a new dimension of well-being has been added to the standard of living of the American worker. It is difficult to recall that as short as forty (40) years ago retirement on pension was practically unknown. A worker continued to work until he was no longer able to do so. As short as only twenty-five (25) years ago, meager Social Security benefits of less than $50 a month were the sole retirement income of most workers. The right to retirement on a public and private pension is now so widely accepted that when, for some reason, a private pension plan fails to deliver a promised benefits, the loss is properly greeted by a sense of outrage. When a pension benefit is lost, a fundamental right and a just reward of work have been violated.

The current pension protection issues arise because the fate of millions of workers and billions of dollars are now involved in the private pension system. Even the general economy is affected by the growth and pervasiveness of this vast new social phenomenon. The question before Congress is not whether additional pension legislation is required to monitor this vast system, but what the nature and the scope of such legislation should be.

Aside from the issues of minimum standards of managerial and fiduciary probity, on which there appears to be unanimous agreement, we believe there are four basic issues on which consensus must be reached before meaningful legislative action can be taken. We believe these four issues are interrelated and inseparable. If only part of the pension protection problem is resolved by legislation, the remaining issues will still have to be acted on, because any single major defect in a private pension plan can result in the failure of the purpose of the entire plan.

Issue No. 1: Pensions as Deferred Income

The first issue concerns the principle that-a pension is deferred payment for services rendered. Of course, there are major significant differences between wages paid for work performed and pension benefits paid after work ceases. Wages represent a share of current production, pensions represent an obligation to the worker after he no longer is able to or has earned the right not to toil. It is the fact that pensions are paid to people who are no longer producing which creates the necessity for accumulating the means to pay for pensions before retirement occurs. Furthermore, unlike wages, pension costs are related to age. The closer a man is to retirement, the more costly is each unit of pension benefit.

When the principle of retirement on pension as a payment for working is accepted, several consequences follow:

> No worker who has earned a pension right should be deprived of that right because his employment with a particular employer terminates prior to the date of his pension eligibility.

No worker who has earned a pension right should be deprived of that right because his employer deliberately failed to set aside the necessary funds to pay the worker his earned right when he became eligible to receive it.

No worker who has earned a pension right should be deprived of that right because the pension plan terminated prior to the time that a pension plan, which was accumulating funds on an acceptably sound basis, became sufficiently funded to meet all its obligations.

Issue No. 2: Deferred Vested Rights

Even if it is accepted as a principle that a pension right once earned cannot in justice be taken away from the worker, the questions still remain: for how long does a worker have to work to earn a pension right, and when does a pension become a vested right?

The reason these question continue to be raised lies in the fact that many commonly accepted present pension plan principles were established long before pensions were a matter of collective bargaining. Before pensions were part of Union labor agreements, they were considered gratuities for long and faithful service. Therefore, it seemed only natural that no one should enjoy a right to a vested pension unless he had attained, say, the age of fifty-five (55) and had completed twenty (20) or more years of uninterrupted service, and his break in service was completely involuntary.

But if pensions are considered to be the same as other remuneration, except that they are deferred to retirement—tney should become an unforfeitable right with each day's work.

Those who continue to argue that pensions should vest only after the passage of many years' service and years of age have never freed themselves from their earlier conception of pensions as a gift. They have not accepted the fact that pensions are an earned right. The concept of pensions as gratuities minimum age and fewer years of service for vesting attests to the invalidity and decline of the pension gratuity theory. So long as any periods of service or age are retained as eligibility requirements, the principle of pensions as an earned right has been compromised.

Having supported the principle. I must now hasten to say that our Union has conceded that for legislative purposes there is a practical necessity for a minimum service requirement for pension vesting. We have said that a five-year service requirement can be justified only on the basis that maintaining records for shorter periods of service is unduly burdensome. We believe, however, even this minimum requirement should be waived where service is broken through no fault of the employee.

It is appropriate at this point to briefly discuss whether an employee's total service should be credited for pension purposes. When, in 1949, the United Steelworkers of America began its pension negotiations, there were some 600,000 workers employed in the basic steel industry ranging in age from twenty to sixty-five, and having service with their employers from a very short period to as much as fifty years. I must say that I do not have any memory of any representative of any major company suggesting that the millions of years of accumulated service of these steelworkers at that time, should be tossed away and only the service after 1949 should be counted for pension purposes. I would hazard the guess that we would still be on strike if anyone tried to push any such proposal on us. Yet, this is precisely the principle advocated by the Administration, a few members of Congress and by some self-appointed "friends" of labor.

Any proposal which deprives older workers of their accumulated years of service prior to the effective date of an Act, for either vesting or determining the amount of benefits will not be accepted by those who have spent their lives working for a living and contributing to this nation's enormous wealth. Anything short of full credit for all years worked for an employer is not acceptable and can only be considered a scheme to reduce pension costs to totally unacceptable low levels. Proposals to only count service after the enactment of legislation contribute nothing to the protection of present private pension plan rights.

Issue No. 3: Accumulating pension reserves

We say that pension rights can exist only where the necessary funds to provide such rights are set aside during the active lifetime of the worker. This proposition is so widely accepted at the present time that no further discussion of the subject would seem required were it not for the fact that it is still suggested that proper pension funding can be achieved by providing income-tax incentives. Michael S. Gordon, Minority Counsel to the Senate Labor Committee has been quoted as pointing out that,

"Since the entire framework of regulatory supervision under the Internal Revenue code hinges on an employer's self-interest in maintaining tax deductions for contributions to a private pension plan, the effectiveness of such regulatory supervision is related to the continuation of the employer's self-interest. When that self-interest ceases, the Internal Revenue Code ceases to be an efficient control mechanism.

"An Internal Revenue approach, he continued, does not help the workers whose plan refuses to deliver vested benefits. The plan can be disqualified from tax benefits, but this does not help the worker who lost. His only recourse would be a breach of contract lawsuit utilizing private lawyers and resources, if he can afford them."

To this should be added that the goal of the Internal Revenue Code is not to protect the rights, pension or otherwise, of workers—the goal of the Internal Revenue Code on pensions is to protect the Federal treasury by ensuring that the government is not cheated out of income taxes by schemes which are deemed not to be bona-fide pension plans.

The problem of pension protection enforcement involves not merely a choice of the location of the administrative agency between two different government departments, but rather involves a choice between different fundamental principles of labor-law enforcement. On the one hand, there is the suggested approach of exclusively voluntary adherence to standards to be encouraged by income tax incentives. This is the basic approach of those who advocate locating pension protection in the Internal Revenue Service. The other approach is that of establishing mandatory norms of administrative and financial conduct and enforcing these standards by denying the privilege of operation to those who fail to adhere to them. This approach depends not only on financial incentives, but recognizes that an inevitable minority (which can eventually destroy any voluntary system) must be compelled to live by legally mandated rules enforceable in a court of law. Those of us who support the latter approach believe that pension protection belongs in the administrative agency established to protect the interest of workers—the Department of Labor.

One important reason for the mandatory funding of pension plans is the ignorance of some who establish pension plans. They simply do not know the consequences of failing to set aside the necessary reserves against growing pension obligations. Here is a situation in which common ignorance is just as dangerous and harmful as dishonesty. Whether an employer deliberately refuses to fund a pension plan in a reasonable fashion or does so irresponsibly out of ignorance, the results are identical: trusting workers irremediably lose the fruits of a lifetime of labor.

The plain fact is that pension funding is essential if promised pension benefits are to be paid eventually. No pension plan should be permitted to be established unless it intends to develop the necessary reserves to meet its accruing liabilities. As in banking and insurance, this principle must be given the force of law. This does not mean that inflexible rules must apply to all regardless of significant differences, but it does mean that all plans must be funded in a fashion reasonably designed to fully meet their obligations when they fall due.

My Union associates itself with those who believe that placing the enforcement of pension protection laws in the Internal Revenue Service is wrong. Many who advocate that the Internal Revenue Service should enforce pension protection legislation also advocate weak, ineffectual controls. They see the granting of jurisdiction over pension protection to the Internal Revenue Service as part of an over-all scheme of little or no controls.

The enforcement of mandatory labor-law standards with respect to wages, overtime, child labor, safety and health standards has been placed in the Department of Labor because it is recognized that labor-law enforcement is a specialized field very different from and unrelated to the enforcement of laws pertaining to commercial transactions.

Issue No. 4: Pension Plan Termination Insurance

It is now generally accepted that even where plans are being funded adequately and continuously, termination prior to the full funding of total liabilities is inevitable in a certain number of cases. In short, the ebb and flow of business activity is no different where pension plans have been established than where they do not exist.

We all know that a responsible man recognizes that one of his responsibilities is to see that if he has a family he does not leave them penniless in the event of his premature death. We also would consider it the height of folly, if not impracticability, if every young man in the land were to attempt to establish over a few years a personal savings account sufficient to meet all his obligations to his family in the event of his early death. Since only a small number of persons with growing families die each year we know that the proper protection of a family against the insecurities of premature death is insurance—the payment of a small premium by many to provide the protection required by a few.

The application of the insurance principle to the protection of private pensions is rapidly becoming a matter not only of simple practicality, but one of great urgency. Consider the magnitude of the funds which would have to be collected if an effort were made by the unions to have every single pension plan in the United States funded as if it might be terminated in the next ten years and would have to meet 100 per cent of its obligations at that time. But, you might ask, why should the unions require *every* employer to so fund? To which we would respond that we would defy anyone to predict exactly which of the thousands of existing pension plans will terminate in the next ten years. What is more, would you not criticize us if we exempted some companies from early full funding because we deemed them indestructible, and if we only went after those visibly weak companies which, by definition, were less capable of accelerated funding than the stronger companies?

It is argued by some that the Congress should do nothing to protect the pension rights of workers who are the victims of prematurely terminated pension plans. Let those workers, it is argued, in effect, who have had the misfortune to have been employed by a terminating employer suffer for having failed to choose more fortunately. This is an unsocial attitude which was long ago rejected by Congress in other areas affecting workers. It is not an attitude appropriate to the United States standing at the threshold of its third century with the wealth not only to fully provide for its own, but to provide for millions beyond its shores. The protection of pension rights by pension termination insurance requires but a minuscule allocation of our vast resources. It is almost ridiculous to have to argue that those who have, by their labor, played an essential part in the creation of this great wealth are entitled in all circumstances to the pension rights they earned by their contribution to our society.

We appreciate the efforts of this Subcommittee to address itself to the problems of private pension plan protection. This issue, however, has been actively before the Congress for at least six years. The House and Senate Labor Committees have held numerous hearings and completed exhaustive surveys over this time. From these lengthy proceedings, the Williams-Javits bill, S-4, has evolved. We have given our full support to this bill, which is a sound, reasonable, and practical approach to solving the country's very serious and immediate pension protection problems.

We were extremely disappointed that the Senate did not act on the Williams-Javits bill during the last session of Congress. We see no reason for delay in this session and must admit we are concerned over the initiation of another set of hearings by a new committee—the same committee which without any study gutted the union pension protection provisions from last year's Williams-Javits bill, which was unanimously voted out by the Labor Committee.

If these hearings can shed more light on the plight of workers who lose their pensions and the pension protection measures which must be enacted, then they are welcomed. No doubt, additional information is needed concerning workers who are not entitled to any, or adequate Social Security, nor to the benefits of a private pension plan.

But such studies of the insufficiencies of old-age income must not deter the Congress from immediately acting to protect and advance the private pension system which is in being. We have urged the Senate Labor Committee to move for quick action on S-4. We hope and trust this Subcommittee will also lend its support for this vital action.

Senator NELSON. The next witness is Sheldon S. Cohen, chairman, Special Committee on Retirement Benefits American Bar Association, accompanied by Donald McDonald, chairman of the section of taxation, and Andrew H. Cox, vice chairman of the Committee on Employee Benefits of the Tax Section, both of the American Bar Association.

Go ahead, Mr. Cohen. You know the rules are 10 minutes and summary except if we ask questions, that doesn't run against you.

STATEMENT OF SHELDON S. COHEN, CHAIRMAN, SPECIAL COMMITTEE ON RETIREMENT BENEFITS, AMERICAN BAR ASSOCIATION, ACCOMPANIED BY DONALD McDONALD, CHAIRMAN OF THE TAX SECTION, AND ANDREW H. COX, VICE CHAIRMAN OF THE COMMITTEE ON EMPLOYEE BENEFITS, BOTH OF THE ABA

Mr. COHEN. Mr. Chairman, and members of the subcommittee, I am Sheldon S. Cohen, chairman of the Special Committee on Retirement Benefits of the American Bar Association, and I am accompanied by Donald McDonald, on my right, of Philadelphia, who is chairman of the tax section of the American Bar Association, and also by Andrew Cox of Boston, on my left, who is vice chairman of the committee on employee benefits.

I will try to quickly summarize the statement you gentlemen have before you and then Mr. Cox will discuss some of the possible, technical problems there might be in this legislation to which we might suggest changes or corrections.

As you know, the American Bar Association has a membership of 163,000 lawyers. We have, for many years, supported legislation to encourage the establishment of voluntary pensions for self-employed individuals and for their employees.

Thirty years ago Congress enacted legislation that gave substantial tax benefits in the general area of employee's benefits, but has had substantial difficulty over the years in equating the rights afforded the self-employed and their employees with the rights of the vast bulk of all other employees throughout the United States. I am sure you gentlemen are all familiar with the course of legislation that began in the early 1950's; the Keogh legislation that was sponsored on this side by the then Senator Smathers.

Now a decade, or a little more than a decade, after the original passage of the Smathers-Keogh legislation, we appear here today to support generally the administration's proposals for amplifying the benefits for the self-employed and their employees. H.R. 7157 on the House side and on this side, S. 1631, encompasses those proposals which would broaden the limitations heretofore held from the self-employed, with certain modifications. Now, the inequity is obvious. It is hard to explain why a person who works for a corporation should receive one benefit and a person who works for a partnership, whether it be legal, medical, engineering, or any other, should be treated differently.

Senator NELSON. You are talking about the amount?

Mr. COHEN. The amounts and the various limitations that might be imposed. Principally, we are concerned with the amount although Mr. Cox will bring up some other problems.

Senator NELSON. Do you believe that there ought to be some limit on the benefits provided to major corporate officials in their pension plan?

Mr. COHEN. I will have to answer that carefully, sir, because the American Bar Association has taken no position on that. If you are asking Sheldon Cohen, the answer is "Yes." There was a proposal made——

Senator NELSON. Your answer is "Yes"?

Mr. COHEN. Yes, sir, on my behalf and not on behalf of the American Bar Association.

Senator NELSON. The bar association hasn't taken a position?

Mr. COHEN. No. If you recall, several years ago Deputy Assistant Secretary of the Treasury Nolan delivered a speech in which he proposed a number of modifications. One of those modifications was that, as part of the package to broaden benefits in the pension area, that the rule of 50 should be put in; that an overall limitation—and at that time he was rather loose in proposing numbers—but I recall at one time, and this may not be exactly accurate, he proposed a limitation of $10,000 as to any one individual and at other times he may have proposed lower numbers.

Senator NELSON. But you think there ought to be some limitation?

Mr. COHEN. It would appear to me that that suggestion by the then Deputy Assistant Secretary of the Treasury was a rational proposal, which I personally think had a good deal to recommend it; yes.

Senator NELSON. Is it the bar association's position that they endorse that beneficiaries under H.R. 10 plans should receive benefits similar to those received by corporate officials, but they wouldn't endorse the proposition that corporate officials benefits ought to be limited similar to the limitation provided under H.R. 10 plans.

Mr. COHEN. If my recollection of the bar association's position is accurate, that would probably summarize it correctly. That is, the bar association believes the self-employed, which would include lawyers and all other self-employed, ought to receive those benefits which were allowed to the corporate employee. The bar stops there. It does not take a position as to whether there ought to be a limitation. If there were a limitation, the self-employed ought to be limited as all other people are limited.

Senator NELSON. Fine.

Mr. COHEN. Now, in my statement, there are some figures which show that the amounts now capable of being saved by the self-employed lawyer, for example, are very small, which has stopped any number of self-employed from instituting plans. This, in effect, again blocks off self-employed benefits.

That is my part of the statement, sir.

Mr. Cox has a few comments on some technical aspects.

Senator NELSON. Mr. Cox?

Mr. COX. Yes. As Mr. Cohen has said, the bar association has not considered, rather, has not taken a position, on all of the many bills that were before the subcommittee. The one bill on which it has taken a position is a predecessor of S. 1631.

Back in 1969, the bar association took the position that the Internal Revenue Code should be amended to eliminate all distinctions in the treatment accorded common-law employees on the one hand and self-employed individuals on the other. The most recent action by the American Bar Association on this matter was in February of this year when the House of Delegates approved a resolution submitted by the section of taxation to the effect that H.R. 12272, which was the individual retirement benefits bill of 1971, submitted just at the end of 1971, should be enacted but recommended that amendments be made. The position of the bar association was that the amendments were desirable but the bill should be enacted even if no amendments were made.

Moving along to this year, as Secretary Shultz has put it, S. 1631 is a revised and expanded version of H.R. 12272. And so it seemed to us that the views of the American Bar Association on H.R. 12272 might be of interest to the subcommittee in considering S. 1631.

The February 1973 action was to the effect, as I said, that H.R. 12272, or any other bill of equivalent purpose and effect should be enacted, but with certain recommended modifications.

Now, S. 1631 does not include the basic recommendations that were made by the American Bar Association. On the other hand, it does make a number of changes in the predecessor bill, which are fully consistent with that basic recommendation and, by that I mean the elimination of distinctions between the common-law employees and the self-employed people. In addition to those changes, S. 1631 adopts other amendments which were recommended by the bar association. I should like, if I might, to direct a few comments to those particular changes, which are now incorporated in S. 1631.

In addition to such changes as the deduction limit to which Mr. Cohen has referred, S. 1631 contains provisions which are designed to enable self-employed individuals to participate in pension plans of the defined benefit type, as opposed to the money purchase type; that is, to provide a benefit without initial consideration of cost as opposed to figuring out the particular number of dollars to be put in, year-by-year.

In the past, that generally has not been feasible for self-employed individuals, to participate in these plans of the defined benefit type because there has been no provision for pooling the contributions made on behalf of the several, self-employed people involved. The American Bar Association supports the changes included in S. 1631 which permit this participation although it may be that certain additional revisions of some of those provisions should be made.

A second change incorporated in S. 1631 is that employees who are included in a unit of employees covered by a collective bargaining agreement should be excluded, not taken into account, that is—in determining whether the percentage coverage test of the code, section 401(A)(3)(a) has been satisfied, and providing that the collective bargaining agreement stipulates that these people are not to be covered. The bar association supports this position, but feels that similar provisions should be made applicable to other sections and specifically 401(A)(3)(b), dealing with another kind of coverage check and also section 404(A)(4) dealing with discriminations in contributions of benefits.

A third change which S. 1631 would make would be to delete section 72(M)(1) from the code, which has a special rule for taxing nonperiodic distributions to owner employees. It is a rule that is less favorable than the rules generally applicable to other people. Since this change is directed at uniformity, the American Bar Association would support it. Another change of less importance, perhaps, is to delete the requirement of present law that the trustee of a trust forming part of a plan, which owner is employees participate, must be a bank. This would be deleted and since it again tends toward uniformity the American Bar Association would support it.

Fourth, and finally, there was a provision in H.R. 12272 which would have authorized the Secretary of the Treasury to establish special eligibility and vesting rules in certain conditions, for plans covering certain kinds of employees, which generally would be employees who have certain ownership in the partnerships or corporations maintaining the plan. The American Bar Association would support the deletion of that provision.

Thank you.

Seantor CURTIS. Mr. Chairman, I didn't hear all of the testimony, but I certainly appreciate the statement.

I feel very strongly that this opportunity to provide for one's own retirement to the self-employed must be improved and liberalized, but it also must be made available to a lot more people. The bill as now written, S. 1631, is going to make it much easier for self-employed persons to adopt a plan than the old Keogh plan because it was admittedly just a start.

Do you favor those provisions also?

Mr. COHEN. We appreciate your aid in sponsoring some of this legislation. We generally applaud the movement in the direction of uniformity that this bill represents.

Senator CURTIS. And there are many people, nonprofessional people and others, some of them are employees and some of them are proprietors, whom it is just not practical to expect their little business to set up a retirement plan of their own, but yet, as indiivduals, they ought to have the right to avail themselves of a very much simplified plan and one that isn't invalidated if a year or two goes by and they can't contribute.

The disparity between those who participate and those who do not is great.

When the corporation makes their contributions before taxes, the plan earns money which is tax free.

Now, about half of our population today has to pay taxes on all of their income. If they are able to save anything for their old age, it is saved only after taxes and then that saving is placed somewhere and earns a little bit and that, too, is taxed. So they have two handicaps in the race that they must run.

I just don't think it is right or fair to bar his privilege from at least half of our population and that is what we are doing, in effect, at the present time.

Senator NELSON. It is a reasonable deduction for me to conclude that the American Bar Association would support the same limitation on amount that can be set aside for a lawyer who is working in his professional corporation as the self-employed lawyer?

Mr. COHEN. I don't know that the bar association has addressed that problem, but our basic resolution, going back to the 1969 resolution, is that the bar association is seeking uniformity, so if the Congress, in its infinite wisdom decides there should be an overall limitation, then, yes, we are willing to live within any overall limitation.

Senator NELSON. Congress doesn't always have infinite wisdom.

Mr. McDONALD. The gist of the tax section resolution, passed in San Francisco and then adopted by the American Bar Association House of Delegates, well, it objected to the former suggestions of the administration. The major amendment we wanted made was the elimination of all distinctions between plans based either on the form of business or the quantity of ownership within that business. And then there was an amendment from the floor, saying "provided present benefits are not reduced."

Senator NELSON. Provided present benefits for self-employed?

Mr. McDONALD. All plans.

Senator NELSON. Well, you would have to reduce benefits if you are going to make them all equal, or were you saying you have to raise everybody up to the maximum?

Mr. McDONALD. They were hopefully wanting to move everybody.

Senator CURTIS. In other words, you are saying to make the limitations prospective?

Mr. McDONALD. Correct.

Senator NELSON. Well, without any deduction, it would mean they would have to go up to the levels now received by corporate executives, wouldn't they?

Mr. McDONALD. They were unwilling to adopt the principle that corporate executives should be cut down.

Senator NELSON. If you drop the principle that everybody should be equal, then they have to go up, don't they?

Mr. McDONALD. They are clearly on record that everybody should be equal.

Senator NELSON. I understand that political difficulty in reaching that conclusion. I have been in positions like that myself.

Well, thank you.

Mr. COHEN. Thank you.

[Prepared statements of Sheldon S. Cohen and Andrew H. Cox follow:]

PREPARED STATEMENT OF SHELDON S. COHEN, ON BEHALF OF THE AMERICAN BAR ASSOCIATION

Mr. Chairman and members of the Subcommittee, my name is Sheldon S. Cohen. I am a member of the firm of Cohen and Uretz in Washington, D.C., and serve as Chairman of the Special Committee on Retirement Benefits Legislation of the American Bar Association. This Association, composed of a membership of approximately 163,000 lawyers, has for many years supported legislation to encourage the establishment of voluntary pension plans by self-employed individuals for themselves and for their employees.

Some thirty years ago, the Congress enacted legislation which offered substantial tax benefits to certain employers and their employees in the establishment of pension plans. Since that time, there has been a tremendous growth in coverage of millions of American workers in private plans. Public policy, which I believe to be sound, continues to encourage the establishment of private pension plans through the tax laws. However, the result of the 1942 legislation was to discriminate in favor of employed persons and consequently against self-employed persons in the very important area of providing an opportunity to save for retirement.

Some members of this Subcommittee will recall that, in the 1950's, then-Congressman Eugene Keogh and the late Congressman Daniel Reed introduced legislation to provide an opportunity for self-employed individuals to participate in tax-deferred retirement plans. It took many years, but finally in 1962 a limited version of the legislation was enacted into law. The contributions under law were limited to the lesser of 10% of annual earnings or $2,500. As a result of a Senate amendment, the measure permitted a deduction of only 50% of the amount contributed by the self-employed individuals for their retirement fund. This 50% limitation was later eliminated in 1966. I recall this legislative history to emphasize the long struggle which your self-employed constituents have endured in seeking some degree of equal tax treatment in the pension area. Although the inequity in the tax laws was recognized by everyone knowledgeable in the field, including representatives of the Treasury Department, it took some 20 years to establish even the principle of limited parity for the self-employed in our tax laws.

I now appear before you more than a decade after passage of the initial Smathers-Keogh legislation to support in principle the approach of the Administration's legislative proposal, and to further offer the latest position of the American Bar Association. S. 1631 and H.R. 7157, as well as an earlier bill S. 374, would increase the limitations under Keogh-type legislation to the lesser of 15% of annual earnings or $7,500. We are encouraged that the Administration has again recommended this provision. I wish to emphasize that such legislation would be a significant step toward bringing about some degree of equality in tax treatment as between self-employed persons and common law employees. However, inequality will continue to exist even if this legislation is enacted. Not only are the limitations on deductions much more severe for self-employed persons, but certain other requirements apply more strongly to qualified Keogh plans.

The lastest policy statement on this subject was adopted by the American Bar Association this year. On the recommendation of the Tax Section that resolution provides:

"*Resolved*, That the American Bar Association recommends to the Congress that the Internal Revenue Code of 1954 be amended by the enactment of the Individual Retirement Benefits Act of 1971 (H.R. 12272) with the recommendation that the Act be modified before enactment:

(1) to eliminate, for purposes of Sections 401 through 405 of the Code, all distinctions between common-law employees and self-employed individuals by striking all restrictions in the Code and Act applicable only to employee benefit plans affecting self-employed individuals;

(2) to eliminate any distinctions based upon ownership, such as those between "owner-employees" and other persons eligible to participate in plans described in such sections; provided that no additional limitations be imposed that would reduce benefits presently allowable under such sections;

(3) if the modification of paragraph (1) is not enacted, to eliminate or raise substantially the limitation of $50,000 of earned income, or compensation, taken into account pursuant to Section 4 of the Act in computing the allowable deduction (but without necessarily increasing the effective $7,500 deduction limit provided in the Act);

(4) if the modification in paragraph (2) is not enacted, to eliminate special Social Security integration rules for owner-employees in self-employed plans, so that the Social Security integration rules which apply under present law to corporate plans will also apply to all self-employed plans;

(5) if the modification in paragraph (2) is not enacted, to delete the provision (Section 2(c) of the Act) which delegates to the Secretary of the Treasury or his delegate the authority to adopt special eligibility and vesting rules for certain plans, and to substitute therefor the specific eligibility and vesting requirements, if any, which are to apply;

(6) to adopt the "Rule of 50" vesting provisions contained in Sec. 2(a) of the Act, but to increase the required period of service from 3 years to 5 years before vesting would be required; and

(7) if the modifications in paragraphs (1) and (2) are not enacted, to make it feasible for self-employed persons and shareholder-employees of Subchapter S corporations to participate in pension plans of the defined benefit type, and, to establish any limits which are imposed with respect to participants in such plans in terms of the amount of benefits which may be provided.

Further resolved, That the Section of Taxation is directed to urge on the proper committees of the Congress amendments which will achieve the foregoing results.

Although I am officially here to represent the legal profession, I should point out that the proposed legislation would provide a degree of fairer tax treatment for a broader segment of our population. Those who would receive fairer treatment as a result of the enactment of this bill would include owners of small business, farmers, other professional persons and their millions of employees.

Those of you who were in Congress during the early sixties may recall the intense interest in this subject among groups representing self-employed persons and their employees. Although some of these groups are not represented at this hearing, I can assure you that the interest has not subsided. On the contrary, interest has increased among the self-employed in their desire to obtain fair tax treatment in providing for retirement savings.

The practicing lawyer has a peak earning period of about twenty years, generally from his middle forties into his sixties. Our study shows that nearly two-thirds of those participating in the ABA Keogh-type plan are between the ages of 40 and 60. The average young lawyer is normally not able to contribute the present maximum of $2,500 because of insufficient earnings during his early years of practice. It is in that period, between 40 and 60 that the professional must set aside enough to provide him and his family with some degree of financial security for his older years. Even if we assume, under the present law, that a person enters a retirement plan at age 45 and contributes the present maximum for 20 years, he will have accumulated only enough to give him an annual pension of about $10,000 at age 65.[1]

If the lawyer in our example was 55 years old when the plan is established under present law, the maximum contribution to a pension fund each year for ten years will provide a retirement income of only $288 per month, or $3,456 per year. Obviously, under the present severe limitations, there is little incentive for the senior partner in his middle fifties to establish a Keogh plan for himself and the younger partners, associates and secretaries since he can accumulate such a small retirement income for himself. By increasing the limitations to 15% or $7,500, the older members of a firm or small unincorporated business could have an opportunity to provide a more reasonable retirement income for themselves and their employees. The taxpayer should not be forced to incorporate in order to receive fair tax treatment in regard to a pension plan or other fringe benefits.

In conclusion, I would again make the following points:

First, it is sound policy for the government to encourage the growth of private pension plans as supplements to social security and other government programs.

Second, the inequity in the tax treatment of self-employed persons and their employees has been recognized by the Congress and the Administration and yet little has been done to correct it.

Third, the present law was too restrictive when it was enacted years ago and has been made more so because of the inflationary trend over the past decade. The present limits provide little incentive to establish plans covering the self-employed and their employees.

On behalf of the American Bar Association, I thank the Subcommittee for this opportunity to present our views in support of reasonable and fair tax treatment of contributions to pension plans for the self-employed and their employees.

Statement of Andrew H. Cox, Ropes & Gray, Boston, Mass.

My name is Andrew H. Cox, I am a member of the Boston law firm of Ropes & Gray and am Vice-Chairman of the Committee on Employee Benefits of the Section of Taxation of the American Bar Association. I wish to present the views of the Association on certain proposed changes in the provisions of the Internal Revenue Code which deal with deferred compensation. Of the several bills before the Subcommittee which are concerned with deferred compensation, I shall limit my comments to S. 1631.

On February 7, 1972 and on February 12, 1973 the House of Delegates of the American Bar Association approved certain recommendations on deferred compensation which had been submitted to the House of Delegates by the Section of Taxation. The 1973 recommendations related to the Individual Retirement Benefits Bill of 1971 (H.R. 12272, 92d Cong., 1st Sess.) which was introduced December 14, 1971. According to Secretary Shultz, S. 1631 is a revised and expanded version of H.R. 12272, and therefore the recommendations of the American Bar Association on H.R. 12272 may be of interest to the Subcommittee in considering S. 1631. One of the three legislative changes contained in the 1972 recommendations is similar to an amendment which S. 1631 would make and it

[1] Assuming a 7% earnings rate.

seems likely that all three recommendations may be of interest to the Subcommittee at this time.

The 1972 recommendations were the following:

(1) To amend the Internal Revenue Code of 1954 to exclude certain bargaining unit employees for purposes of the coverage and anti-discrimination requirements for qualified employee benefit plans;

(2) To amend the Internal Revenue Code of 1954 to expand the provisions permitting retroactive amendments to cure defects in pension, profit-sharing, stock bonus and annuity plans; and

(3) To amend the Internal Revenue Code of 1954 to provide that beneficiaries of non-qualified trusts and annuity plans will not be taxed until distributions are received or otherwise made available.

The 1973 action approved a recommendation that the Individual Retirement Benefits Act of 1971 (H.R. 12272, 92d Cong., 1st Sess.) or any other bill equivalent in purpose and effect, be enacted, with a further recommendation that certain modifications be adopted prior to enactment.

These four recommendations are discussed below.

(1) *To exclude certain bargaining unit employees for purposes of coverage and anti-discrimination requirements for qualified employee benefit plans.* Section 401(a)(3) of the Code establishes two alternative requirements as to the employees who must be covered by a plan if a trust forming part of the plan is to be a qualified trust. The first of these alternative requirements (contained in section 401(a)(3)(A)) is that the plan benefit 70 percent or more of all employees, or 80 percent or more of all eligible employees if at least 70 percent of all employees are eligibe. In making this computation, certain short service, part time and seasonal employees are excluded.

The second alternative requirement (contained in section 401(a)(3)(B)) is that the plan benefit such employees as qualify under a classification which is not discriminatory in favor of officers, shareholders, supervisory employees or highly compensated employees.

Particularly in recent years, many employers have encountered much difficulty in attempting to pursuade the Internal Revenue Service that a plan which does not include bargaining unit employees meets the requirements of section 401(a)(3). Since the plan will ordinarily not satisfy the requirements of section 401(a)(3)(A), the empolyer has to rely on section 401(a)(3)(B). In applying the provisions of that subparagraph the Service takes the view that the employees actually covered by the plan must be a representative cross-section of all employees, including more than a nominal number of employees in the lowest pay brackets. In many cases, the employer cannot meet this test if bargaining unit employees are not covered by the plan.

Frequently the employer may be willing to include the bargaining unit employees in the plan, but these employees may decide that they would rather have their compensation paid to them in some form other than a qualified plan, or they may decide that they would rather be covered by a union plan which does not provide comparable benefits. The result has often been that employers have been unable to establish qualified plans for other groups of their employees.

The theory of the proposal is that bargaining unit employees are in a position to bargain for the benefits they want. If they should decide on an increase in cash wages rather than a pension plan or profit-sharing plan maintained by the employer, or if they should decide on a union pension plan rather than the employer's plan, it does not seem reasonable that their action should make it impossible for the employer to establish or continue a pension or profit-sharing plan for other employees.

Accordingly, the legislative recommendation would provide that bargaining unit employees are to be excluded in applying the percentage tests of section 401(a)(3)(A) if the collective bargaining agreement does not provide that they are to be included in the plan. In addition, section 401(a)(5) would be amended to provide that the determination whether a plan is discriminatory within the meaning of paragraph (3)(B) or (4) is to be made without taking into account bargaining unit employees if the collective bargaining agreement does not provide that they are to be included in the plan. Qualification under section 401(a)(3)(B) would be important in a case, for example, where an employer wished to establish a qualified plan at a particular plant.

The proposal is not anti-union and does not take any rights away from unions. Instead, the proposal takes the view that in a case where some employees are represented by a union, it is consistent with Congressional policy that the qualified status of any plan for non-union employees should be based on the extent of coverage of non-union employees and upon the absence of discrimination among such employees.

S. 1631 would amend section 401(a)(3)(A) substantially as described above and this amendment is supported by the American Bar Association. The Association believes, however, that a further amendment should be made to section 401 (a)(5) to provide that the determination whether a plan is discriminatory within the meaning of paragraph (3) (B) or (4) is to be made without taking into account bargaining unit employees if the collective bargaining agreement does not provide that they are to be included in the plan.

(2) *To expand the provisions permitting retroactive amendments to cure defects in qualified plans.* Present law permits retroactive curative amendments to allow a plan to satisfy the requirements of the following paragraphs of section 401(a): paragraph (3) relating to coverage, paragraph (4) relating to discrimination in contributions or benefits, paragraph (5) relating both to discrimination in coverage and to discrimination in contributions or benefits, and paragraph (6) relating to coverage. There seems to be no satisfactory reason why retroactive amendments should not be allowed to comply with the requirements of the other paragraphs of section 401(a).

A second difficulty of present law is that it does not clearly authorize retroactive amendments of provisions which have been included in the plan by way of amendment.

A third difficulty is that the period permitted for retroactive amendments is very short—no later than the fifteenth day of the third month following the end of the taxable year in which the plan was put into effect. Many plans are adopted late in the employer's taxable year and in such cases they may not be submitted to the Internal Revenue Service until shortly before the statutory period expires. Thus it may be impossible for a defect in the plan to be determined in sufficient time to permit amendment by the prescribed date.

The legislative proposal would permit retroactive amendments in order to satisfy the requirements of all paragraphs of section 401(a), would permit retroactive amendments in order to satisfy such requirements following an amendment of the plan, and would extend the period during which retroactive amendments could be made. The period would be extended to the fifteenth day of the fifteenth month (rather than the third month under the present law) after the close of the employer's taxable year in which the plan or amendment was put into effect, or to such later date as the Secretary or his delegate might approve. A similar change would be made with respect to the retroactive provision in section 1379(a) to extend the period which the necessary amendment may be made.

Practitioners have long recognized the desirability of statutory authority permitting greater flexibility in making such retroactive amendments to a plan as may be required by the Internal Revenue reviewer. Where the changes suggested are minor, the Service has generally taken the view that they are not essential for qualification and, therefore, has been willing to accept the retroactive amendment. However, without specific statutory authority there are problems with retroactive amendments making substantial changes.

S. 1631 does not contain any provision with respect to retroactive amendments. However, it is submitted that the Subcommittee may wish to consider including such a provision in the Bill.

(3) *To defer tax on beneficiaries of non-qualified trusts and annuity plans until distributions are received or otherwise made available.* The Tax Reform Act of 1969 made substantial changes in the taxation of non-qualified funded deferred compensation. Revisions were made both in the rules governing non-qualified trusts under section 402(b) and the rules governing non-qualified annuities under section 403(c) in order to conform to the new rules applicable under section 83. Thus the changes provided that income was realized when valuable rights in the trust or annuity contract attributable to prior contributions became vested, rather than when the funds or property were actually received or made available.

The Tax Reform Act of 1969 did not change the rules applicable to unfunded deferred compensation, which continues to be taxable only when actually received by or otherwise made available to the employee.

The decision to tax contributions to non-qualified trusts in the same way as transfers of property under section 83 is presumably based on the theory that the employee is in substantially the same circumstances in both kinds of transactions. However, there is a major difference in the employee's ability to realize on his interest when it is no longer subject to a substantial risk of forfeiture. If he owns the property, he can sell all or a portion of it in order to raise the money to pay his tax. If it is in a trust, he will ordinarily have no way to realize on his interest until it is distributed to him under the terms of the trust instrument.

Accordingly, the recommendation of the American Bar Association is that interests in non-qualified trusts and annuities be taxed on a "cash receipts" method, as a substitute for the treatment now applicable under sections 402(b) and 403(c). The employee would be taxed when distributions were received or made available to him under these non-qualified trusts and annuities, and the issue of forfeitability would be entirely removed. Since the employer's deduction would be deferred until the time when the employee was subject to tax, there would seem to be no significant revenue loss in the proposal.

(4) *To recommend enactment of H.R. 12272 and to recommend certain modifications therein.* On February 12, 1973 the American Bar Association adopted a recommendation of the Section of Taxation that it support the enactment of H.R. 12272 with the recommendation that the bill be modified before enactment in seven respects. The three basic modifications recommended were the following:

(a) To eliminate for purposes of section 401 through 405 of the Code all distinctions between common-law employees and self-employed individuals by striking all restrictions in the Code and Act applicable only to employee benefit plans affecting self-employed individuals;

(b) To eliminate any distinctions based upon ownership, such as those between "owner-employees" and other persons eligible to participate in plans described in such sections; provided that no additional limitations be imposed which would reduce benefits presently allowable under such sections;

(c) To adopt the rule of 50 vesting provisions contained in section 2(c) of the Act but to increase the required period of service from three years to five years before vesting would be required.

In addition, the following changes were recommended:

(d) If the modification of paragraph (a) above is not enacted, to eliminate or raise substantially the limitation of $50,000 on earned income or compensation taken into account pursuant to section 4 of the Act in computing the allowable deduction (but without necessarily increasing the effective $7,500 deduction limit provided in the Act);

(e) If the modification in paragraph (b) is not enacted, to eliminate special Social Security integration rules for owner-employees in self-employed plans, so that the Social Security integration rules which apply under present law to corporate plans will also apply to all self-employed plans;

(f) the modification in paragraph (b) is not enacted, to delete the provision (section 2(c) of the Act) which delegates to the Secretary of the Treasury or his delegate the authority to adopt special eligibility and vesting rules for certain plans, and to substitute therefor the specific eligibility and vesting requirements, if any, which should apply; and

(g) If the modifications in paragraphs (a) and (b) above are not enacted, to make it feasible for self-employed individuals and shareholder employees of Subchapter S corporations to participate in pension plans of the defined benefit type, and to establish any limits which are imposed with respect to participants in such plans in terms of the amount of benefits which may be provided.

The two principal revisions which the American Bar Association recommended be made in H.R. 12272 before enactment were (i) to eliminate for purposes of sections 401 through 405 of the Code all distinctions between common-law employees and self-employed individuals by striking all restrictions in the Code and the Act applicable only to employee benefit plans affecting self-employed individuals and (ii) to eliminate any distinctions based upon ownership, such as those between "owner-employees" and other persons eligible to participate in plans described in such sections; provided that no additional limitations be imposed that would reduce benefits presently allowable under such sections. These two recommendations would require many more changes than would have been made by H.R. 12272 or would be made by S. 1631.

At the present time the provisions of the Internal Revenue Code dealing with qualified pension, profit-sharing, stock bonus and bond purchase plans provide different sets of rules (i) for plans in which self-employed invididuals participate and (ii) for plans in which only common-law employees participate. (Shareholder-employees of Subchapter S corporations are subject to contribution limitations similar to those which apply to self-employed individuals.) The most important differences applicable to all self-employed individuals are the limits imposed on deductible contributions for self-employed individuals, the less favorable tax treatment of certain lump-sum distributions, and the absence of certain estate and gift tax exemptions. In the case of plans in which owner-employees participate, other restrictive rules apply, the most important of which are stricter coverage requirements, immediate vesting requiremetns, restrictions on distributions prior to age 59½, limited Social Security integration rules, and complex rules dealing with excess contributions.

There is substantial concern that at a time when qualified plans are being given a careful review the failure to eliminate the existing distinctions will tend to perpetuate them. This seems unfortunate, since as the President stated in his message of December 8, 1971, the distinction in treatment between corporate employees and self-employed persons "is not based on any difference in reality, since self-employed persons and corporate employees often engage in substantially the same economic activities." It seems clear that self-employed persons face the same problems upon retirement as do common-law employees and have the same need to set up during their working years a fund which will provide a source of income after they retire.

Despite the importance of the modifications recommended, it was the position of the American Bar Association that H.R. 12272 should be supported even if no changes were made in the bill. It is, of course, true that the Association's support for H.R. 12272 cannot be directly translated into support for S. 1631, since S. 1631 includes a number of provisions which have not yet been considered by the Association. Thus, the Association has not considered the minimum funding standard contained in S. 1631, the definition of accrued benefit, the provision for reinvestment of lump-sum distributions, the proposal with respect to prohibited transactions, or the provision requiring an employee to include in gross income contributions under a money-purchase pension plan in excess of 20 percent of compensation. Accordingly, it is not now possible to give the position of the American Bar Association on these matters.

At the same time it should be emphasized that many of the differences between H.R. 12272 and S. 1631 are fully supported by the American Bar Association. Indeed, apart from the two major changes in H.R. 12272, mentioned above, which were recommended by the Association, S. 1631 includes three of the five other recommended changes in H.R. 12272. (The two changes not included were (1) to increase from three years to five years the period of service which may be required before any vesting must occur under the rule of 50 and (2) to eliminate the special Social Security integration rules for plans in which owner-employees participate.)

The differences between S. 1631 and H.R. 12272 which are supported by the American Bar Association include the following:

(1) S. 1631 deletes a provision contained in H.R. 12272 which would have authorized the Secretary of the Treasury or his delegate to adopt special eligibility and vesting rules for closely-held partnerships and corporations. This change is consistent with the Association's recommendations for revision of H.R. 12272.

(2) S. 1631 does not include the limit of $50,000 on earned income or compensation which must be taken into account by self-employed individuals and shareholder-employees of Subchapter S corporations in computing the amount deductible. This change is also consistent with the Association's recommendations for revision of H.R. 12272.

(3) S. 1631 adopts a part of the recommendation approved by the American Bar Association in February, 1972, which would provide for excluding bargaining unit employees in determining whether a plan satisfied the eligibility and nondiscrimination requirements under the Code. As noted above, the Association recommends a further change on this matter.

(4) S. 1631 contains provisions (section 7(c) and related provisions in sections 7(a) and 7(f)) which are designed to enable self-employed individuals to participate in pension plans of the defined-benefit type. Heretofore it has generally not been feasible for self-employed individuals to participate in such plans, partly because of the inability to pool the contributions for self-employed individuals. The American Bar Association supports the changes necessary to permit such participation, although it may be that some further revision of these provisions will be advisable.

(5) S. 1631 would strike out section 72(m)(1) of the Code, which provides a special rule for the tax treatment of certain non-periodic distributions to owner-employees. The rule is less favorable than the rule generally applicable to other persons. This change will tend toward uniform treatment and is supported by the American Bar Association.

(6) S. 1631 deletes the requirement of present law that the trustee of a trust forming part of a plan in which an owner-employee or owner-employees participate must be a bank. This change tends toward uniform treatment and is supported by the American Bar Association.

Senator NELSON. Our next witness is Douglas B. Hunter, second vice president of the Connecticut General Life Insurance Co. of Hartford, Conn., on behalf of the American Life Insurance Association, accompanied by Verne J. Arends, superintendent of pension research, Northwestern Mutual Life Insurance Co. of Milwaukee, Wis.

STATEMENT OF DOUGLAS B. HUNTER, SECOND VICE PRESIDENT OF CONNECTICUT GENERAL LIFE INSURANCE CO. OF HARTFORD, CONN., IN BEHALF OF AMERICAN LIFE INSURANCE ASSOCIATION, ACCOMPANIED BY VERNE J. ARENDS, SUPERINTENDENT OF PENSION RESEARCH, NORTHWESTERN MUTUAL LIFE INSURANCE CO. OF MILWAUKEE, WIS.

Mr. HUNTER. I am Douglas B. Hunter and this is Verne J. Arends. We appear today on behalf of the American Life Insurance Association. This association has a membership of 349 life insurance companies, holding 99 percent of the reserves of insured pension plans in the United States. We appreciate this opportunity to express the views of the ALIA. We have submitted a written statement and I will briefly summarize our position.

Senator NELSON. Your statement will be printed in full in the appropriate place in the record.

Mr. HUNTER. Thank you.

Mr. Arends and I will be happy to answer any questions the committee might have.

I would first like to note that the American Life Insurance Association has supported legislation designed to strengthen the private pension system during the 92d Congress and during this session. Mr. Arends and I have appeared before the Senate Labor Subcommittee, the House Labor Subcommittee, and the House Ways and Means Committee, in general support of bills for strengthening the private pension system, and to comment on the various bills.

We have filed written statements with the committees on these specific bills and filed a written statement in general support of the administration's bill of the 92d Congress.

We support pension reform legislation on disclosure, fiduciary responsibility, vesting and funding. We also support measures to encourage coverage for the large numbers of people not now covered by private pensions.

We have reservations on the plan termination insurance proposals although we have worked out some general principles which we believe must be incorporated in any such system if it is to work. We oppose the proposals for portability as being unnecessary at this time.

Our reasons for supporting pension reform legislation are simple——

Senator NELSON. Which legislation are you talking about now?

Mr. HUNTER. All of the pension plan legislation; the total body of legislation.

Senator NELSON. You aren't speaking on behalf of any one of the three major bills?

Mr. HUNTER. No. This is more of a general statement.

We think it is time that we have to have legislation in this general area. While the private system has worked well in the great majority of cases, there have been some instances of abuse and some instances where worker expectations have not been met. We believe strongly that the voluntary private retirement system must be continued and we believe the proposed legislation will strengthen this system by providing desirable initiative to improve it, so it will continue to be a viable system.

Our prepared statement includes a more detailed statement of our position on the specifics of the various proposals before Congress. I will, however, briefly summarize the more important parts of it.

First, as to vesting and eligibility. We support reasonable vesting and eligibility requirements, subject to appropriate transitional rules. We support as reasonable, 100 percent vesting after 10 years of plan participation; the so-called rule of 50, 30 percent vesting after 8 years of service increasing 10 percent per year, to 100 percent after 15 years of service; and 25 percent vesting after 5 years of participation, increasing 5 percent per year to 100 percent after 20 years of participation.

Eligibility requirements of at least 3 years of service and age 25 is very desirable to avoid unnecessary expense, particularly with respect to contributory plans and smaller plans which are frequently funded by means of individual policies. This would have a very minimal effect upon an individual's benefits.

As to funding, we support sound and adequate funding of private pension plans carried out under the guidance of qualified actuaries. We have supported the funding requirement for total benefits in the Williams-Javits bill, and the Bensten bill, and the funding requirements for vested benefits in the Dent bill as being examples of reasonable standards.

The administration's bill has a combination of the two which we believe is also reasonable.

We feel strongly that funding assumptions and methods should be left to the discretion of the sponsor subject to certification by a qualified actuary. They should not be prescribed by a regulatory agency.

Next, as to disclosure and fiduciary responsibility. We support much of the proposed legislation in this area. We do, however, express concern that the required reports and conformance to complex regulations act as a deterrent to the adoption of new pension plans and to the efficient administration of existing plans.

Now for some general comments. We believe that the Federal Government should preempt the regulation of plans in the area of disclosure, plan design, including vesting, funding, investment restrictions, and fiduciary responsibility. State and local laws should not be enacted that encroach upon these areas and existing laws of this type should be repealed.

Federal regulation of pension plans should be consolidated in a minimum of departments and bureaus. Federal departments and bureaus should coordinate their reporting requirements. Existing and proposed regulations must be reviewed carefully to make sure that the requirements are meaningful and do not consist of a multitude of forms, which are carefully filed away and serve no real purpose.

The proposed regulations should be extended, in our opinion, to public employee pension plans where appropriate.

Now, on termination insurance we are concerned that such a program may act as a real deterrent to the adoption of new plans and the enhancement of existing ones. We also recognize that, without such a program, there cannot be complete assurance that participants will get their vested benefits. Under these circumstances, we felt it would be helpful if we set forth the principles we felt must underpin any such program if it were to be effective, and we have done this and are prepared to discuss our suggestions with the staff of the subcommittee.

As to portability, we believe there is confusion between portability and vesing. The objective of portability is the preservation of pension rights for employees who change their employment and insurance of fulfillment of their rights. This can be achieved satisfactorily by vesting combined with sound and adequate funding recordkeeping, and accurate communications.

We support all of these items and believe if adequate legislation is enacted in these areas, the addition of a new and complex Government requirement for portability is unnecessary and undesirable.

Senator NELSON. You are saying to define the vesting provisions so portability is protected for the employees?

Mr. HUNTER. We are saying that, when people talk about portability, what they are really saying is they want assurance that they will have benefits if they terminate early and that they will get those benefits at age 65. We say vesting along with adequate funding will accomplish this same thing.

Now, as to encouraging growth, we support the administration's proposals to encourage, through tax incentives, individual retirement plans, contributory pension plans, and the liberalization of plans for self-employed individuals. We suggest, however, that the $1,500 limit and the 30-percent tax penalty are unduly severe and ask that they be reviewed in the light of the stated objectives.

We do note with pleasure the administration's latest proposal which makes it possible for employers to provide pension coverage for nonunion employees in situations where coverage of union employees is subject to bargaining.

The American Life Insurance Association believes there is agreement on the need for legislation on disclosure, fiduciary responsibility, vesting and funding, and we also support legislation to encourage coverage for the people not now covered. We urge Congress to go forward with this legislation. We stand ready to offer our suggestions as to specific proposals and will be pleased to work with the staff of the subcommittee on the more technical aspects of the legislation.

We appreciate the opportunity to present our views.

Mr. Arends and I will attempt to answer any questions you might have.

Senator NELSON. Do you think that funding should be based upon all accrued liabilities or only upon accrued liabilities that have already vested?

Mr. HUNTER. All accrued liabilities or only accrued vested liabilities? We think either one from a funding viewpoint is satisfactory. There are advantages and disadvantages in both. We have supported both approaches. As I said in the testimony, the major concern we have on this is to avoid undue regulations which will tend to inhibit the development of plans and put us all in straightjackets, as to funding procedures. We hope that the methods and assumptions will be left to the extent possible to the sponsor and the actuary.

Senator NELSON. Do you think that requiring funding to be based upon all accrued liabilities rather than on accrued vested liabilities would discourage some managements from entering into a plan?

Mr. HUNTER. We don't think the difference would do that, no.

Senator NELSON. What is your view on the administration of the plans? There is a difference, as you know, between the proposal by the administration and introduced by Senator Curtis and S. 4, reported out by the Labor Committee.

Mr. HUNTER. Our major concern on this is to see pension regulations coordinated and simplified and brought to the extent possible into one agency.

Senator NELSON. Do you have a preference for either agency?

Mr. HUNTER. Not a strong preference. We don't oppose moving it into the IRS, but we do not, as an association, have a strong position on that.

Senator CURTIS. At this point, you don't think it is proper or desirable, either one, to send it to the Labor Committee; that is, the tax provisions of this plan?

Mr. HUNTER. I think that would be a pretty difficult thing to do.

Senator CURTIS. I don't think you can have two tax authorities.

Mr. HUNTER. No.

Senator CURTIS. And all of these plans rest upon the tax provisions?

Mr. HUNTER. Yes, I think that is your major decision; it is based on that.

Senator CURTIS. In order to qualify to have funds going into a retirement plan, tax free, they have to meet certain requirements and an additional benefit of that is that the income to the fund is tax free so it seems to me that that should stay within the agency that handles our tax program?

Mr. HUNTER. We would urge you under those conditions to try to bring as much of the rest of the regulations to the IRS also as possible.

Senator NELSON. Mr. Arends, do you have anything to add?

Mr. ARENDS. No, sir.

Senator NELSON. Thank you very much, gentlemen.

[Prepared statement of Douglas B. Hunter follows:]

STATEMENT OF AMERICAN LIFE INSURANCE ASSOCIATION, PRESENTED BY DOUGLAS B. HUNTER

My name is Douglas B. Hunter. I am Second Vice President of the Connecticut General Life Insurance Company of Hartford, Connecticut. Accompanying me is Verne J. Arends, Superintendent of Pension Research, Northwestern Mutual Life Insurance Company of Milwaukee, Wisconsin.

We appear today on behalf of the American Life Insurance Association which has a membership of 349 life insurance companies holding 99 percent of the reserves of insured pension plans in the United States. We appreciate this opportunity to express the views of the ALIA on the important issues concerning pension and profit-sharing plans which are outlined in the Subcommittee's Press Release of May 2, 1973. I would like to present our prepared statement and then both Mr. Arends and I will be happy to attempt to answer any questions the Subcommittee may have.

As a matter of format, my statement will discuss the broad policy issues involved in these hearings, and will attempt a line-by-line analysis of the specific bills before your Subcommittee. If the Subcommittee's deliberations are eventually focused on a particular bill, we hope we may have the opportunity of discussing any technical problems peculiar to that bill with the staff at the appropriate time.

General Statement of Position

At the outset, I would like to set forth our general position—

Private retirement plans are a key source of income after retirement for millions of workers, both those currently retired and those currently active. The life insurance business has played a major role in the private retirement system since life insurance companies underwrote their first plans in the early 1900's, and more than ten million active workers are currently covered under plans handled by insurance companies. In addition, over 1.3 million retired workers received over $1.5 billion in pension benefits from insurance companies during 1971.

With this background, the American Life Insurance Association supports all reasonable measures, including appropriate Federal legislation, which encourage the growth and expansion of private retirement plans and which increase the effectiveness of these plans in fulfilling the needs and expectations of covered participants.

In the remainder of my statement, I would like to discuss specific Federal leigslative measures which we believe would represent significant steps toward achieving these objectives. I will also comment in certain other issues, including ones mentioned in the Subcommittee's Press Release, which are relevant to the consideration of pension legislation.

Discussion of Specific Issues and Proposals

I. ENCOURAGING THE GROWTH AND EXPANSION OF PRIVATE RETIREMENT PLANS

Private retirement plans, individual savings and Social Security benefits, together, have the job of providing retirement income security for American workers. It is important that there be a proper balance among these three mechanisms. In this regard, Social Security benefits should be designed to provide retired workers with basic economic protection in their retirement. The provision of retirement income above this level is and should be the responsibility of individual workers and their employers—with appropriate encouragement being provided by the Government—through the use of various private savings media, including insurance company products.

Effective, soundly conceived private retirement plans have an important role in meeting retirement needs and helping maintain the proper balance between private and Government actions. A vital and dynamic system of private retirement plans can provide the flexibility by which private enterprise, working through a voluntary system, can make desirable adjustments to suit the needs of particular groups of employees in different firms, industries, unions and geographical locations. Moreover, private retirement plans are an important source of private capital needed for future economic growth.

To this end, maximum encouragement should be given to the continued vigorous growth and expansion of private retirement plans. This involves both (A) the expansion of coverage of private retirement plans through the establishment of new plans and the extension of existing plans to additional participants and (B) the increase in adequacy and scope of private retirement plans through the improvement of benefits provided under such plans. To achieve these objectives, any measures must, in the main, stimulate action by smaller firms and self-employed persons since they involve the major elements of the work force currently not adequately covered by private retirement plans.

Measures which the ALIA supports to encourage the growth and expansion of private retirement plans include the following:

(1) Liberalizations should be made in the Internal Revenue Code provisions applicable to plans for self-employed individuals to give the self-employed greater encouragement to establish and maintain retirement programs for themselves and their employees. An increase in the limitations on allowable contributions and tax reductions, removal of various restrictions, and replacement of mandatory full vesting by a more flexible schedule of vesting would lead to an expansion of coverage of self-employed persons and their employees. For similar reasons, we believe that there should be a liberalization of the existing limitations on the allowable tax deductions with respect to plans covering shareholder-employees of so-called Subchapter S corporations.

(2) Revisions should be made in the Internal Revenue Code to provide income tax deductions or credits for contributions made by employees to tax-qualified pension and profit-sharing plans together with appropriate disincentives against premature withdrawal of such contributions. This would encourage employees to share in the costs of pension and profit-sharing plans and, thus, would help employers set up plans and improve benefits in situations where the employer would be unable to pay the full cost of the plan or the benefit improvement.

(3) As a companion to the preceding proposal, tax deductions or credits should be allowed for amounts set aside by individuals in their own retirement accounts in situations where they are not covered under an employer-sponsored plan or where they desire to supplement their coverage under such a plan. This would encourage persons to provide for retirement through personal savings and would mean an expansion of the individual savings mechanism for providing income maintenance needs of the aged.

Proposals along the lines I have just outlined are included in both S. 1179 and S. 1631, although the former bill (introduced by Senator Bentsen) does not deal with the tax rules applicable to the self-employed or shareholder-employees of Subchapter S corporations. Although we believe that certain revisions in particular aspects of these proposals would aid materially in achieving the desired objectives, we believe that, on the whole, they represent a framework for legislation which will result in a significant expansion of the private retirement system.

We would like to call particular attention to two aspects of these bills which we believe should be revised:

First, we believe that the annual limitation on the available tax deduction or credit for an individual—especially when combined with the offset for employer contributions to a qualified plan on his behalf—is unnecessarily restrictive and could severely curtail the effectiveness of the proposal in meeting its objective of increased pension coverage. We recognize, of course, that there are revenue considerations inherent in setting the ceiling. However, we urge that these considerations be carefully balanced against the disadvantages flowing from too restrictive a program and that the highest possible deduction or credit level be set consistent with revenue constraints.

Second, we believe that the 30 percent penalty tax applicable to early withdrawals is unduly harsh and should be replaced with a penalty tax provision comparable to that which is presently applicable to the self-employed in such a situation. There will be situations when an individual has a valid need for funds short of becoming disabled or dying. Not only will the provision now in the bills impose an unreasonable burden on such an individual, but it will also undoubtedly discourage many individuals from even utilizing the new retirement savings provisions. In most cases—especially at the younger ages—an individual will have no way of making a considered judgment as to whether he is able irrevocably to commit a significant portion of his savings towards a single end or whether some intervening emergency will arise requiring the use of some or all of these funds. And it does not seem fair to ask him to make such a decision. However, this would be the effect of the 30 percent additional tax penalty.

We also have further suggestions, of a more technical nature, which we would like to discuss with the Subcommittee staff at the appropriate time.

In addition to tax incentive measures, we believe that simplifications in the mechanisms for employers, particularly small firms, to adopt, qualify, and administer retirement plans would also aid materially in fostering the growth and expansion of the private retirement system. For example, we believe that, contrary to current IRS policy, it is necessary to allow an employer flexibility in providing pension coverage for his non-union employees in situations where coverage of union employees is subject to collective bargaining. A provision along these lines is included in S. 1631 (section 7(b)). Moreover, we believe that Congress should urge the IRS to simplify certain of its rules and reporting procedures. To this end, we would be happy to discuss possible areas of simplification with the Subcommittee staff.

Now let me turn to the second important objective which we believe should be addressed in Federal legislation—that is, increasing the effectiveness of private retirement plans.

II. INCREASING THE EFFECTIVENESS OF PRIVATE RETIREMENT PLANS

To carry out their important role in helping to satisfy the income maintenance needs of the aged, private retirement plans must be healthy and effective. This means they must be designed to be responsive to the needs of plan participants, they must enhance retirement security and they must, in fact, fulfill the needs and expectations of the participants they are designed to protect. To this end, we generally support (a) increased disclosure of meaningful information, (b) higher standards of fiduciary responsibility for plan trustees and administrators, (c) reasonable vesting provisions, and (d) sound and adequate funding. To the extent that these are not being accomplished under existing law, Federal legislation should be enacted.

I will limit my remarks to the latter three issues, since it appears that the question of increased disclosure is a matter within the jurisdiction of another committee. In this regard, we have submitted statements to both House and Senate Labor Subcommittees expressing our views on this issue, and would be glad to make them available to your Subcommittee if you desire.

A. *Vesting*

Vesting is a valuable feature of a retirement plan and we favor reasonable vesting in all retirement plans to reduce instances in which the pension expectations of employees are not met. Very significant improvements in vesting provisions have been, and are continually being, made on a voluntary basis. However, we believe that the adoption of a reasonable mandatory minimum vesting requirement for all pension and profit-sharing plans would accelerate this trend to better vesting and provide greater assurance to covered employees that they will actually receive pension benefits.

To date, there have been several minimum vesting formulas proposed which, subject to appropriate transitional rules, have been supported by the ALIA in statements presented to the appropriate Congressional committee or subcommittee. They include—

> Vesting of accrued normal retirement benefit after ten years of service (excluding, for this purpose, service prior to age 30) as included in H.R. 2 introduced by Congressman Dent.
>
> Vesting under the so-called "rule of 50" as proposed by the Administration.
>
> Vesting of 30 percent of accrued normal retirement benefit after eight years of total service, increasing ratably to full vesting seven years later, as included in S. 4 introduced by Senator Williams and reported by the Senate Labor Committee.

The ALIA also supports the minimum vesting formula contained in S. 1179 (introduced by Senator Bentsen) under which vesting of 25 percent of accrued normal retirement benefit would be required after five years of plan participation, with full vesting, under a ratable formula, required after 20 years of participation.

We would note, however, that the statements we have submitted suggest certain revisions in the details of the proposals to which they were addressed. We would, of course, be happy to furnish the Subcommittee with copies of these statements.

In addition to those outlined above, we believe that there are other reasonable vesting formulas that could be developed. However, we believe that the following should be incorporated in any vesting formula adopted by your Subcommittee:

(1) If the formula measures the required period of service for vesting on the basis of total service with the employer—as contrasted to plan participation—it should provide that a plan may, at its option, count only service after the establishment of the plan in determining whether an employee has acquired the prerequisite years of service to qualify for vested benefits.

(2) Appropriate transitional rules should be provided along the following lines:

> A minimum period of one year following enactment of legislation should be provided in order to allow time for the Government to issue necessary regulations and establish administrative procedures.

Following this initial gearing-up period, all plans (including those established during this period) should be allowed at least three full plan years in which to conform to the new requirements and to obtain any necessary Government approval.

Liberal and flexible provisions should be included allowing the new vesting requirements to be phased-in so as to avoid imposing severe cost hardships on some existing plans. In this regard, plans in existence on the effective date of the legislation could be permitted to exclude an employee's service before the effective date of the legislation for purposes of computing the amount of benefits in which he must be vested. Another approach might be to allow existing plans to bring their vesting schedules in line with the new requirements in a series of steps over, perhaps, the ten-year period following the effective date of the legislation or date of adoption of the plan.

(3) An option should be available for plans to define vested accrued benefits in terms of the dollar amounts which would have been accumulated in the plan for an employee, as of the date of his termination of service, under a level deposit method of funding his benefits.

Moreover, we believe that a provision (such as that included in S. 1631) which defines an employee's vested benefit under a defined benefit plan in terms of a pro rata share (based on years of service over potential years of service) of his potention retirement benefit is much too rigid. This concept appears to be designed to prevent circumvention of the vesting requirement by providing an artificially low rate of benefit accrual during early years of employment. While we agree with this basic objective, we believe that a straight pro ration formula is deficient in that it does not recognize reasonable benefit accrual formulas that are common in pension plans. For example, it does not take account of the fact that many plans provide a lesser rate of benefit accrual for service prior to the establishment of the plan or prior to a benefit increase. Similarly, such a formula may give undue weight to an employee's salary in his final year of employment since it is to be projected over his potential service until retirement age. It would be preferable, in this regard, to allow the vested benefit to be determined under the plan's own provisions, providing they are in substantial conformity with the objectives of the mandatory vesting provisions. Alternatively, the definition could allow the choice of several specified proration formulas which would embrace, among others, the types of pension benefit formulas referred to above.

Finally, we have certain technical problems with the provisions in S. 1631 for defining the portion of an employee's benefit which is considered derived from his own contributions and would appreciate the opportunity to discuss these matters with the Subcommitee staff.

(4) Any mandatory minimum vesting standard should make clear that an employee will have vested rights at such time as he is eligible to retire under a plan's early retirement provisions.

Finally, on a related matter, legislative proposals on vesting generally include limitations on the maximum age and service requirements which may be imposed as a condition for eligibility under private retirement plans. We do not oppose reasonable requirements in this area so long as they are carefully designed so as to minimize the administrative complexity and cost that will, in many types of plans, be involved in covering employees earlier in their employment than is presently required. In this regard, it is important to note that there are many employees who remain with an employer for only a few years and even if they are technically required to be covered by a plan, it is highly unlikely that they will acquire any vested rights as a result of the coverage. To avoid the unnecessary administrative costs of having to enroll such employees in a plan, we believe that the law should permit a waiting period of at least three years and a minimum age requirement of at least age 25.

B. Funding

As a general principle, we believe that a reasonable mandatory minimum funding standard, to assure that funding of pension promises is being carried out on a sound and adequate basis, will significantly strengthen the private retirement system. Moreover, we believe that such a standard is appropriate for all types of plans, including multi-employer plans.

In this regard, it is important to consider that vesting without funding may actually increase frustrated pension expectations. Vesting legitimately creates expectations, and if funding is not adequate to support the payoff on such expectations, the frustrations of covered employees may well be greater than if there had been no vesting provision.

To date, there have been two minimum mandatory funding standards which have been supported by the ALIA in statements presented to the appropriate Congressional committee or subcommittee. They are—

The provision in S. 4 under which the plan sponsor must make minimum annual contribtuions to cover the pension plan's normal service costs and to amortize the plan's intial unfunded liability (existing on the effective date of the requirement or on the effective date of any new plan or plan amendment) over a period of not more than 30 years. A similar provision is included in S. 1179.

The provision in H.R. 2 under which the plan sponsor must make minimum annual contributions sufficient to fund over 25 years the plan's liability for vested benefits.

The ALIA also supports the minimum mandatory funding standard included in S. 1631 which has elements of each of the formulas described above in that it would require the plan sponsor to make minimum annual contributions sufficient to cover the pension plan's normal service costs, interest on the plan's unfunded liability, and 5 percent of the plan's unfunded vested liability.

In each case, however, we believe that certain revisions should be made in the detailed provisions of the formula.

Moreover, we think that there could be other reasonable standards developed. In any event, we believe that the following should be incorporated in any funding standard adopted by your Committee:

(1) Appropriate transitional devices should be provided to give plan sponsors sufficient time to reach the mandated standard.

(2) Funding assumptions and methods utilized in a particular plan should be left to the discretion of the sponsor, subject to certification by a qualified actuary. They should not be prescribed by a regulatory agency. Each plan represents funding considerations peculiar to the particular provisions of the plan, the make-up of the covered participants, and the financial considerations applicable to the employer or employees involved. There is no single set or range of funding methods and assumptions that are suitable for all situations.

(3) Flexibility should be allowed for handling experience gains or losses which may develop because actual plan experience differs from the actuarial assumptions utilized in determining the contributions. Spreading such gains or losses over a period not to exceed five years (as provided in S. 4) is one approach, but there are other accepted actuarial approaches to handling such amounts (as, for example, the approach embodied in S. 1179) and we believe that they should be allowed, based on the guidance of a qualified actuary.

(4) Plans funded exclusively through the purchase of level premium individual insurance or annuity contracts, profit-sharing plans and money purchase pension plans should be exempt from minimum funding requirements.

(5) Minimum funding requirements should be determined and reported periodically by an actuary certified as qualified to make such determinations and reports. Membership in the American Academy of Actuaries should generally be accepted as a sufficient basis for certification of qualified actuaries.

(6) The existing tax restraints on funding should be removed, recognizing that present IRS rules provide adequate protection against discrimination in favor of the higher paid officers and employees in the event of plan termination.

C. Fiduciary Responsibility

Measures which the ALIA supports to achieve higher standards of fiduciary responsibility for plan trustees and administrators include the following:

(1) Requiring administrators, trustees, officers and employees who handle and invest pension funds to be accountable for their actions and to exercise the same degree of care and skill as would be exercised by a reasonable and prudent man acting in like capacity.

(2) Reasonable Federal legislation to prohibit "conflict-of-interest" transactions in connection with pension plans.

(3) Limiting the percentage of pension plan assets that can be invested in securities of the employer.

(4) Prohibiting a person convicted of a felony from serving as a pension plan fiduciary, at least for a considerable period of time following his conviction and, if applicable, his imprisonment.

(5) Authorizing the Federal government to make reasonable investigations of pension plans when necessary, subject only to safeguards to prevent harassment of plan officials.

(6) Authorizing the Federal government to secure injunctive relief on behalf of plan participants.

D. Other Related Issues

The adoption of measures I have been discussing—that is, mandatory minimum vesting and funding standards—together with improved disclosure and the establishment of a fiduciary responsibility standard would, in our opinion, represent a significant step towards increasing the effectiveness of the private retirement system in fulfilling the needs and expectations of covered participants. I would now like to discuss briefly certain other programs which are frequently proposed as necessary elements of a legislative approach to strengthening the private retirement system, but which we believe are either unnecessary or present serious conflicting considerations.

(*1*) *Portability.*—Portability of pensions has as its objective the preservation of pension rights for employees who change employment and the assurance of the fulfillment of those rights. These objectives are achievable by satisfactory vesting combined with sound and adequate funding, accurate record keeping, and adequate communications. To this end, employees should be given statements at the time of termination of employment specifying (a) the amount and nature of their vested benefit, (b) the degree of financial assurance for such benefit, and (c) the procedure for claiming the benefit. Plan administrators should be required to maintain records of such vested rights and, if the individual fails to make application for benefits, provision should be made for the administrator to seek the help of the Social Security Administration in locating the former vested employee. In combination, these provisions and procedures would provide the essential elements of portability of pensions and make unnecessary any furthet and more formal and costly arrangements.

In this regard, we believe that the provisions in S. 1179 and S. 1631 permitting an individual to reinvest his distributions from a qualified plan or an individual retirement account in another such plan or account without having to pay a current tax will also allow for more flexibility in the handling of retirement benefits and, thus, would represent a worthwhile addition to the law.

(2) *Plan Termination Insurance Program.*—The basic question of whether a pension plan termination insurance program should be adopted presents serious—and competing—considerations which must be carefully balanced.

On the one hand, it is inevitable that there have been, and will continue to be, situations—even under what would be considered adequate funding arrangements—when pension plans terminate without funds to meet all the vested pension rights then existing. Complete protection of these rights could probably be obtained through some sort of plan termination protection program.

On the other hand, the desirability of providing such complete protection must be carefully balanced against the inevitable consequences of establishing a termination protection program. First, it is reasonable to expect that the institution of such a program will lead at least some employers to adopt a weaker funding program than they otherwise would, knowing that there is a guarantee fund available to underpin their plans. Such a trend would weaken the ability of these plans to meet their ongoing pension commitments.

Second, if such a program places greater obligations on employers than they have at present, in terms of either stronger funding or employer liability at plan termination, the adoption of the program will necessarily deter to some degree the establishment and liberalization of pension plans.

A third important consideration involves the issue of whether the problem is of enough magnitude to justify the administrative complexities and burdens associated with the establishment and operation of such a program.

If, on balancing these considerations, it is decided that a pension plan termination insurance program is to be included in legislation, it is important that its basic structure include the following:

(a) Employers whose plans terminate must be the first source of any funds needed to provide protected benefits.

(b) The program must be underpinned by a strong minimum mandatory funding standard in order to avoid serious adverse selection against the program.

(c) The administration of the program (including the handling and investment of the program's funds) should be placed in the hands of a Federally chartered nonprofit corporation operating in the private sector under the direction of persons knowledgeable in the investment and administration of private pension funds.

In addition to these three major areas, there are many detailed problems involved in establishing the program. The ALIA has designed a trial program on the basis that the insurance business, regardless of its position on the basic issue of the advisability of such a program, should be ready with ideas on the subject. We would appreciate having the opportunity of discussing this trial program with the Subcommittee staff.

Finally, I would like to comment on certain other broad issues, including ones mentioned in the Subcommittee's Press Release, that are pertinent to pension legislation—

III. PUBLIC EMPLOYEE PENSION PLANS

The ALIA is concerned about the large and growing obligations of the public empolyee (Federal, state and local government) pension plans, some of which appear to be unsoundly financed despite the fact that they require substantial employee contributions. In general, we believe that the measures applicable to private pension plans to increase their effectiveness should, where appropriate to the nature of such plans, apply also to such public employee pension plans.

IV. DUPLICATION OF REGULATION

The ALIA is concerned that the present level of required reports and conformance to complex regulations acts as a deterrent to the adoption of new retirement plans and that further additions to these requirements will make worse what is already a bad situation. Thus, to minimize these problems, we believe—

(A) That the Federal Government should preempt, over state and local laws, the regulation of private retirement plans in the areas of disclosure, plan design, funding, investment restrictions applicable to pension funds, and fiduciary responsibility.

(B) Federal regulation of pension plans should be consolidated in a minimum number of departments and these departments should coordinate their reporting requirements so that the same reports may serve more than one purpose. One possibility would be to create a new Federal agency charged with all aspects of pension regulation. This idea has appeared in several bills and has been somewhat controversial. Tied up with such a proposal are questions of how to secure compliance with proposed legislation, that is, through loss of tax qualification or by other types of penalties. We believe that careful study should be given to the various alternatives and the results that might flow from adopting any of them.

V. LIMITATIONS ON TAX DEDUCTIBILITY OF CONTRIBUTIONS UNDER QUALIFIED PLANS

There has been considerable discussion over the years of the desirability of providing more uniformity in the treatment of retirement savings so that all individuals in the work force will have the same opportunity—and incentive—to provide for their retirement through the private retirement system. We generally agree with this objective and, therefore, as already indicated, support proposals to liberalize the tight limitations presently imposed on plans for self-employed individuals and shareholder-employees of Subchapter S corporations and to grant tax deductions for employee contributions to employer-sponsored plans or to individual retirement accounts. Each of these measures would operate to encourage the growth and expansion of the private retirement system.

On the other hand, there has been some discussion of measures which would contract the existing tax provisions for qualified pension and profit-sharing plans established by corporations in order to bring them down to a level more nearly comparable to self-employed plans. We strongly believe that any such effort, whether directed at all corporate plans or merely at the owners of closely held businesses, would not only raise serious questions of tax equity but would also run directly contrary to efforts to encourage the growth and expansion of the private retirement system. For these reasons, we are opposed to such limitations.

On the question of tax equity.—A pension or profit-sharing plan is essentially a mechanism by which an employee's wages or salary can be averaged over his working and retirement years and the tax rules for qualified plans merely recognize this basic concept. We do not see any logic in cutting off this averaging concept at a specified level of salary or wages. In this regard, we believe that the progressive tax rate schedule maintains the basic "ability to pay" concept of the tax laws as respects retirement income and that further tax burdens on the higher paid are inappropriate.

There are presently in the Code ample provisions to prevent abuse of the averaging concept embodied in the qualified plan rules. First, the pension or profit-sharing plan contributions must meet the reasonable compensation test of section 162. Second, both the coverage of the plan, and the contributions or benefits under the plan, may not discriminate in favor of the highly paid. In other words, the benefits of the averaging mechanism must be made available to a broad spectrum of employees at all income levels and not merely to the higher paid.

Finally, no matter how drafted, any limitations on qualified plan contributions or benefits based on level of salary would inevitably operate in many cases as an effective limit on the retirement benefits which are accumulated for the employee. We do not believe this represents sound public policy. The purpose of saving for retirement is to permit an individual to continue somewhat the same standard of living after retirement as before. This goal would seem appropriate at all income levels.

Thus, for the various reasons set forth above, we believe that tax equity does not support the imposition of further limits on the contributions or benefits that may be provided for particular individuals under tax-qualified plans. Moreover, we believe that, for many of the same reasons, it would be inappropriate to impose new limitations on other types of plans, for example, in the case of annuity plans for public school teachers and for employees of certain exempt organizations.

As indicated above, we also believe that the imposition of further limitations on the contributions or benefits under qualified plans would run contrary to efforts to encourage the growth and expansion of the private retirement system. In designing a plan, an employer will naturally strive to meet the needs of all of his employees, both high and low income. It is reasonable to expect that any limitations on what he may provide for one group will have an effect on the overall design of his plan. We strongly believe that whatever reasons there may be for imposing such limitations clearly do not justify taking the chance that such limitations may result in a contraction of private pension coverage or benefits for employees in general.

This problem would become even more acute if action is taken—as we believe it should be—to strengthen the effectiveness of the private retirement system through the adoption of measures such as minimum vesting and funding standards. A delicate balance must be maintained in designing such legislation so that it will achieve its purpose without deterring the establishment and expansion of private retirement plans. The multiple effect of measures such as vesting and funding combined with limitations on contributions or benefits could easily swing the balance the wrong way. We do not believe this chance should be taken.

In *conclusion*, we strongly object to the imposition of new limitations on the contributions or benefits that may be provided under tax-qualified plans established by corporations. While we endorse the concept of more nearly equalizing the treatment of retirement savings as among different segments of the work force, we believe that this should be accomplished solely through expanding the tax incentives for groups (such as the self-employed and employees not presently receiving adequate coverage) which are now limited under the tax laws. We oppose the idea of combining these liberalizations in a package that includes limitations on other groups.

VI. TAX TREATMENT OF LUMP SUM PENSION AND PROFIT-SHARING PLAN DISTRIBUTIONS

The tax treatment enacted in 1969—which attempts to break a lump-sum distribution from a pension or profit-sharing plan into a capital gain element and an ordinary income element (subject to an averaging formula)—has proved to be an administrative nightmare as evidenced by the fact that the Treasury Department has not been able to formulate regulations for applying the new rules. The problems flow from the fact that such a distribution must be divided into three separate elements: (a) First, it must be allocated between pre- and post-1969 years; and (b) second, the post-1969 portion must be further divided into an amount attributable to employer contributions and an amount attributable to earnings.

The ALIA believes that the law should be amended so as to treat a lump-sum distribution as all one kind of income for tax purposes. However, in making this recommendation, we stress the need for an adequate tax formula to account for the fact that the distribution represents amounts which were accumulated over a period of years.

Conclusion

Thank you for giving me this opportunity to present the views of the American Life Insurance Association on this very important subject. As I indicated at the outset, we firmly believe that private retirement plans have an important role in meeting the retirement needs of American workers and in helping maintain the proper balance between private and Government actions. To this end, the ALIA supports all reasonable measures which will encourage the growth and expansion of private retirement plans and which will increase the effectiveness of these plans in fulfilling the needs and expectations of covered participants.

Mr. Arends and I will be happy to attempt to answer any questions you may have.

Senator NELSON. Our next witness is Mr. Frederick E. Seibert. vice president, Bank of America and chairman, Employees Trust Committee, Trust Division, the American Bankers Association, accompanied by Robert L. Bevan, assistant Federal legislative counsel of ABA.

STATEMENT OF FRED E. SEIBERT, VICE PRESIDENT, BANK OF AMERICA, AND CHAIRMAN, EMPLOYEES TRUSTS COMMITTEE, TRUST DIVISION, THE AMERICAN BANKERS ASSOCIATION, ACCOMPANIED BY ROBERT L. BEVAN, ASSISTANT FEDERAL LEGISLATIVE COUNSEL, ABA

Mr. SEIBERT. Mr. Chairman and members of the subcommittee, my name is Fred E. Seibert and I am a vice president, Bank of America, San Francisco, and chairman of the Employees Trusts Committee, Trust Division, the American Bankers Association. I am accompanied by Robert L. Bevan, assistant Federal legislative counsel of the association.

About 96 percent of the commercial banks in the country are members of the ABA. Banks hold as trustees about $100 billion of assets in more than 120,000 employee benefit accounts. Approximately 1 million bank employees are covered by the benefit plans. Consequently, the association has a deep interest in all employee benefit legislation and we appreciate the opportunity to present to the subcommittee our position.

The ABA urges the Congress to enact pension legislation containing fiduciary standards, greater disclosure, minimum vesting and funding standards, provisions to further encourage the growth of private pension plans and a provision to cure the present lump sum distribution problem.

Much has been said regarding the department or agency which should administer and enforce legislation dealing with private pension plans.

We firmly believe that comprehensive legislation would require legislation by the Treasury Department because its impact would go far beyond the welfare and protection of workers. The administrator will have to consider:

(1) The ability of companies to bear the costs imposed by the statute and implementing regulations;

(2) The effect of the new statute and implementing regulation on tax structure and revenues;

(3) The impact of pension contributions and investments on the Nation's economy. The Labor Department does not have a broad enough perspective to do the job which would be necessary.

With regard to disclosure, the ABA recommends provisions requiring pension plans to file annually a summary statement of receipts and disbursements, a schedule of all assets and a schedule of party-in-interest transactions. This would provide the information needed to protect plans participants and the public interest. The disclosure requirements in pending bills are duplicative and would result in the filing of such a mass of papers that the reports would not be an effective regulatory tool.

The association strongly supports the establishment of fiduciary standards which would apply to trustees and all persons who handle or control employee benefit funds. The standards should include a prudent man-rule and specific prohibited transaction provisions such as those contained in S. 4. These provisions have been carefully drafted and, for the most part, have our full support. Our prepared statement discusses the few problems we have had with section 510 of S. 4.

The ABA believes the legislation should provide for free access to the courts to protect pension funds and pension rights. However, we also believe that provision must be made to deter frivolous strike suits and have suggested specific language.

Senator NELSON. May I interrupt? You have suggested specific language?

Mr. SEIBERT. Yes, sir, in our expanded statement. This is just a summary.

A reasonable vesting standard is important to adequate pension legislation and the ABA believes the rule of 50 proposed by the administration is reasonable except the rule should be applied retroactively to benefits earned before the enactment of the new law. Regardless, however, of what vesting standard may be adopted, it should serve only as a standard allowing companies to adopt any vesting schedule so long as it is at least comparable to the statutory formula.

The problem of employees losing pension rights because of the sale or shut-down of a plant or operating division of a company can be partly solved by an Internal Revenue Code amendment treating such actions as partial terminations and vesting accrued pension benefits to the extent they are funded for all employees who lose their jobs.

A funding requirement is also essential to sound legislation and we recommend full funding of all accrued liabilities within a 30- to 40-year period. We suggest this somewhat limited requirement because the compounded effect of required vesting and required funding may have a devastating cost impact on some employers and the purpose of the legislation would not be served by forcing such employees to terminate their plans. A little caution, we believe, would be in the public interest. Also, the Secretary should be authorized to grant variances for good cause.

The Association generally supports the administration proposed individual retirement program and improvements in the self-employed retirement program. Current law is not going to do much to extend pension coverage to those who do not have such coverage. Some new incentives are needed and the administration's proposal, we believe, would help expand private pensions.

The 1969 change in the tax treatment of lump sum distributions have proved completely unworkable.

Senator NELSON. Unworkable?

Mr. SEIBERT. Unworkable.

Senator CURTIS. Pardon me?

Mr. SEIBERT. Do you want me to repeat the sentence?

Senator CURTIS. Yes.

Mr. SEIBERT. The 1969 change in the tax treatment of lump sum distributions has proved completely unworkable. After more than 3 years, the Internal Revenue Service has not been able to issue final regulations regarding either the computation of the tax imposed or the determination of the capital gains and the ordinary income elements of such distributions.

If the 1969 law is so complex that the Service cannot draft regulations. it is not difficult to imagine the problems faced by the average worker who receives a lump sum distribution on retirement. I am not thinking of the wealthy retiree who can afford counsel to prepare his tax return, but the retiree who must do it himself or seek the help of one of the commercial tax preparers. In addition to his complexity, the 1969 provision proposes an almost insurmountable recordkeeping burden on smaller companies and on more sophisticated pension plans. We suggest at return to the pre-1969 law which would still mean an increase of tax because of the 35-percent top rate on capital gains and the application of the minimum to capital gains.

The Association has carefully reviewed all portability and termination proposals that have been introduced. We feel that all of them fail to recognize or meet any of the problems incurred in operating such programs. We believe the enactment of such programs, at this time. would be counterproductive and urge additional intensive study before action is taken on them.

Our reference to portability refers to the types found in S. 4 and H.R. 462 and not that found in S. 1179.

We thank the subcommittee for this opportunity to discuss pension legislation. We would be glad to meet with the subcommittee or its staff at any time to answer any questions raised by our comments and to help in any way.

Senator NELSON. Thank you very much.

Senator Curtis?

Senator CURTIS. When you refer to disclosure, are you referring to a public disclosure or a disclosure placed in the hands of the employees and expected beneficiaries of a pension plan?

Mr. SEIBERT. I think we are talking about both types. We think that there should be disclosure to each of the participants who understand what the state of the particular fund is. We think, however, that this should be made available in a place that is convenient to them.

Senator CURTIS. Would you feel that that should be a simplified process; that it should be as simple as possible?

Mr. SEIBERT. Yes.

Senator CURTIS. A definite requirement should be as simple as possible.

Mr. SEIBERT. Yes, sir.

Senator CURTIS. And then possibly with a further right of interested parties to seek upon request additional background information.

Mr. SEIBERT. Yes, sir, we do.

Senator CURTIS. An earlier witness made reference to loading busy individuals with just mountains of minutiae. It might be an impression to some people but it isn't very informative.

Mr. SEIBERT. That is correct.

Senator CURTIS. To refresh our memory about just why, what did the 1969 law provide in substance in lump sum distributions?

Mr. SEIBERT. Very simply, pre-1970 interest would be treated as long-term capital gains treatment and then the post-1970 interest, the post-1969 interest would be treated on the 7-year averaging basis, but Mr. Cohen, who was formerly with the IRS, indicated that their computers had reduced this to somewhere between 33 and 66 separate calculations. There is much controversy as to how the tax could be calculated.

Senator CURTIS. I have never found anything good about the 1969 act. I opposed it then.

Mr. SEIBERT. Just try to hypothecate where you would be retiring and I think you would get some sense of the magnitude of the problem.

Senator CURTIS. I think it is just not good, but I won't clutter the record at this time.

Senator NELSON. I understood on May 3, proposed regulation for proposed lump sum distribution was proposed. What is your observation about the Bowen proposal?

Mr. SEIBERT. I think those will be too complicated for the average taxpayer. Mr. Bevan was just reminding me the American Bankers Association Committee is meeting tomorrow afternoon to discuss this issue—the proposed regulations.

Senator CURTIS. You have testified that you generally support the specific prohibitive transactions approach as an S. 4. Now the administration bill also prohibits a series of types of transactions which have been enforceable by the use of tax sanctions.

Mr. SEIBERT. Well, our concern, of course, is that it is going to be extremely difficult—and this takes in all interested parties—it is going to be extremely difficult to really detect a prohibitive transaction until after the fact and there are some rather sizable penalties which may have to be assumed by a party who is not party to the transaction. I am speaking primarily on behalf of corporate fiduciaries who may be exposed to a penalty without being able to have determined or detected in advance or at the time an investment was made. So this would be particularly true of such trusts where the corporate fiduciary does not have investment responsibility under the terms of the trust but accepts investment directions from others.

We are not opposed to it but that is what we are concerned about.

Senator CURTIS. In other words, you feel that some of these prohibitions you cannot enforce with restrictions, and that you must vest it within the Labor Department? Is that what your answer amounts to?

Mr. BEVAN. Senator, I would say that we feel that the excise approach is probably a better one than the qualification where the employee would lose his pension plan or something, because of a prohibitive transaction and that the excise tax approach is probably better. However, we have some concern about that and this is the reason we are interested in the specific transactions section as set out in the letter and we hope that they be as specific as can be.

This is the reason we do support S. 4 as opposed to provision in S. 163, because the Labor Department has done a very good job in working with the prohibitive transactions and getting the language down so you know what actions are prohibited and you don't have to guess whether what you are doing is prohibited or not. If we were left with the ones in the current law it would be a very difficult job, because you wouldn't know in advance. Under current transactions in many instances, it would be your judgment against what may be determined later.

Senator CURTIS. Do you have any information concerning the existing private pension plans as to how many of them are management managed and how many of them are managed by employees and how many have joint management?

Mr. SEIBERT. I am not aware of any statistics, Senator, on this.

Senator CURTIS. Thank you.

[Prepared statement of Fred E. Seibert follows:]

PREPARED STATEMENT BY FRED E. SEIBERT, CHAIRMAN, EMPLOYEES TRUSTS COMMITTEE, TRUST DIVISION, THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the subcommittee, my name is Fred E. Seibert. I am a Vice President of the Bank of America, San Francisco, and Chairman of the Employees Trusts Committee, Trust Division, The American Bankers Association. I am accompanied by Robert L. Bevan, Assistant Federal Legislative Counsel of the Association.

INTRODUCTION

The American Bankers Association has a membership of 13,000 banks and trust companies which constitutes about 96 per cent of the commercial banks in the country. Approximately 3,500 of these banks exercise trust powers and are members of the Trust Division. The banks in this country hold as trustees about $100 billion of assets in more than 120,000 employee benefit accounts. Members of the Association maintain employee benefit plans for their employees who number approximately one million. Consequently the ABA has a vital interest in all employee benefit legislation.

We appreciate the opportunity to present to the Subcommittee the Association's position on legislation in this area because any action taken by Congress will undoubtedly have a significant impact on employees, employers, and the public generally.

Before discussing specific legislation, the Association would like to express its view that, despite all the criticisms and some obvious problems, the private pension system has done a remarkably good job. This is true even though the major growth in the size of these funds has taken place in the relatively short space of 30 years. If we may be permitted to say so, we think the banks have had an outstanding record in the handling of the funds entrusted to them.

The reason for this record of accomplishment is that banks have acted as trustees for well over 100 years, during which time they have accumulated vast knowledge and experience in managing property and funds belonging to others. Many of the problems which have been brought to the attention of Congress stem from the fact that the persons entrusted with employee benefit funds often have not been qualified to act as fiduciaries. In addition, they have not always been financially responsible and thus able to discharge any liability arising from any improper acts they might perform. Banks, of course, have large capital funds which are available to discharge any personal liability they might incur. If some way could be found to assure that fiduciaries are qualified and financially responsible, the need for legislation would not be so great.

The Association has carefully reviewed all the major employee benefit bills that have been introduced in the Congress during the past few years. We have testified at numerous Congressional hearings. Over this period of time the Association's position has changed as additional information has been developed and as attitudes toward pension plans have progressed.

The Association urges the Congress to enact legislation which contains fiduciary standards, greater disclosure, minimum vesting standards, minimum funding standards, and provisions to further encourage the growth and development of private pension plans.

ORGANIZATION

The legislation also should provide for the establishment of a separate office or bureau in the Treasury Department to administer the new law. Regardless of what specific substantive provisions are contained in the bill finally approved by Congress, it will undoubtedly provide a whole new scheme of pension regulation. The Association is strongly opposed to the granting of regulatory powers to the Secretary of Labor as provided by most bills and urges that the Secretary of the Treasury be granted whatever regulatory authority is provided.

The purpose of the Department of Labor as stated in Title 29, Section 551, of the United States Code is "to foster, promote, and develop the welfare of the wage earners of the United States, to improve their working conditions, and to advance their opportunities for profitable employment." The supervision and regulation of employee benefit plans and funds which would be provided in any bill would go beyond these purposes. The administration of any new law must also involve the consideration of the ability of industries and companies to bear the cost of the requirements laid down by statute and by the implementing rules and regulations both as to plan provisions and administrative requirements; the effect on the tax structure of the requirements of the Act and the administrative decisions under it; the interrelationship with bank, insurance, and other governmental supervisory agencies; and the effect of contributions and their investment on the economy of the country. It is clear that a broader viewpoint is required than can be expected of any governmental agency which has been established to protect the interests of only one particular group.

The Secretary of the Treasury already has under his jurisdiction two offices which are involved in the supervision of employee benefit plans and funds—the Internal Revenue Service which administers the provisions of the Internal Revenue Code dealing with these plans, and the Comptroller of the Currency who, as part of his supervision of national banks, examines the activities of trust departments and gives special attention to the manner in which they handle employee benefit funds. Consequently it would seem to be most appropriate to give the authority to administer the law to the Secretary of the Treasury.

DISCLOSURE

The ABA supports more detailed and more meaningful disclosure of the financial and administrative activities of pension plans.

Legislative proposals introduced to date would meet the criterion of more detail, but would fail to make disclosure more meaningful. The quantity of information required to be filed under them would literally inundate the agency receiving it. Some larger pension plans would have to file boxes of paper each year. The disclosure of such quantities of information cannot be an effective regulatory tool because the data cannot be adequately reviewed.

The Association suggests that annual filing of a summary statement of receipts and disbursements, a schedule of all assets, and a schedule of party-in-interest transactions exempting loans to participants in profit-sharing plans which are available to all on a nondiscriminatory basis would provide the information needed to protect plan participants and the public interest.

Often employee benefit funds managed by banks are invested in collective funds. A single employee benefit trust may be invested in several collective funds and, of course, several employee benefit trusts participate in each collective fund. Collective funds under Regulation 9 of the Comptroller of the Currency must prepare and file annual reports. We suggest a copy of the annual report of each collective fund in which employee benefit trusts participate be filed directly by the bank with the agency receiving reports on employee benefit trusts. Then each such trust in its annual report could incorporate by reference the annual report of any collective fund in which it participates.

FIDUCIARY RESPONSIBILITY

The Association strongly supports the establishment of fiduciary standards which apply to trustees and all persons who handle or control employee benefit funds. The definition of fiduciary in the various pending bills differs. The Association prefers the more specific definition in H.R. 2 which includes persons who render investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of any employee benefit fund. All persons who exercise authority over the investment of employee benefit funds should be subject to the same standards of conduct.

On the other hand the Association favors the provisions of S. 4 establishing a federal prudent man rule and governing the disposition of funds when a plan is terminated. Once all vested liabilities are paid, there is no reason to prevent an employer from receiving the surplus except to the extent it is due to employee contributions. The ABA does not argue with the prohibited transaction provisions in S. 4 except subparagraph (E). Considerable attention has been given to the clarification of these provisions and, with the exception of (E), they establish clear standards of conduct and have our support. We suggest subparagraph (E) be amended to read:

"(E) accept for his own account or for the account of a party in interest of the fund from any source any bonus, commission, or compensation for any act done by him in connection with the administration of the fund."

The Association supports S. 4's exceptions to the prohibited transaction provisions with certain qualifications. Proposed Section 15(C)(4)(A) would allow the purchase and the holding of certain quantities of employer securities. Proposed Section 15 would require divestiture of such securities in excess of the quantity limitation even if the investment had been proper under the prudent man rule when made and continued so since. Also, if such securities through market appreciation grew above the prescribed limitation, they would have to be sold. The Association questions the wisdom of requiring divestiture in these cases and recommends the quantity limitation be applied only to purchases.

S. 4 while limiting pension funds to 10 per cent of the employer's securities, would authorize profit sharing, stock bonus, thrift and similar plans to buy and hold in excess of 10 per cent if the plan explicitly provides for such investment. Such plans would not be subject to any diversification rules; however, the prudent man rule would apply.

These types of plans are normally established to provide incentive for employees as well as retirement benefits. If employee contributions are involved, the plan must be registered with the SEC so the employee will have the information necessary to decide if he wants his money so invested. The provision of S. 4 subjecting such purchases of employers' stock to the prudent man rule may seriously impact the establishment of employee benefit plans by young growing companies. Such companies for many reasons frequently prefer these types of plans and adopt them prior to or in lieu of pension plans.

It has been suggested that the tax incentives for employee benefit plans be restricted because pension fund managers invest in blue chip growth stocks and neglect the capital needs of new and smaller companies. The future economic growth of our country will depend on the availability of capital for new companies. Consequently we believe more thought should be given to the employer securities provisions.

A literal reading of the prohibited-translation provisions of S. 4 could raise doubts regarding the investment of employee benefit funds in collective funds. If these provisions are adopted, we recommend a specific exception for investment of employee benefit funds in this time-tested vehicle.

S. 4 prohibits leasing property of a fund to a party-in-interest. The prohibition applies prospectively only and does not affect current lease terms. If an employee benefits fund owns property used by the employer, there is no reason why such leases should not continue as allowed by S. 4. Beyond this, the Association would recommend that any new legislation permit a fiduciary in appropriate circumstances, with the approval of the Secretary, (1) to carry out existing provisions of such a lease, such as an option or an extension; (2) to modify existing leases; and (3) to make additional investments in the property and, in such instances, to extend the lease provisions on appropriate terms. The market for such property is limited, and such authority would allow the employee benefit fund to protect its investment. If it becomes imprudent to hold such a lease, the trustee would dispose of it under the prudent man rule.

In addition to the prohibited-transaction provisions and the exception thereto, a number of bills including S. 4 contain other provisions further defining the duties and obligations of a fiduciary.

S. 4 and the Administration bill, S. 1557, both contain language which relieves a fiduciary from liability for acts or omissions of a cofiduciary if he objects in writing and files a copy with the Secretary. However, the filing of an object wtih the Secretary would not adequately protect the beneficiaries of a trust. If a trust agreement requires all the trustees to agree in administering the trust and there is disagreement; the trustees should seek instructions from a court of competent jurisdiction. Consequently such language should be rejected.

Any legislation, on the other hand, should contain language which provides that where there is an allocation of duties or responsibilities among fiduciaries, no fiduciary will be liable except for the proper performance of such duties as are specifically assigned to him under the plan or trust agreement and that no fiduciary shall be liable for any action taken or omitted to be taken in good faith pursuant to the direction, instruction, or approval of others if ~~he~~ is required to so act by the terms of the plan or trust agreement.

There is no need for language such as is found in S. 4 authorizing a three-year period to dispose of improper investments. If the restriction on employer securities applies to purchases only, and if it is made clear that the prohibited transactions are instantaneous in nature and not continuing, then there is no need for such a provision. The prudent man rule will require a trustee to dispose within a reasonable time of investments that do not meet the test of prudence. Three years may be far too long a time for a trustee to hold an imprudent investment; and, likewise in some circumstances, it may be in the best interest of the fund for the trustee to hold such an investment more than three years before he disposes of it.

Many bills prohibit a fiduciary from serving an employee benefit fund if he has been convicted of certain crimes. This prohibition should be specifically limited to individuals. A bank or insurance company should not be forced out of the pension business because one officer or employee acts improperly.

Further, banks and insurance companies which are subject to federal or state regulation and examination should not have to post bond to serve as a fiduciary, and their records should not be subject to independent audit under pension legislation.

ENFORCEMENT

Participants and beneficiaries should have free access to the courts to protect their rights and the fund, but should not be encouraged to bring frivolous suits. Past experience with "strike suits" makes it clear that there is a basis for concern. Such suits can be costly to pension plans not only because of direct costs (legal fees, court costs, etc.), but indirect costs could also be significant. The constant threat of suit may tend to hold down innovations in the management, investment, and operation of plans. This would be detrimental to all plans over the long run.

The AGA suggests the following language be included in any legislation authorizing court actions to enforce pension rights:

(1) In any action by a participant or beneficiary the court in its discretion may

(A) allow a reasonable attorney's fee and costs of the action to any successful party to be paid from the fund or such other source as the court shall determine;

(B) require the plaintiff to post security for payment of costs of the action and reasonable attorney's fees.

(2) Except as to actions brought by the Secretary, no action shall be brought except upon leave of the court obtained upon verified application (which application may be made ex parte or on notice as the court shall determine) and for good cause shown, and in determining good cause, the court shall consider the probability of success of the action, the burden on the parties, the difficulties likely to be encountered in the management of the action, and such other factors as the court shall deem appropriate.

Under this language the court would have the authority to award attorney's fees and costs to defendants, if succesful in the action, as well as to a successful participant or beneficiary and to determine the source of payment of fees and costs. Authority in the court to require the plaintiff to post security for payment of costs and attorney's fees may serve to discourage wasteful "strike suits."

The court should be permitted to require that application be made on notice so that, if the court wishes, the preliminary position of the defendant may be heard before leave to bring the action is granted.

The words "good cause" are vague. Consequently, the proposed provision adds various factors which the court should consider in determining "good cause."

The problems involved in strike suits were recently outlined by the Second Circuit Court of Appeals. The Court, in *Eisen v. Carlisle and Jacquelin*, 41 LW 2586 (5/1/73), said:

"Class actions have sprouted and multiplied like the leaves of a green bay tree. No matter how numerous or diverse the so-called class may be or how impossible it may be to compensate individual members of the class, a champion steps forth. Thus class actions have been brought 'on behalf of all subscribers of business telephones in New York County, all Master Charge credit card holders similarly situated, all consumers of gasoline in a given state or states, all homeowners in the United States, and even all people in the United States.' Not a single one of these class actions involving millions of indiscriminate and unidentifiable members has ever been brought to trial and decided on the merits. But the preliminary procedures, including the preliminary mini-hearing on the merits, and the huge and unavoidable expense of producing witnesses and documents pursuant to discovery orders, have brought such pressure on defendants as to induce settlements in large amounts as the alternative to complete ruin and disaster, irrespective of the merits of the claim.

"The 'in terrorem' effects of the innovations described in Dolgow have been highly praised by those who invented or applied them. But Professor Milton Handler, mincing no words, calls these procedures 'legalized blackmail.'"

Banks are supervised by the Comptroller of the Currency (national banks), Board of Governors of the Federal Reserve System (state member banks), and the Federal Deposit Insurance Corporation (state nonmember banks). All these agencies periodically make unannounced comprehensive examinations of banks, including the activities of their trust departments. Thus, reason dictates that the facilities of these agencies should be used in the administration of any new law, and we suggest that any bill include language requiring the Secretary to use such facilities.

COVERAGE

The Association sees no reason to exempt from legislation pension plans covering fewer than 25 employees or even fewer than eight employees. The employee of the small business firm also needs the protection of legislation.

VESTING

The Association supports a requirement that normal retirement benefits be vested after completion of a reasonable combination of age and service. It regards the rule of 50, proposed by the Administration, to be a reasonable approach. This rule recognizes the immediate needs of the older employee for early vesting and provides reasonable vesting for the younger employee.

Under the rule an employee's normal retirement benefit must be 50 per cent vested when the employee's age plus years of service under the plan equal 50. Thereafter the benefit vests an additional 10 per cent each year over the next five years.

The rule as proposed by the Administration would apply only to benefits accrued after its enactment. The Association does not believe this is realistic and supports the application of the rule retroactively.

It has been argued that the rule of 50 would deter the hiring of older persons. We do not agree.

Former Under Secretary of the Treasury Edwin S. Cohen testified before the House Ways and Means Committee on May 8, 1972, that the discounted single-premium cost of providing $100 of retirement income for a worker aged 55 is $570 if no vesting is provided and $585 if the rule of 50 is applicable. The increased cost of about 2.5 per cent is, in our opinion, not large enough to serve as a further deterrent to the already existing deterrent of high pension costs for older persons..

While the ABA endorses the rule of 50 as reasonable, we do not believe the Congress should require all plans to conform to a single federal vesting mold. A number of different vesting proposals have been suggested in bills currently pending in Congress. H.R. 2 provides for 100 per cent vesting after 10 years' service, but allows the plan to exclude all service prior to age 30. The bill also contains two transitional formulae for existing plans. S. 4. provides for 30 per cent vesting after eight years' service, then 10 per cent more per year until benefits are 100 per cent vested at 15 years.

During recent years there has been a trend to include early vesting in pension plans, and a variety of vesting schedules have been adopted depending upon the specific circumstances surrounding each plan. We urge that the vesting formula adopted by Congress be only a standard allowing plans to include whatever vesting provision is most appropriate for the company and best serves the needs of the employees so long as it is at least comparable to the statutory formula.

In addition to a vesting standard for pension plans there should be a vesting requirement for "class year" profit-sharing plans. These plans provide for separate vesting of each annual contribution made by the employer on behalf of an employee. We suggest that such plans be required to vest 100 per cent of the employer's contribution on behalf of an employee with respect to any given year not later than the end of the fifth year following the year for which such contribution was made.

There is one more vesting problem that has concerned the Association for some years, and it relates to employees who lose their jobs because of plant shutdowns or the shutdown of an operating division of a company. Under the Internal Revenue Code, if a company terminates its pension plan accrued pension benefits become vested to the extent they are funded. For a number of years the ABA has urged the enactment of an amendment to the Code which would treat plant or operating division shutdowns as partial terminations and require similar vesting of pension benefits for those employees who lose their jobs. Properly enforced, such a provision would have prevented some of the unfortunate losses of pensions which have been described. We again urge the enactment of such an amendment.

FUNDING

The American Bankers Association has for years agreed that plans should be voluntarily funded on a reasonable basis to assure the adequacy of funds to pay pension benefits as they become due. After continuing study, the Association recently decided to urge the enactment of legislation which would establish a reasonable minimum funding standard.

The Association reached this decision with some reservations because flexibility is important to proper funding, and it will be difficult to establish a minimum without reducing flexibility. Employers should be encouraged to fund at a greater rate than any minimum schedule during good years, but they cannot be expected to do so unless they can cut back during lean years.

With regard to the period of time prescribed to achieve full funding, it should not be so long as to discourage early funding by employers who can afford it, nor should it be so short as to force some employers to terminate their plans.

If the funding requirement caused plans to terminate, it would have exactly the opposite impact from what is intended—that is, protection of pension benefits. This problem may become particularly acute if both funding and vesting requirements are enacted.

If funding and vesting requirements are enacted, many plans will have to amend their vesting provisions, which would increase the cost of the plan to the employer. Similarly, many plans will have to change their funding practices, which would further increase the cost of the plan to the employer. Some employers are going to find the total increase more than they can handle. It would be unfortunate if some employees were to lose their pension coverage because the requirements of legislation impose too great a burden on their employers. A little more leeway, a little more time for employers to meet funding requirements could save some plans. Thus we suggest a period of between 30 and 40 years to achieve full funding of accrued liabilities and suggest that consideration be given to authorizing the Secretary to grant variances where there is good cause shown.

To encourage faster funding, the Association for a number of years has suggested legislation to amend the Internal Revenue Code to allow employers to make additional deductible contributions on account of past service in excess of 10 per cent of the original unfunded cost to the extent that such contributions in previous years were less than 10 per cent. We again urge such action.

Both the vesting requirement and the funding requirement should be tied to qualification under the Internal Revenue Code. This would tend to make these provisions self-enforcing since the employer's ability to deduct his contributions would be at stake. The IRS already provides an audit mechanism with experience and expertise, and this further supports the use of the Treasury Department to administer the legislation.

Further, because of the close relationship of vesting and funding to the Internal Revenue Code we urge the adoption of a provision specifically superseding any state laws in these areas. Such pre-emption is necessary also because of the chaos which might result for interstate plans if states were free to set their own vesting and funding standards.

PORTABILITY

The establishment of a portability program would create a number of complex problems as to which answers have not been found.

There are many differences in the types of plans and benefits maintained by different employers. The actuarial assumptions used vary considerably. The reserves accumulated under an employer's plan are based on all the benefits provided for in the plan, but when an employee terminates employment with a vested right, he may be entitled to only a retirement benefit at normal retirement age. This means that only a portion of the reserves which might be considered to have been set aside to provide the employee's benefits need be transferred when he terminates employment. As a result, there are numerous questions concerning determination of the amount of reserves to be transferred and their status in the trust to which they are transferred because of a similar situation on that end. Another difficulty that should be considered is the impact on the status of remaining participants when a vested benefit is transferred out of a fund that is not fully funded.

Further, trustees would find it necessary to keep a larger portion of the fund invested in liquid securities in order to transfer lump-sum amounts when employees terminate service. This would reduce the investment return on the funds which, in turn, would affect the extent to which liabilities of the plan are funded. This, in turn, would tend to hold down the size of plan benefits.

If legislation is passed to require plans to have reasonable vesting provisions and adequate funding provisions, there is no pressing need for portability.

For these and many other reasons we feel strongly that further intensive study must be made of the need for and of the legal and technical difficulties that must be overcome before such a program is established.

PLAN TERMINATION INSURANCE

All plan termination insurance proposals put forth to date have failed to recognize or meet many of the problems inherent in operating such a program.

The problems include the absence of any meaningful cost data that would provide a long-range projection of probable premiums; the absence of a relationship between the insured risk and the premium; the probability of encouraging the adoption of plans providing overly large benefits without regard to whether the employer is financially able to make the necessary contributions over a period of time; and the discouraging of faster funding of plans because of the availability of the insurance.

It has been suggested that plan termination insurance is similar to the insurance provided for bank accounts by the Federal Deposit Insurance Corporation. However, there is a big difference between the two situations. The Federal Deposit Insurance covers existing dollar deposits and provides assurance for the protection of those deposits through the establishment of administrative requirements and periodic examinations to determine that banks are following safe procedures. In the case of pension plan termination insurance, there is no provision for establishing underwriting rules.

Employers are permitted to determine the amount of benefits to be provided and the actuarial assumptions to be used. They may determine the rate of funding the initial unfunded liability within whatever time period may be prescribed. Without underwriting rules the insurance program might well impose an unreasonable burden on employers following more conservative practices.

Even if an insurance scheme could be designed which would take care of these problems, we believe the administrative burden would be great, and the additional cost to employers would be substantially higher, not only because of the insurance cost but also because of the restrictions on actuarial assumptions which would entail larger contributions.

The amount of the insurance payable under most proposals has been fixed at the difference between the realized value of the plan's assets and the amount of vested liabilities under the plan. This means that the insurance would guarantee investment results—a liability which could be considerable if a plan is terminated during a period of depressed investments. Once the Federal Government begins to guarantee investment results, how long can it wait before it begins to regulate investments? Would not termination insurance lead us down the road to a federal legal list and an end to investment freedom?

Most proposals introduced give the Secretary of Labor very broad authority to set up and administer a plan termination insurance program. The proposals establish benefit criteria, premiums for the first three years, and legal investments for the insurance fund, but leave most of the rest up to the Secretary.

The ABA believes it would be inadvisable to proceed with the establishment of an insurance program until Congress has answers to the above problems and can set out in the statute how the program is to work. As with portability, there is no pressing need for termination insurance if legislation is passed requiring reasonable vesting and funding.

GENERAL COMMENTS

A bill containing fiduciary standards, greater disclosure, vesting, and funding would strengthen substantially the private pension system, and we again urge the enactment of such legislation. It could be counter-productive to add portability and termination insurance which are so complex and subject to so many unanswered questions. Consequently, we continue to urge the Congress to move slowly with regard to portability and plan termination insurance.

In addition to fiduciary standards, greater disclosure, vesting, and funding, the ABA urges that any legislation which is enacted contains provisions to encourage the expansion of the private pension system to the more than 50 per cent of the labor force which is not now covered.

We suggest that the Individual Retirement Plan recommended by the President be included as well as the President's proposal to improve the H.R. 10 self-employed program.

Most uncovered employees work for small firms or are farm or other seasonal workers. Thus the incentives of current law are not apt to have much effect in further expanding the private pension system to these employees. It is universally recognized that, despite continuous increases in social security benefits, they are barely adequate to meet subsistence needs. Supplemental income is considered a necessity for most retired Americans. Therefore, something new is needed.

The Individual Retirement Plan would shift the tax incentive to the persons who would benefit from the retirement plans. Admittedly the program would not be met with open arms by millions of workers. However, the double incentive of tax deferral and retirement savings may help many uncovered workers save for their retirement years. The Individual Retirement Plan would also help workers who are already covered by a retirement plan. It would encourage them by a limited tax deferral to supplement their retirement income. Finally, it would place the employee in a contributory plan more on a par with his employer by giving them both a tax deduction for funds set aside for pension benefits. For the employee, however, it would be only a deferral.

The limitations of the President's proposal would, for practical purposes, restrict the benefits of the program to the lower- and middle-income worker who needs their help. The program would provide more equity among American workers in their efforts to achieve adequate retirement income.

The H.R. 10 self-employed program enacted by Congress a decade ago has met with uneven success. One of the reasons for this is the limitation on the amount which can be deducted for retirement purposes. If the program is expanded as suggested by the President, it may add sufficient incentive to accelerate the growth of self-employed plans. Support for this can be found in the number of partnerships that have converted to corporations partly to take advantage of the tax laws relating to corporate retirement plans.

If an Individual Retirement Program and an extension of the H.R. 10 program are to achieve their maximum impact, it is necessary to reduce administrative costs. Thus bank trust departments and insurance companies which are subject to close federal or state regulation should be able to administer such plans without registering them under the federal securities laws. If SEC registration is required, the cost becomes prohibitive; and banks and insurance companies will be limited severely in what they can provide.

The impact of the two programs on the growth of the private pension system even if all collateral obstructions are removed may not be sensational, but we must begin to take steps to expand the system as we strengthen it because the increased costs are going to have their effect.

LUMP-SUM DISTRIBUTIONS

The 1969 change in tax treatment of lump-sum distributions from employee benefit plans has proved unsatisfactory to recipient taxpayers, employers, and the government. Under pension and other retirement plans a beneficiary accumulates benefits over the span of his employment, but if he receives his benefits as a lump sum, it is taxable in the year of distribution.

Prior to 1969 this bunched income problem was alleviated by allowing the recipient to treat the distribution excluding any contribution he made as capital gains. In 1969 Congress decided this treatment was too favorable and provided that that portion of lump-sum distributions attributable to post-1969 employer contributions be taxed as ordinary income. To alleviate the bunched income problem the Congress established a special seven-year averaging rule applicable to the ordinary income portion.

Competent experts both in and out of government have been unable to develop administrative provisions to implement the 1969 change. The Internal Revenue Service issued proposed regulations regarding the determination of the capital gain and the ordinary income elements of lump-sum distributions and the computation of the tax under the averaging rule. Because of the very serious complexities involved, the Service has not been able to issue final regulations and, in fact, has just reissued proposed regulations on the computation of the tax under the averaging rule. To date some of the problems seem to defy solution. Also, the recordkeeping obligations are extremely burdensome and have created difficulties that are almost insurmountable, particularly for small companies and for some of the more sophisticated plans.

Thus the Association suggests a return to the pre-1969 law. It should be noted that the top capital gains rate is now 35 per cent, and part of the gain is subject to the 10 per cent minimum tax on preferential items. Consequently the tax burden on lump-sum distibutions would be greater than it was in 1969 even if there would be a return to the old rule.

The Association would be happy to meet with the Subcommittee and its staff to discuss any questions which may be raised by these comments or to help in any respect on this legislation because we are strongly committed to supporting a sound, growing, private pension system.

Senator CURTIS. Our next witness is Mr. Robert C. Ware, president, Trustee Life Insurance Co., in Gadsden, Ala., in behalf of the National Small Business Association, accompanied by Joseph L. Seligman, Jr., partner, law firm of Cotton, Seligman & Ray, San Francisco, and also somebody else.

STATEMENT OF ROBERT C. WARE, PRESIDENT, TRUSTEE LIFE INSURANCE CO., GADSDEN, ALA., IN BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION, ACCOMPANIED BY JOSEPH L. SELIGMAN, JR., PARTNER, LAW FIRM OF COTTON, SELIGMAN & RAY, SAN FRANCISCO, AND JEROME R. GULAN

Mr. WARE. Mr. Chairman, I would like to limit my remarks to two areas, and Mr. Seligman will get into some of the details.

Mr. name is Robert C. Ware. I am president of Trustee Life Insurance Co., in Gadsden, Ala. My monthly column, "Be Aware," appears in the Insurance Salesman magazine and has appeared there for the last 12 years.

I am appearing here on behalf of the National Small Business Association representing firms doing business in more than 500 industry categories and representing 40,000 member firms of the small business community.

As I said before, I have the pleasure of appearing with an esteemed colleague, Mr. Joseph L. Seligman.

Senator Curtis, we support the provisions of S. 1631, increasing the limit for deducting tax contributions from the present $2,500 or 10 percent of earned income to $5,500 or 15 percent, whichever, is less, and we thank you for sponsoring such a bill for small business.

The maximum amount allowed under the present law has declined since it was enacted until about $1,800.

We urge that you further consider allowing for some flexibility in funding to allow for inflationary factors. Our position is that we seek no weakening of corporate pension plans or their structures. Perhaps the strongest point I would like to make is that the Treasury Department should allow and encourage flexibility in the investment of self-employed retirement funds so that the money accumulated by a smaller firm can be directed to the expansion and growth of small enterprise.

I would say, here, off the record, that we have greater issue of voluntary self-assessment in our tax structure. There are so many bigger issues that the fear that small business might somehow avoid or evade some intended rule is to be overcome by enacting a law which they can understand and connect upon. And also, in this area of prohibited transactions. I think it is legally impossible for a garageowner to have a small pension plan, that even after he resorts to counsel it is such a tough road to do to figure out these prohibited transaction rules that he will often steer away from it and perhaps not plow his money back into his own business.

My last point I would like to make is to ask you to try to write the tax code in simple and less confused language. For example, in S. 4 I counted up 1,100 words in 1 sentence.

Thank you.

Senator NELSON. Well, it was drafted by a lawyer.

Mr. SELIGMAN. Mr. Chairman and members of the subcommittee, my name is Joseph L. Seligman and I am from San Francisco and am a practicing attorney. I want to thank you for the opportunity to appear and the Small Business Association for asking me and Mr. Ware for sharing his time with me.

I had the privilege of testifying before this committee in connection with the 1954 Revenue Code, and then before the 1959 Mills committee in the House on employee benefit legislation.

My main emphasis at that time was that all employee contributions to any type of retirement plan, including social security, should be deductible and all distributions should be taxable. My other main emphasis was on the simplification of the tax law, or, we are going to lose our basis of self-assessment.

I think those are still the two most important issues in 1973, but as an independent lawyer talking for the Small Business Association, I have selected five more specific things which I wish to cover today.

The first—and I think as a practical matter one of the most important to businessmen—is a provision which is hidden in Senator Curtis' bill as section 7(b). Most people I have talked to don't even know that it is in there, and it would in my opinion solve the great majority of the so-called salaried only problems that small employers are having with the Internal Revenue Service today. This results from the existing provision of section 401(a)3, which has a 70-percent mathematical test for qualification for coverage. If you cover 70 percent of the employees of your business, you are automatically——

Senator NELSON. Excuse me, what percentage was that again?

Mr. SELIGMAN. Seventy.

Then there is another one, if 70 percent are eligible and you covered 80 percent of the eligible, but basically it is 70 percent.

The second provision is, any other classification found by the Commissioner to be nondiscriminatory in terms of the highly paid, supervisory and so forth, and that problem is where you have a small company with unionized employees usually participating in a collective bargaining agreement plan and you have four or five executives and managers, who are highly paid and you have three or four clerks and the rest are union employees, the Service will not approve a plan for the salaried only excluding the union people today because that doesn't meet the 70-percent test. They won't approve it under paragraph B. Now Senator Curtis' bill would allow you to exclude all of the employees who are covered by a collective bargaining agreement unless the agreement provides to the contrary, and this, I think, would solve a great majority of these problems and would help immeasurably in permitting the small businessman to adopt a qualified plan.

I would suggest that the language of the bill be checked with the experts in the labor relations field to make sure that using that language would not be a violation of the Taft-Hartley law as an unfair labor practice, but that is a very technical matter.

I would also provide or recommend that the language of the bill be extended to paragraph B of section 401(a)3 and this is what the American Bar Association representative earlier recommended. However, I don't think that is as important, not nearly as important as keeping in the language that is there now and getting that enacted.

Senator NELSON. Are you saying that if there was a union contract and you had 100 employees and 10 clerks and management, that the 10 people would be covered and you would exclude the organized employees, whereas if it were a plan where nobody was organized, you would have to cover the 100 who are not organized?

Mr. SELIGMAN. Well, 70 percent of them or a nondiscriminatory classification, that is the current law. Yes.

Senator NELSON. What are the reasons for the distinction between the treatment of the employees if they are organized and if they are not?

Mr. SELIGMAN. There is no distinction under the present law. The reason I recommend is——

Senator NELSON. But that is what I am asking, why do you recommend it?

Mr. SELIGMAN. Because the organized employees will usually have a plan of their own or, as Senator Long asked Mr. Greenberg earlier, they will have have negotiated something in lieu of a plan under their collective bargaining agreement. If they want a plan, they can still have it under Senator Curtis' proposal and it would specifically then be included, but where they do not want a plan or where they have a plan of their own to which the employer has to contribute pursuant to the collective bargaining agreement, in that case it is extremely unfair that the salaried employees cannot have a plan that will qualify in the smaller company. If you have a big company it will qualify because you have a representative cross section of high-paid and low-paid salaried employees.

Senator NELSON. What if you have a situation in which the union members do not have a plan?

Mr. SELIGMAN. Presumably that is because they bargained for something else or, if the committee would want to change it to exclude only those who are covered by a union plan, that would go a long way too.

Senator NELSON. That is quite a bit different from those who are not covered by any plan.

Mr. SELIGMAN. In practice, I don't think so. In my practice at least it wouldn't make a great deal of difference. I think the important thing is that where you have a large group of union employees, which is typical of the small warehouse or the small manufacturer, and you have two or three top people and you have a handful of clerks and bookkeepers, usually 2 or 3 or 4 or 5, and then you have up to 500 unionized employees who are working in the small fabricating plant, for instance, in the warehouse, or in the trucking company or whatever it is that you are running, today you cannot provide, you cannot safely provide a viable plan for the salaried only employees.

My second point has also been alluded to by the prior speakers and that is lump-sum taxation: the taxation on lump-sum distribution, section 515 of the 1969 act. It is a fiasco. Why it has been left in the pension law and something isn't done about it, I don't know.

Assistant Secretary Cohen made a statement to the Council of Profit-Sharing Industries a year and a half ago that the best minds of the IRS had been unable to write intelligible regulations. I asked him afterwards if he meant that and he said those words were carefully chosen. He went on to say we must have legislative relief.

The people in the Internal Revenue Service charged with the responsibility of writing those regulations, the ones I know at least, would agree with me that it has been imposible to devise regulations that will apply properly to all situations.

In my opinion it should be repealed as of its effective date if constitutionally and politically possible. If not, as of January 1 of 1978 or at the earliest possible date. There should be a substitute to alleviate the bunched income problem.

I would recommend that that substitute not use the term, "capital gains," and I would recommend that that substitute not employ any type of income averaging concepts, because it is extremely complicated to so provide and it is very hard to keep the records. There are voluminous records that have to be kept for that type of a provision. And I would also hope that you could avoid a grandfather's clause because that is what essentially is so complicated in section 515.

In my own view, I think a simple special deduction can be worked out, but there are many, many other solutions. I don't think the important thing is the form of the solution, but to correct the present law. I am today advising small employers and large to advise their employees they cannot make the split between ordinary income and capital gain. I don't know how it is to be done.

Senator NELSON. May I interrupt? I think there is a rollcall on. We will recess now for 15 minutes.

Mr. SELIGMAN. Shall I remain here?

Senator NELSON. Just stay around.

[A brief recess was taken.]

Senator NELSON. We didn't take 15 minutes after all. Sorry for the interruption. You were on your third point, I believe.

Mr. SELIGMAN. I was just starting. I would like to say a few words about disclosure and fiduciary responsibility. I take it the great impetus of this to provide adequate disclosure and fiduciary responsibility is to run the crooks out of the pension business. I'm not talking about the Studebaker type situation where there was no crookedness in the plan termination and no poverty-in-interest transactions. I am talking about the ones that involve criminal or quasi-criminal type of activity.

I think what we need is more meaningful disclosure, but an awful lot less paperwork. Right now everything is buried in a mass of paperwork. I think there are five essential elements here. One, I think a fiduciary ought to be carefully defined in order to cover only those who have the power to exercise judgment or discretion. Somebody who is only to do what he is told is not a fiduciary in my judgment even though he is called a trustee. The trust fund can be protected against his misdeeds by bonding, but the fiduciary actually is the only one that can engage in the more subtle party-in-interest transactions. Whether he is a corporate employer or labor union executive or whoever, if he has the power to make and control decisions, then I think we need a complete detailed disclosure. We need such disclosure on only two things. One, each and every party transaction and two, every fee, commission, or other payment that is higher than normal.

Now, I am not talking about a disclosure of brokerage fees paid in accordance with the rules of the New York Stock Exchange, but where special commissions, special fees, special salaries are paid there ought to be a complete disclosure. Then, in my opinion there should be practically nothing else in the way of disclosure.

I would also recommend that there be required by law an annual statement to each participant in every plan that would describe his rights in terms of ultimate benefits. In other words, how many dollars he would receive if he was fired, how many he would receive if he was laid off, how many if he died, if he retired this year or if the plan terminated this year, these ought to be known by him.

Finally, I think there ought to be an audit of all plans each year.

Senator NELSON. Do any of the three bills provide for an annual audit?

Mr. SELIGMAN. Yes.

Senator NELSON. Each of them do?

Mr. SELIGMAN. I can't tell you that, each of them, but at least two of them do.

Now, perhaps, shocking or not, in my opinion the existing rules of the Internal Revenue Code, the exclusive benefit rule of section 401 (a) and the prohibited transactions of 503(b) would take care of all of the situations that need taking care of if—but this is a big if—there was appropriate remedy. At this point under the law when somebody commits a bad party-in-interest transaction, the only remedy that is available under the Internal Revenue Code is to disqualify the plan next year. This doesn't protect the employees and it doesn't protect the fund and it doesn't hurt the unscrupulous employer because it can merely not make a contribution next year and it isn't hurt. This disqualification of the fund makes the income of the fund taxable from there on, which means there is less to provide benefits for the employees and it makes any employer contribution thereafter made currently taxable to the employees to the extent of their vested interest. So the only people that are hurt by disqualification of the plan really are the employees and those are the very people you are trying to protect in the part-in-interest transactions.

Senator NELSON. What is your remedy for that?

Mr. SELIGMAN. Pardon?

Senator NELSON. What is your remedy for that?

Mr. SELIGMAN. To provide an adequate remedy in the Internal Revenue Code. Now, the usual reason they say this can't be done is that the Internal Revenue Service is only a tax collecting body and we can't provide a remedy in the Internal Revenue Code that would protect the fund and protect the employees——

Senator NELSON. Excuse me, but regardless of where you provide for it in the code, what is your suggestion for the remedy?

Mr. SELIGMAN. That the persons who have committed the transaction, the party in interest transaction, have to give back to the fund any profit they made and make the fund good for any loss that is suffered.

Senator NELSON. They would have to have a bond, then, wouldn't they?

Mr. SELIGMAN. No, not necessarily.

Senator NELSON. Supposing they don't have the resources to pay it, suppose it was dissipated somehow?

Mr. SELIGMAN. If you are talking about many big corporations, they have the resources. The personal liability of the individual who commits the party in interest transaction which is not now present under the Internal Revenue Code, now if that person was liable, I think that would be a greater deterrent than anything else in and of itself. In other words, most of us, even though we don't have enough money to make good, don't like to go to jail.

Senator NELSON. But that still doesn't provide protection.

Mr. SELIGMAN. Provide for the bond, too, then, Senator.

Senator NELSON. That is what I was implying. Is there any particular reason why you wouldn't want to require a bond?

Mr. SELIGMAN. No, but I think to require a bond of a large solvent corporation is stupid.

The fourth point I would like to talk about—I just want to make the statement today that you cannot get a ruling for a tax-exempt organization authorizing it to have a qualified profit-sharing plan. There is one person, so I am told, in the L. and R. division of the Chief Counsel's office that says a tax exempt organization can't have profits, therefore it shouldn't have a profit-sharing plan.

There are many reasons why a tax exempt organization should have plans that can only qualify under the existing law as a profit-sharing plan—there have been all types, of cost-saving, cost-reduction plans that have been suggested for hospitals. If they are put on a deferred basis the only way they can qualify is as a profit-sharing plan and the Service says they won't qualify a profit-sharing plan.

Three Commissioners, to my understanding, during the last 5 years have said they felt this is ridiculous, but haven't been able to get it off dead center. Maybe Congress can do something about this.

Finally, there are three problems in the area of foreign problems: One, where a domestic employer contributes to a plan covering only foreign aliens working abroad and the contribution is made to a foreign bank or insurance company or other funding agency, you still have to qualify the plan even though there is no U.S. individuals in the plan. You still have to qualify the plan in order to get a deduction under 404 (a) 4. Now, I would recommend that that deduction be changed to a 162 deduction where the taxing jurisdiction of the United States does not extend to anything except the domestic employer. I am talking about a plan where no U.S. nationals or people participate in the plan. The funds are paid out overseas to foreign banks or insurance companies.

The second point is where a plan covering American employees working abroad, you still have to count the foreigners who are not subject to U.S. tax laws for qualification purposes. I think they should be excluded for the same reason that we were talking about earlier, that employees covered by collective-bargaining agreements should be excluded for qualification purposes. In other words, you just look at the people that are subject to U.S. taxes.

Third, we have had the DISC since section 407 was written, and I think that there are some technical amendments needed to 407 so that DISC employees can participate on the same as Western Hemisphere trade employees can participate.

Senator NELSON. DISC?

Mr. SELIGMAN. Yes, that is a technical matter but nobody has mentioned it so far.

Senator NELSON. Does anybody else have anything?

If not, thank you very much.

[The prepared statements of Robert C. Ware and Joseph L. Seligman, Jr., follow:]

PREPARED STATEMENT OF ROBERT C. WARE, ON BEHALF OF NATIONAL SMALL BUSINESS ASSOCIATION

Mr. Chairman and members of the Committee, my name is Robert C. Ware. I am President of Trustee Life Insurance Company in Gadsden, Alabama. My monthly column, "Be Aware", appears in the *Insurance Salesman Magazine* and has reached about 100,000 readers for the past twelve years. I am appearing here today on behalf of National Small Business, an Association representing firms doing business in more than five hundred industry categories and representing 40,000 member firms of the small business community.

I also appear here today on behalf of the National Committee for Small Business Tax Reform, the co-ordinating group for national associations whose membership predominantly consists of small business firms. The National Committee seeks fair and equitable treatment for small business in the Tax Code.

We are in favor of laws that will strengthen private retirement funding and planning by owners and non-owner employees of small business entities. We encourage individual thrift. We endorse programs that allow individuals who wish to save independently for their retirement or to supplement employer-financed programs to deduct certain deductions on their income tax returns for the amounts set aside for these purposes.

We support the provisions of S. 1631 relating to self-employed pension plans. Under the proposed bill self-employed persons who invest in pension plans for themselves and their employees would be able to increase the limit for deductible contributions from the present $2,500, or 10% of earned income, to $7,500, or 15% of income, whichever is less.

After liberalization of the Self-Employed Individuals Tax Retirement Act in 1966, many people in the same business community and in Congress believed a large quantity of funded retirement plans would develop. This Act did go a long way toward establishment of equality of tax deduction for retirement plan contributions by small business compared with corporate pension and profit-sharing plans. But the expected surge in the development of such plans did not develop. In part this could be attributed to the lack of understanding by the small business community of the provisions of the present law and in part to the lack of sufficient incentives to establish a program. The strong movement of groups to set up professional corporations in order to take advantage of the more liberal pension and profit-sharing provisions of the Internal Revenue Code is an example of what might be done if sufficient incentives are present. Another factor discouraging use of the existing law was the methods used by promoters of split-funded and insured programs. These methods asked for high cost commitments and mandatory contractual arrangements beyond the financial capacity of most small employers.

Recently, a third factor, the ceiling tax rate of 50% of earned income, diluted the foreseeable spread between pre- and post-retirement tax rates and thereby diminished the tax advantage especially in conjunction with the resulting fetterment of small business capital invested in a qualified retirement plan. (Let it be firmly re-asserted, however, that this 50% ceiling is one of the very great achievements of recent Federal tax legislation. From a revenue-getting viewpoint it encourages voluntary tax assessment and payment. From a social viewpoint, on behalf of many small businessmen, let me say how pleased I personally am to live in a capitalistic society which lets me hold on to fifty per cent of what I earn.)

Inflation in the past few years has been the enemy of retirees relying upon public and private pensions to provide living expenses. The maximum amount allowed under present law ($2,500) has actually declined to about $1,800 in terms of today's purchasing power. We urge that future programs have some flexibility in funding to allow for inflationary factors.

According to press reports, the United Automobile Workers will request a $650 a month pension program after 30 years service for members of their Union. Based on present calculations, approximately $78,000 would have to be accumulated in the employee's account at his time of retirement. *In terms of simple equity certainly small employers and their employees should be able to provide a similar program for themselves.*

In reality most business and professional people are not able to establish a pension program until they have been in business for at least 10 or 15 years, which should put them in the 45-50 year age range. Over 70 per cent of all employers have less than eight employees. For this purpose we can assume he has three employees. To establish a pension program that would provide him with $650 a month it would be necessary for the employer to set aside $3,000 a year for himself and an additional $4,100 for his employees.

There should always be fairness in our laws. These laws should never give more favorable treatment to the corporate employee—as to his pension benefits—than it does to the employee of the self-employed. If equality does exist, why then the growing movement of groups—lawyers for example—to set up professional corporations to take advantage of what they obviously regard as more liberal pension and profit-sharing provisions of the Internal Revenue Code for corporations? Why were Subchapter S corporations denied the right, under the last amendments to the Code, to continue benefits of pension plans available to large industrial corporations?

We do not seek the weakening of corporate pension benefits; we only urge that the truly small—the self-employed and his employees—at least be given equal treatment.

One of the major problems arising from the present and future programs under the Self-Employed Retirement Act is that the money set aside would accumulate principally with banks and insurance companies or other trustees such as mutual funds. The normal practice is for the trustees and others responsible for such investment to purchase securities in firms listed on the stock exchanges. In effect, we are taking the financial benefits of hard years of small business growth and utilizing those funds to finance major corporate operations. Many of these firms listed on the stock exchanges are in competition with small businesses that are providing the capital. *In effect, small business may aid in its own strangulation. We therefore urge that the Treasury Department encourage and allow flexibility* *in investment in order that the money accumulated by a smaller firm can be directed, as feasible, to expansion and growth of small enterprise and encouragement of new business concerns.* Initial implementation of this flexibility could be the pamphlet publication of IRS guidelines telling how, using examples, a small businessman can re-invest his retirement funds in his own business. We believe the existing "arms-length transaction" rules are sufficient and that no new legislation is needed.

We realize that whenever social and revenue-producing goals are incorporated into one law the result is some intricate language to describe complex ideas. So it is with the Internal Revenue Code. Pending such time as we have a reassessment of the entire tax law and goals, there are some rules of draftsmanship we respectfully assert to the end that people can understand the law. These rules are:

(1) Use short sentences,
(2) Use first person singular, simple present tense, and
(3) Utilize common grammar.

For example, in S. 4 beginning page 164, line five and ending page 169, line three, you have one sentence with vicinity of 1,100 words. And, when you refer to a concept set out in another sentence state the concept as well as its section number in order that the reader can assimilate the total subjective thought set out. We believe respect for law may be increased in some measure by laws the people can read and understand. This is particularly true of small businessmen who would like to understand tax favors that apply to them.

Thank you for this opportunity to express our views.

Prepared Statement of Joseph L. Seligman, Jr., on Behalf of National Small Business Association

Mr. Chairman and members of the subcommittee, my name is Joseph L. Seligman, Jr. I am an attorney in San Francisco and, during the past twenty-five years, I have increasingly specialized in the legal and tax problems of qualified employee retirement plans and other deferred compensation arrangements. I represent in this field a number of small and large employers and a few joint boards of trustees of Taft-Hartley employee benefit plans. For more than fifteen years, I have been actively involved in several Sections of the American Bar Association concerned with these problems and in 1968, on nomination of the American Bar Association, I was appointed to the Secretary of Labor's Advisory Council under the Disclosure Act of 1958. I was one of the founders and the first president of the Western Pension Conference.

I am privileged to appear before you and file this statement through the kind offices of the National Small Business Association. Acting in accordance with the Committee's request in the notice of hearing to consolidate testimony, I requested and am fortunate to have received in the preparation of this statement the assistance of Pillsbury, Madison & Sutro, a large San Francisco law firm which represents a number of West employers and others in the area of employee benefits, and by the Zischke Organization, Inc., San Francisco's largest pension consulting firm. While I obviously take full and sole responsibility for the views expressed herein, they have been developed in discussions with a number of small and large employers, some of which are interested in only one or two of the issues I have selected to discuss.

I. ELIGIBILITY AND COVERAGE REQUIREMENTS OF QUALIFIED RETIREMENT PLANS—IRC SECTION 401(a)(3)

I would expect practically everyone to agree that one of the first and most significant objectives of any legislative effort to improve an existing private pension system is to increase the number of workers covered by qualified retirement plans. One large group of employees that are largely not covered by qualified retirement plans are the white-collar employees of the small employer. Probably the greatest deterrent to the expansion of such plans to cover the white-collar workers of small employers is the Internal Revenue Service's misguided, but certainly successful, attack on retirement plans which are designed to cover salaried employees and exclude hourly employees.

Section 401(a)(3 of the Code sets forth the coverage requirements for a qualified plan. Subparagraph (A) provides a purely mathematical test of 70 per cent or more of all employees or alternatively 80 per cent or more of eligible employees if at least 70 per cent of all employees are eligible. To compute the percentage of all employees covered or eligible, subparagraph (A) directs us to disregard all seasonal and part-time employees and short-term regular employees with less service than the plan's required waiting period, which may not be more than five years.

If a plan does not meet the mathematical coverage requirements of subparagraph (A), it will still qualify under subparagraph (B) if the Service finds that the covered employees form a "classification" that does not discriminate in favor of highly-compensated or supervisory employees or officers or shareholders. Even though Section 401(a)(5) has always provided that a "classification shall not be considered discriminatory within the meaning of paragraph (3)(B) or (4) merely because * * * it is limited to salaried or clerical employees", the Service has in recent years asserted that a plan restricted to salaried employees will not qualify if the revenue agent finds that under the facts of that case, the exclusion of hourly employees creates a classification that discriminates in favor of the prohibited group. Starting with the *Pepsi-Cola* case in 1968, the courts have sustained the Service's argument and relied on the word "merely" in Section 401(a)(5) to emasculate and render that paragraph entirely meaningless insofar as "salaried only" plans are concerned.

I have never understood why the Service mounted the all-out attack on salaried plans that we have witnessed in the past ten years. In actual practice, it is usually the small employer that cannot qualify a salaried only plan. The larger employer will typically have enough white-collar salaried employees receiving compensation comparable to the hourly employees that the salaried only classification does not appear to discriminate in favor of the prohibited group, and hence the Service will qualify the plan under subparagraph (B). The smaller company employing mostly unionized houry workers, however, finds itself in a very difficult position. There are thousands of such companies staffed by a handful (usually less than 10) executives and/or managers, a few secretaries, clerks and/or bookkeepers, and fifty to five hundred or more hourly employees covered by one or more collective bargaining agreements, each of which may require the employer, among other things, to contribute to a multi-employer, area-wide or industry-wide negotiated Taft-Hartley type retirement plan. Unless the number of salaried employees receiving compensation comparable to the hourly employees is significantly greater than the number of salaried employees included in the prohibited group, most revenue agents today will refuse to qualify the plan under subparagraph (B).

Faced with such a refusal, some employers will fight on and a few may succeed under some facet of the comparability theory which the Service has developed as an escape hatch. However, because this more sophisticated approach is time-consuming, costly, and often frustrating, many—maybe most—small employers caught in or faced with this situation will leave their salaried employees with no qualified retirement plan and take care of the executives and managers with some other form of deferred compensation arrangement that does not have to qualify under Section 401(a).

In my opinion, the Service's successful attack on salaried only plans has not been in the national interest. It has resulted in preventing or discouraging thousands of smaller employers from adopting or trying to adopt qualified retirement plans covering their lower-paid, white-collar employees.

Section 7(b) of Senator Curtis' bill (S. 1631) takes a big step to correct and alleviate the problem. It would amend subparagraph (A) of Section 401(a)(3) of the Code to add to those who can be excluded from the number "of all employees" in computing the 70 per cent test, all of those employees who are covered by a collective bargaining agreement. I strongly and equivocally support this change and urge its immediate enactment into law. The most surprising fact about this change is that as late as May 10, 1973, I could find no one outside the Service who knew that Senator Curtis' bill had any provision applicable to the salaried only problem. I am sure that as soon as those interested in pension legislation become aware of the existence of Section 7(b), they will flock to its support. It is long overdue, and the only possible drawbacks are (i) that the proposed change does not go far enough, and (ii) that the language of the proposed change in subparagraph (A) might create problems under some interpretations of our existing labor laws.

The language of Section 7(b) makes it clear that it derives from study and proposals made by the Tax Section of the American Bar Association. The original ABA proposal was in two parts, but for some reason, the draftsmen of Section 7(b) took only the first part of the proposal, which would amend

Section 401(a)(3)(A), but did not pick up the second part of the proposal that would make the same exclusion applicable to the determination of a discriminatory or non-discriminatory classification under Section 401(a)(3)(B). This could be accomplished either by making the new language set forth in Section 7(b) of Senator Curtis' bill expressly applicable to both subparagraph (A) and subparagraph (B), i.e., to all of Section 401(a)(3) or, as some suggest, comparable language could be added in Section 401(a)(5) in order to revitalize the salaried only exception in that Section. In my view, the decision between expressly adding the new language to subparagraph (B) of Section 401(a)(3) or adding it to Section 401(a)(5) should be left to those responsible for the final draft of the bill that will be enacted. Indeed, I think the present language of Section 7(b) is adequate to take care of the great majority of the salaried only plans that should be permitted but are today being denied qualification. There are, however, a number of salaried only plans which, because they are applicable to only one plant or one operation of a large employer, could never qualify under the 70 per cent test and should be allowed to qualify under the non-discriminatory test of subparagraph (B) without taking into account the employees covered by collective bargaining agreements.

The great virtue of Senator Curtis' proposal is that it would solve most of the problem without interfering in the free collective bargaining process. The bargaining unit employees would be excluded from the definition "of all employees" for purposes of the 70 per cent test only if the collective bargaining agreement "does not provide that such employees are to be included" in the plan. Thus, without interfering with labor's right to bargain, it would correct the present unfairness which now permits the collective bargaining process to operate to the real disadvantage of unrepresented employees. In passing, I would comment that while I do not consider myself qualified to testify on our present labor laws, I believe that most experts would agree that if a qualified retirement plan used verbatim the language of Section 7(b) of Senator Curtis' bill, it would not thereby involve the employer in an unfair labor practice. However, I would hope that this Committee would have this language reviewed by qualified labor law experts and, before it is enacted, revised as necessary to avoid any conflict between the Internal Revenue Code and our labor laws with respect to this specific point.

Finally, I would urge this Committee to go one step further in solving the salaried only problem and problems closely related thereto. Under the Service's existing policies and procedures, if a negotiated, multi-employer Taft-Hartley type plan is submitted to the Service for qualification under Section 401(a), the Service does not test the coverage provisions of that plan against each contributing employer under Section 401(a)(3) and does not test under Section 401(a)(4) whether "the contributions or benefits provided under the plan do not discriminate in favor of" the prohibited group as to each separate employer. The Service tests the plan as a plan and looks at the total group to which the plan applies as though it were one group. I would be the first to agree, and have indeed always urged, that this is the only practical and intelligent way in which the Service can apply Section 401(a)(5) to the multi-employer plans which have developed under Section 302(c)(5) of the Labor-Management Relations Act. The problem arises from the fact that the Service will not apply the same approach or the same standards to an employees retirement plan adopted by a group of affiliated companies. I would urge the Committee to incorporate in the Code an appropriate, express provision that would achieve the following result. Where two or more employers adopt a common and identical retirement plan, designating one of the employers as the employer that established the plan and retains the power to designate and remove the trustee, members of the committees, and to effect amendment or termination of the plan, then, in that event, the Service should determine whether or not such plan qualifies under Section 401(a) by combining all of the companies as though they were one company. I submit that this approach should be used in the non-negotiated plans of a corporate family or a group of employers subject to common operational control or engaged in a common business enterprise without regard to whether the unity of control or community of interest derives from stock ownership, contract or otherwise, and without regard to whether the various employers are corporations, companies without issued stock, tax-exempt organizations, partnerships, sole proprietors, joint ventures, or whatever. Please bear in mind that this recommendation for treating the various employers as though they were one employer applies *only* to qualification of the plan under Section 401(a) and not to the deductibility of contributions under Section 404. Nor am I suggesting or recommending that this provision make any change in the existing exclusion from such plans of those who are not common law employees.

II. THE TAXATION OF LUMP-SUM DISTRIBUTIONS—IRC § 402(a)(5)

Section 515 of the Tax Reform Act of 1969 added subparagraphs 402(a)(5) and 403(a)(2)(C) and amended Section 72(n)(1) and (4) in an effort to curtail the capital gain treatment previously accorded lump-sum distributions from qualified retirement plans on account of termination of service or death after termination. It is quite clear that Congress intended that the employee's allocable share of employer contributions made after 1969 should be taxed as ordinary income subject to a new 7 percent forward-averaging rule. The result, however, was a fiasco.

Mr. Cohen, when he was still Assistant Secretary of the Treasury for Tax Policy, in an address to the 1971 Annual Meeting of the Council of Profit Sharing Industries, said that the best minds in the Internal Revenue Service had been unable to write intelligible regulations and that they had to have legislative relief. There has been no advance and certainly no breakthrough in this area in the last eighteen months. Final regulations have never been published and, hopefully, never will be for I believe that it is impossible to devise regulations which will not be unfair and improper and invalid when applied to distributions from one or more of the myriad types of existing qualified retirement plans. I and other reputable attorneys and tax men are today advising employers that when they are confronted by a Treasury form (currently No. 1099R) which purports to have the employer advise the employee of the dollar amount of the ordinary income element of a qualifying lump-sum distribution, the employer should report "unknown".

In my view, if tax legislation is so complicated that even the experts cannot agree on its meaning and proper application, the very foundation of our entire tax system is endangered. If the average taxpayer cannot compute his own tax even with the help of experts, our whole concept of self-assessment will soon be unenforceable. The root of this problem with respect to Sections 402(a)(5) and 72(n) is the almost infinite variety of qualified retirement plans that exist today and the complexity and quantum of record-keeping that is inherent in any averaging system. Without belaboring the point, I would hope that the following statements are non-controversial:

1. Simplification of our existing income tax law is a desirable goal in and of itself.

2. Sections 402(a)(5) and 72(n) are so complicated that they are not working and no one has been able to draft implementing regulations or formulas (including computerized programs) for computing the tax that cannot be shown to reach unfair and improper results in some face situations.

3. Although I do not necessarily agree with the view that capital gain treatment is improper or inequitable, I recognize and accept what I believe to be the political realities of the situation, namely, that Congress will not return to full capital gain treatment as it existed under Section 402(a)(2) before the 1969 Tax Reform Act. There are just too many influential people who feel that, even as an expedient, it is improper to treat the employer contribution to a qualified retirement plan as a capital gain because (i) it is a payment for personal services, and (ii) our tax law must treat all such compensation, whether current or deferred, as ordinary income.

4. Any income averaging provision is inherently cumbersome and complicated and requires the establishment and maintenance of extensive records.

Believing, as I do, that everyone, whether within or without the Service, who has encountered these Sections of the Code advocates and would welcome the immediate repeal in toto of Section 515 of the Tax Reform Act of 1969, I am amazed that, as far as I know, none of the many bills presently before this session of Congress mentions Section 402(a)(5). All I can say is that if there is some valid reason for retaining it in its present form, I have not heard it articulated. I urge you to give your most serious attention to the following recommendations:

A. Repeal Section 515 of the 1969 Tax Reform Act as of its effective date if constitutionally and politically possible, but if not, then as of the earliest possible date.

B. Enact a substitute provision that would appropriately recognize the bunched income problem inherent in the distribution in one taxable year of employer contributions that have been made and accumulated over many years and that would not further complicate the Code by various grandfather provisions that cannot be easily computed and applied.

The exact form and language of such a substitute provision is, in my view, of very secondary importance if it is simple and unambiguous; and if it does not try to classify the accumulated employer contributions as capital gain; and if it does not require for its application the development and maintenance of voluminous new records. One such approach would be an amendment of the Code along the following lines:

1. A lump-sum distribution from a qualified retirement plan is ordinary income to the distributee in the year in which received or made available to the extent it exceeds the sum of (i) employee contributions and (ii) unrealized appreciation in employer securities.

2. If a distribution from a qualified retirement plan qualifies as a lump-sum distribution, then the distributee would be entitled to a special deduction equal to XY per cent of the portion of the distribution that is includable in gross income. Generally X would be the period after 1969, or if less, the number of years the employee participated in the plan, i.e., the period during which the income was bunched. In plans providing credit for service before the employee became a member of the plan, years of credited service could be used instead of participation. Presumably, years during which the employee withdrew anything other than his own contributions would be subtracted from the years of participation or credited service in computing X. Y would be some numerical factor from 1 to 10 which Congress would select. If a factor such as 1½ were selected, a maximum XY percentage would not seem to be necessary but could be included if, for instance, Congress felt that a 60 per cent deduction was too much for an employee who had participated for 40 years. On the other hand, if Y were established at 5 or 10, a maximum XY percentage of 50 or 60 per cent would have to be included in the Code to prevent deductions of 100 per cent and more of the amount of the distribution that is includible in gross income.

3. A qualifying lump-sum distribution could be limited under existing rules to those where the entire account balance is distributed within one taxable year of the distributee on account of the employee's termination of service or death after termination of service.

Hopefully, Congress would broaden existing rules to include lump-sum distributions on account of termination of the plan. If minimum age or service or participation requirements were felt to be necessary, they could easily be included, but none of these requirements would seem to be necessary or desirable inasmuch as the deduction would automatically decrease with shorter years of participation.

I respectfully submit that the foregoing approach could be readily understood and applied by any taxpayer and would not involve any additional recordkeeping by employers or taxpayers. It does not attempt to be the mathematical equivalent of capital gain treatment or of any type of averaging. Rather, it seeks to achieve a fair and reasonable end result that will mitigate the bunched-income problem. It may well be necessary in the interests of equity to provide for some type of transition rules under which the taxpayer could use an alternate special deduction equal to 50 per cent of the fair market value on December 31, 1969, of his accrued interest in the plan, whether or not vested, plus XY per cent of the amount by which the lump-sum distribution exceeds the December 31, 1969, balance. Here X would be the period of participation or credited service after 1969.

If the foregoing strikes a responsive reaction with the members of this Committee, it should not be difficult to work it out in more detail and to resolve such supplementary questions as to whether the special deduction should be included or excluded in the computation of preference income and related but subsidiary matters. I would hope that any refinement of the basic approach would not significantly detract from its simplicity, which is its primary virtue.

III. DISCLOSURE AND FIDUCIARY RESPONSIBILITY

The establishment of a precedent of federal responsibility by the enactment of the Welfare and Pension Plans Disclosure Act in 1958 and its amendment in 1962 has added tons of paper but unhappily does not seem to have stopped or reduced to an acceptable level the looting, corruption, self-dealing and mismanagement in the administration of employee welfare and pension plans. The Studebaker closing and other less publicized plan terminations have added fuel to the fire.

Unfortunately, the public outcry and Congressional response have largely failed to differentiate between three entirely different types of problems that are surfacing. We have the outright criminal acts of theft, embezzlement, forgery and the like. We have the subtler but no less venal party-in-interest transactions. Finally, we have situations like the Studebaker closing which involve no misfeasance or malfeasance whatsoever but merely the harsh operation of the economic forces of the free enterprise system. I will leave to others to discuss the largely social and economic pros and cons of mandatory vesting, funding, reinsurance and portability. I would like to discuss briefly how we can run the crooks out of the pension business.

I submit that different means of detection and different remedies are needed if we are to deal effectively with both the outright criminal act and the party-in-interest transaction. In my view, no amount of disclosure and no penalty for failure to disclose can be relied upon to protect the participants and their funds and punish those who engage in outright criminal acts involving theft, embezzlement, forgery and the like. Rather, the participants and their funds should be, and readily can be, protected by adequate bonding of those whose jobs give them the physical ability to steal, embezzle, forge, etc., without the financial resources to make good. The wrongdoers can and should be deterred and punished by ordinary federal and state criminal laws and nothing more. In the main, these criminals will be discovered not by more detailed disclosure regulations but only by regular and careful audits and thorough investigation upon reasonable cause. By contrast, the prominent corporate executive or labor leader and/or employer, funding agency or investment adviser cannot tolerate the glare of public disclosure when, by manipulation of his power to control investment or administrative decisions, he has dealt with a plan's assets at less than arm's length for his own or his employer's benefit.

I urge the Committee to analyze the asserted shortcomings of the private pension system in this light. If you do, I think the following will become quite clear:

1. The underlying purpose of any legislation affecting disclosure and fiduciary responsibility that may come out of these hearings should be to protect the participants and their retirement funds and to deter and punish those who would rob them or use these funds for their personal benefit.

2. The shortcomings of the existing Federal Disclosure Law and the proposals that would amend it are, first, that they start with the erroneous proposition that if a little bit of disclosure is good, more must be better; second, that they fail to define correctly who is and who is not a fiduciary; and third, that they do not provide appropriate remedies and punishments for theft and other outright crimes on the one hand and the more subtle forms of self-dealing on the other.

3. The law should require more *meaningful* disclosure. I earnestly suggest that this means less total disclosure, for it is no secret that employers and government are already overwhelmed with the volume of existing disclosure. I represent a group of affiliated corporations, many of which employ less than 200 people, who have estimated that full and complete compliance with the existing disclosure requirements of the Internal Revenue Service and the Labor Department and the State of California would require the annual filing of a stack of over 20 linear feet of 8½ x 11 inch paper. No one but a computer can utilize this volume of disclosure. As the recent Equity Funding scandal illustrates, it only serves as a haven in which to hide evidence of fraud and misfeasance. The present quantum of disclosure is already counterproductive.

4. Rather than require additional disclosure and further competition between the Internal Revenue Service and the Department of Labor to see which agency can burden employee benefit plans with the most cost to produce and file the greatest amount of indigestible and unusable data, I would urge this Committee to draft legislation that would amend applicable federal laws to require the following annual disclosure of all qualified retirement plans:

a. A realistic and understandable statement to each participant, setting forth his rights and legitimate expectations under the plan as of the end of the preceding year, written, to the extent feasible, in terms of dollar amounts that he or his beneficiaries will receive upon the happening of certain specified events such as retirement, death, disability, lay-off, termination of employment and termination of the plan.

b. An annual audit by independent certified public accountants.

c. Annual disclosure to a designated government agency of (i) all of the details of each and every party-in-interest transaction; and (ii) the amount and circumstances justifying the payment of all salaries, fees and commissions which are more than those prescribed by law or common practice; and (iii) nothing but the barest summary of all other financial and administrative transactions.

5. It is of the utmost importance that any legislation supported by this Committee contain definitions of a fiduciary and a party-in-interest transaction that are clear, precise, realistic and not in conflict with the basic concepts of our legal system. The keystone and most unique feature of the Anglo-American concept of trust law is that the trustee or fiduciary is one who holds, invests and administraters another's property in trust for the benefit of a specified beneficiary or beneficiaries. The cornerstone if this concept is that the fiduciary has a dual duty to the beneficiary—100 per cent loyalty and the non-delegable duty to exercise his own discretion or judgment for the benefit of the beneficiary. I submit that any law you enact should make clear that one who has no power to exercise judgment or discretion is not a fiduciary even though he is called a trustee, while one who has power to exercise judgment or discretion is a fiduciary even though he is called a director or an administrator or an advisor or a committee member.

A clear and unambiguous definition of a fiduciary is critical for two reasons. First, one who is not a fiduciary cannot engage in self-dealing or party-in-interest transactions because, by definition, he can only do what he is directed to do and has no power to exercise any choice. Second, while bonding may protect the fund against the outright theft of the fiduciary or non-fiduciary, no one will bond against the loss suffered by a trust when the fiduciary engages in an improper party-in-interest transaction. These typically involve an abuse of discretion, a violation of the rule if 100 per cent loyalty adn not an outright act of theft or forgery.

6. Finally, any legislation you support should contain remedies that would appropriately protect the participants and their retirement funds and would also, in each case, appropriately deter and punish not only the thieves and other outright criminals but also the corporate and labor leaders and their allies and agents who improperly use these trust funds for their personal benefit. Any consideration of appropriate remedies should, I believe, start with the awareness that both the outright criminal acts as well as the improper party-in-interest transactions could be adequately dealt with under the existing provisions of the Internal Revenue Code if, but only if, Congress provides an adequate remedy.

At the present time Section 401(a) provides that a retirement plan will only if it is part of a plan of an employer "for the exclusive benefit of his employees or their beneficiaries." Section 503(b) lists six types of party-in-interest transactions which are prohibited transactions if the trust is damaged or the fiduciary is benefited by reason of the party-in-interest relationship, i.e., the fiduciary's conflict of interest causing an abuse of discretion. I submit that any criminal act or party-in-interest transaction with which we are concerned can be reached as a violation of either the exclusive benefit rule or the prohibited transaction rules.

The problem is that the only existing remedy or punishment is prospective disqualification of the plan. This neither protects the participants and their funds for punishes the wrongdoers. Only the innocent participants are really hurt by disqualification, for the income of the trust becomes taxable and any employer contributions thereafter made are currently taxable to participants to the extent of their respective vested interests. The employer who wants to protect itself will not thereafter make any contributions which are not fully vested. So the wrongdoers go scot-free while the participants suffer the loss resulting from the prohibited transaction and incur a second loss if the Service invokes disqualification.

Section 6 of S. 1631 would cure part of the present absurdity by invoking a tax penalty against the wrongdoer, but it does not go far enough and makes no provision to compensate the participants for their loss. Somehow Congress should provide a remedy comparable to that in our civil law to protect the participants and their retirement funds. Where a fiduciary of a private trust is found by a state court to have engaged in an improper party-in-interest transaction, not only does the fiduciary have to make the trust whole for any loss it may have sustained, but he also has to pay over to the trust any gain he derived even if the trust did not suffer an out-of-pocket loss.

In conclusion, no amount of disclosure, audits, annual statements to participants, or anything else, is likely to eliminate or lessen to an acceptable level the occasional criminal act and improper party-in-interest transaction unless Congress can develop and provide various remedies and protections and deterrents, each of which is appropriate, adequate and practical to the particular set of facts to which it is to be applied.

IV. FUNDED DEFERRED COMPENSATION PLANS FOR TAX-EXEMPT ORGANIZATIONS

No one would question the right of a tax-exempt organization to establish and maintain a funded employee pension or annuity plan that would qualify under Section 401(a) of the Code. There are hundreds or thousands of them operating around the country today. However, for the past ten or fifteen years, the Service has refused to issue a ruling or determination letter qualifying a deferred profit-sharing plan established by a tax-exempt organization for the exclusive benefit of its employees and meeting all of the requirements of Section 401(a). The reason for this, so I am told, is that one individual in the Chief Counsel's office of the Internal Revenue Service has long and successfully asserted that the "not-for-profit" concept that underlies the granting of tax exemption under Section 501(c) is so diametrically opposed to the words "profit-sharing" that Congress could not have intended to allow a tax-exempt organization to adopt and maintain a qualified profit-sharing plan.

In my humble opinion, this is an absurd and utterly pedantic extension of a literal interpretation to reach an illogical, undesirable and inequitable result that no one wants. When Congress first used the words "A trust * * * forming part of a stock bonus, pension or profit-sharing plan" in Section 165(a) of the 1942 Revenue Act, it was describing types of plans and not types of employers. I respectfully submit that there are many compelling economic, social and equitable reasons why a tax-exempt organization should be allowed to use a qualified profit-sharing plan in exactly the same way any ordinary employer can use one. I know of no reasons to the contrary. I have been told that the American Red Cross used to have a qualified profit-sharing plan, but whether that is correct or not, I have been personally hounding the Service, at least since 1965, in an unsuccessful effort to get someone to reverse its announced position that it will not give a favorable ruling on a profit-sharing plan for a tax-exempt organization. Although several prior Commissioners of Internal Revenue and a number of other high-placed officials of the Service have openly agreed with my position and have tried to break the log jam, pedantry remains unconquered.

Let me give a specific illustration of the problem. For many years, the Department of Health, Education and Welfare has been holding meetings in Washington to pressure hospitals, most of which are tax-exempt organizations, to do everything in their power to hold down the rising cost of medical care. The hospital administrators go home, report to their boards, hire management consultants and receive elaborate reports which almost always recommend the establishment of some type of incentive, cost-sharing program. For tax and other business reasons, it is often desirable to design such arrangements as funded, deferred compensation plans. If they are to qualify for tax purposes, they can only be as a "profit-sharing plan" because under the Service's definitions, they cannot qualify as a pension or stock bonus plan and the Code does not provide for the qualification of any other types of funded deferred compensation plans. Thus, even though the plan is written as a cost-sharing arrangement and the word "profit-sharing" is never used, the Service cannot qualify it except as a profit-sharing plan.

I urge the Committee to include in any bill it reports to the Senate whatever provision the Committee feels is necessary to make clear that a tax-exempt organization should not be denied the right to establish and maintain a funded, deferred compensation plan that would otherwise qualify under Section 401(a) just because such a plan has to qualify as a profit-sharing plan because it is neither designed nor intended to pay "definitely determinable benefits". These are the magic words of Section 1.401-1(b)(1)(i) of the Treasury Regulations that define a pension plan and distinguish it from a profit-sharing plan. Please make it entirely clear that a tax-exempt organization is not barred from establishing and qualifying a funded, deferred compensation arrangement that is not designed or intended to provide definitely determinable benefits and hence must qualify, if at all, as a profit-sharing plan.

V. FOREIGN EMPLOYEES AND FOREIGN PLANS

There are a number of problems areas under Subchapter D of the Code when it is to be applied to foreign employees, foreign plans and foreign funding agents.

While these problems are of relatively minor importance in the overall picture because they do not occur frequently, they are extremely troublesome when they do arise. I would urge this Committee to develop amendments that would immediately eliminate the following problems which, as far as I know, are non-controversial:

1. The Deductibility of Employer Contributions to Foreign Plans Covering Only Foreign Nationals IRC §404(a)(4)

Where a United States employer contributes to a foreign plan which covers only its non-resident, alien employees and the contributions are made to a foreign trust, insurance company or other funding agency, the deductibility of the employer's contribution should be determined under Section 162 rather than Section 404(a)(4). There is no reason to require the employer to qualify the plan under Section 401(a), which Section 404(a)(4) in effect requires, if every element of the plan and its participants are without the jurisdiction of the United States except the employer. Sections 406 and 407, enacted in 1964, do not apply to this situation if the United States employer operates as one company rather than through subsidiaries. Section 406 deals only with plans covering United States citizens employed by foreign subsidiaries of domestic parents, while Section 407 is likewise restricted to plans covering United States citizens employed by a domestic subsidiary of a domestic parent.

2. The Exclusion of Non-Resident Aliens—IRC § 401(a)(3)

Many domestic companies operating abroad use only one entity as the employer of both United States employees working abroad and the non-resident aliens. Usually the United States dollar payroll employees will be covered under a retirement plan designed to qualify under Section 401(a), while the foreign nationals will participate in a separate plan. For the very same reasons that I discussed above in connection with salaried only plans, the plan for the United States employees may fail to qualify under Section 401(a)(3) if the foreign national employees are included. In my view, they should not be included for purposes of Section 401(a) (3) and (4). I would strongly recommend an appropriate amendment of the Code similar to Section 7(b) of S. 1631 discussed above, which would exclude the non-resident alien employees of the company from the census of employees that is used to determine qualifications of the United States dollar payroll plan under Section 401(a)(3) and (a)(4).

3. Coverage of DISC Employees in Qualified Retirement Plans—IRC § 407

Section 407 permits an employee of a domestic subsidiary to be covered by the qualified plan of the subsidiary's parent as long as the subsidiary meets certain ownership and income requirements. The income requirements are identical to the requirements which must be met by Western Hemisphere Trade Corporations, which by definition export or extend almost all of their products and/or services throughout the Western Hemisphere. Traditionally Western Hemisphere Trade Corporations have tended to be subsidiaries of much larger companies which have channeled their products and services through the Western Hemisphere Trade Corporations in order to enjoy the tax benefits Congress provided for Western Hemisphere Trade Corporations. Because Western Hemisphere Trade Corporations have frequently been conduits, they have tended to have very few employees.

In 1971, Congress enacted special provisions regarding Domestic International Sales Corporations, which resemble Western Hemisphere Trade Corporations to the extent that they tend to be arms of larger concerns, offer tax incentives to earn income from abroad and which further tend to have few employees. Under Section 407, the employees of a DISC can participate in the qualified retirement plan of its parent only if the DISC meets the income requirements set forth in section 407. While these requirements accommodate the income characteristics of Western Hemisphere Trade Corporations, it is not surprising that they will not always accommodate the special requirements of a DISC inasmuch as they were enacted some seven years before a DISC was ever heard of. I would urge this Committee to develop an appropriate amendment of Section 407 that will give DISC employees the same opportunity to participate in the parent's qualified retirement plan that Western Hemisphere Trade Corporations employees presently enjoy.

Senator NELSON. Our next witness is Mr. Buckley Hubbard, Jr., vice chairman, Committee on Federal Law and Legislation, National

Association of Life Underwriters and Immediate Past President of Association for Advanced Life Underwriting.

Mr. Hubbard, if you would identify your associates for the reporter?

STATEMENT OF BUCKLEY HUBBARD, JR., VICE CHAIRMAN, COMMITTEE ON FEDERAL LAW AND LEGISLATION, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS, AND IMMEDIATE PAST PRESIDENT, ASSOCIATION FOR ADVANCED LIFE UNDERWRITING, ACCOMPANIED BY GERALD H. SHERMAN AND NICHOLAS P. DAMICO, COUNSEL FOR ASSOCIATION FOR ADVANCED LIFE UNDERWRITERS

Mr. Hubbard. My name is Buckley Hubbard. I am vice chairman, Committee on Federal Law and Legislation, National Association of Life Underwriters, and immediate past president, Association for Advanced Life Underwriting and am accompanied by Mr. Gerald H. Sherman and Mr. Nicholas P. Damico, counsel for the Association for Advanced Life Underwriting.

My remarks are made on behalf of both associations; National Association of Life Underwriters and Association for Advanced Life Underwriting.

The National Association of Life Underwriters is the largest association of life insurance agents in the country. We have over 115,000 of them, many of whom are involved in the sale and administration of insured retirement plans.

The Association for Advanced Life Underwriting is a smaller but substantial group of members who are affiliated with NALU. The membership of AALU is restricted to NALU members who specialize in one or more fields of advanced life underwriting. Almost without exception, members of the smaller AALU are deeply involved in the installation, funding and administration of qualified pension and profit-sharing plans.

I would like this afternoon in this oral testimony to highlight some of the items in our written testimony. Time does not permit me to cover all of the points, but I would like to emphasize a few.

Both NALU and AALU support and commend the efforts of this Congress and the administration to provide a meaningful pension program. It is generally agreed that 50 percent of the workers in this country are not covered by pension plans. This 50 percent of the work force is for the most part made up of individuals and employees of small corporations. Most of the large corporations today have pension plans.

The uncovered segment of the work force generally would have their pensions installed and administered by the insurance industry. The reason for this is that the insurance industry has the ability to pool mortality risk and investment income and to provide built-in actuarial and administrative functions for these small plans.

Senator Nelson. When you say, small plan, what is your definition?

Mr. Hubbard. Well, under 100 lives.

The weight of the existing Internal Revenue Service and Labor Department forms is ominous.

Senator NELSON. The what?

Mr. HUBBARD. The complicated regulations make pension plans an extremely expensive item for the smaller employer. The forms, completed by the employer with 5 employees are pretty much the same as those for the employer with 5,000 employees. The pending legislation requires even more information. The small businessman must hire outside talent in order to complete forms and comply with regulations that are enforced or being contemplated.

This fact alone could be a serious deterrent to expanding the private pension system to cover this 50 percent of the Nation's work force.

For these reasons we respectfully request that the committee consider exempting from reporting requirements on those plans, employers with fewer than 100 participating employees. I emphasize reporting requirements. We believe small plans should live under the same vesting and funding requirements as larger plans, but we do feel that there should be some relief from administrative detail.

We firmly support the program for individual retirement plans. This should go a long way toward covering those who are not now members of a pension system. We hope, however, that you will consider raising the deduction limit of $1,500 found in H.R. 7157 and S. 1631 to $5,000. This is a figure which we feel is more practical and realistic.

We support $7,500 as the maximum for H.R. 10 and subchapter s corporations.

We enthusiastically support reasonable vesting and eligibility standards. Eligibility requirements should not be so stringent, however, as to prevent flexibility of plan design. Many small corporations by their very nature have transient and mobile labor forces which make it administratively unwieldy to enroll young people and people with short service. This would not necessarily deprive individuals of any benefits, but merely be administratively more convenient.

We support funding requirements and plan termination insurance. We hope when considering funding, there will be accommodations again for the small businessman who has peaks and valleys in his profit statements. There are years when contributions into a pension plan might be fiscally irresponsible and conversely there are years when the employer should be able to put in very large amounts to make up for deficits created in lean years.

Senator NELSON. How would you manage that? What kind of provision would you have and still have a qualified plan?

Mr. HUBBARD. I think the ultimate goal in the bills already expressed is 30-year funding of past service and so forth. I think that is justified. It is getting there. However, requiring the same amount in each year could be difficult.

Sentaor NELSON. You are talking about past funding now?

Mr. HUBBARD. Past funding and future.

Senator NELSON. Not occurring? Do you mean both?

Mr. HUBBARD. Well, past funding, with that there were two approaches: the actuarial approach of using a past service liability and the so-called level premium method. In both instances we feel that the goal of having funds there at retirement and being monitored is good, but there should be opportunity during times of distress so that the employer does not have to contribute as much. Conversely, we are asking for a removal of the existing 10-percent limit on deductible contributions for past services liability.

Senator NELSON. How many years would you allow an employer not to contribute? What would be the guidelines for that?

Mr. HUBBARD. In our testimony before the Senate Labor Subcommittee we had a formula and the language was set forth in that, which answers your question, but I can't quote it today.

Senator NELSON. If you would submit it for the record it would be helpful.

Mr. HUBBARD. I will.

[Mr. Hubbard subsequently supplied the following information:]

ASSOCIATION FOR ADVANCED LIFE UNDERWRITING,
Washington, D.C., May 29, 1973.

Hon. GAYLORD NELSON,
Chairman, Senate Finance Subcommittee on Private Pension Plans,
U.S. Senate, Washington, D.C.

DEAR SENATOR NELSON: On Monday, May 21, Mr. Buckley Hubbard, accompanied by Gerald H. Sherman, Esq. and myself, appeared before the Senate Finance Subcommittee on Private Pension Plans in behalf of the National Association of Life Underwriteers (NALU) and the Association of Advanced Life Underwriting (AALU) to express the views of these organizations on pension reform. During the course of Mr. Hubbard's oral testimony he referred to the need for flexibility in applying minimum funding requirements to the small employer and alluded to a formula for providing such flexibility, which was included in joint NALU-AALU testimony before the Senate Labor Subcommittee, last year.

Pursuant to your inquiry, it was agreed that the formula would be described and explained in writing to you as a supplement to Mr. Hubbard's statement. The formula, as presented to the Senate Labor Subcommittee, was addressed to a proposed provision at that time in S. 3598 for a minimum funding requirement of all normal costs plus 1/40th of the initial unfunded liability in each year.

As applied to the minimum funding requirements of S. 3598, the formula would provide (as stated in our statement to the Senate Labor Subcommittee) as follows:

"1. An employer would be obligated to contribute all normal service costs of his plan plus 1/40th of the initial unfunded liability in each year except in those years in which the employer encountered a business reversal. A year of business reversal would be defined as a year in which profits were less than 25% of the immediately preceding year's profits or less than 75% of the average profits for the immediately preceding 5 years. In a year of business reversal no funding of either normal service costs or unfunded liability would be required.

"2. Notwithstanding the above, however, the employer would be required to fund all normal service costs to date plus 20% of his initial unfunded liability within 10 years after establishment of the plan. All normal service costs and 40% of initial unfunded liability would be required after 20 years. All normal service costs and 70% of initial unfunded liability would be required after 30 years. All normal service costs plus 100% of initial unfunded liability would be required after 40 years."

In the AALU testimony before the House Ways and Means Committee this year, on tax reform, the formula was applied to the 30 year funding requirement of S. 4, as follows:

"1. An employer would be obligated to contribute all normal service costs of his plan plus 1/30th of the initial unfunded liability in each year except in those years in which the employer encountered a business reversal. A year of business reversal would be defined as a year in which profits were less than 25% of the immediately preceding year's profits or less than 75% of the average profits for the immediately preceding 5 years. In a year of business reversal no funding of either normal service costs or unfunded liability would be required.

"2. Notwithstanding the above, however, the employer would be required to fund all normal service costs to date plus 25% of his initial unfunded liability within 10 years after establishment of the plan. All normal service costs and 60% of initial unfunded liability would be required after 20 years. All normal service costs and 100% of initial unfunded liability would be required after 30 years."

In essence, the above formula would require minimum funding standards measured at ten year intervals. However, as applied to an individual year in which an employer suffered a business reversal, the formula would permit the employer to skip a contribution, if desired.

In terms of existing Federal income tax requirements, the failure to make a contribution to a pension plan in a particular year is characterized, under Treasury regulations as a "suspension" of contributions rather than a complete discontinuance of contributions if certain requirements are met. In this connection, the relevant provisions of the Treasury regulations provide as follows:

"In the case of a pension plan, a suspension of contributions will not constitute a discontinuance if—

> (i) The benefits to be paid or made available under the plan are not affected at any time by the suspension, and
>
> (ii) The unfunded past service cost at any time (which includes the unfunded prior normal cost and unfunded interest on any unfunded cost) does not exceed the unfunded past service cost as of the date of establishment of the plan, plus any additional past service or supplemental costs added by amendment." *

Consequently, existing Treasury regulations allow a significant degree of flexibility in contributions, which the formula would preserve (and perhaps, extend) in the "business reverse" situation.

We would be glad to discuss this proposal or any other aspect of Mr. Hubbard's statement with you, other members of the Subcommittee, or its staff.

It is respectfully requested that this letter be included in the record as an attachment to Mr. Hubbard's statement.

Respectfully submitted.

NICHOLAS P. DAMICO,
Associate Counsel, AALU.

Mr. HUBBARD. We do not believe that special funding and plan termination insurance provisions should be applied to certain types of insured plans. By their very nature, some of these insured plans are fully funded because they are insured. This we have strongly emphasized in testimony before other committees of the Congress. And subsequent to our testimony, our position has been supported by an interim report of the Departments of the Treasury and Labor on pension plan termination in 1972. This particular report points up the strength of insured plans and the fact that employees could not lose benefits under them. Our written testimony also portrays some graphs which are based on samplings we have made in the insured pension plan field.

We support portability on a voluntary basis. Again, insured plans already involve long-term portability through the means of individual deferred annunity contracts. These are frequently called for in insured plans.

The terminated employee receives a contract which gives him a right for annuity at age 65 or funds for his beneficiary in case of death. These benefits are backed up and guaranteed by an insurance company.

Time does not permit me to touch on other points in our written testimony, but by leaving them out of this oral testimony, I do not mean to lessen their importance to us and the clients we serve.

We sincerely hope the committee will keep in mind the small employer and the plans he must adopt. These plans are invariably insured. Pension bills which have been presented have been directed at the larger plans and perhaps this is valid: however, in drafting a new bill, we hope you will consider the small plan with under 100

*Section 1.401-6(c)(2) of the Income tax regulations.

participants. This is the plan that will be adopted to cover that 50 percent of the work force who are not privileged to be covered by pension plans, today.

Thank you for your time. We will be glad to help the committee or the staff in any way we can.

Senator NELSON. I share your concern, as I am sure most of the Congress does, about the amount of paperwork designed by the various agencies whenever you give them a law to administer. I remember during the Second World War, I read a newspaper article about an award to Henry Kaiser for launching the Liberty ship, and they asked him how did he do it, and he said it was very simple; he said, we weighed the Federal paper and, when it equaled the weight of the Liberty ship, it was launched.

Sometimes that is also true in other situations.

Well, thank you.

[The prepared statement of Buckley Hubbard follows:]

PREPARED STATEMENT OF BUCKLEY HUBBARD, CLU, VICE CHAIRMAN, COMMITTEE ON FEDERAL LAW AND LEGISLATION, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS (NALU)

Mr. Chairman, my name is Buckley Hubbard. I am Vice Chairman of the Committee on Federal Law and Legislation of the National Association of Life Underwriters (NALU) and Immediate Past President of the Association for Advanced Life Underwriting (AALU). My remarks today are made on behalf of both NALU and AALU.

NALU is the largest national association of life insurance agents, many of whom are involved with the sale and administration of insured retirement plans as part of their work. NALU has over 110,000 members across the country. AALU, a smaller but substantial organization, is an affiliate of NALU. Its membership is restricted to those NALU members who specialize in one or more fields of advanced life underwriting. Most AALU members devote a substantial portion of their work time to the installation, funding and administration of qualified pension and profit sharing plans.

Both NALU and AALU support the broad scheme of pension reform and applaud the efforts of this Congress and the Administration to provide meaningful pension reform. My remarks today will be addressed to the problem of achieving pension reform consistent with the goal of continuing a strong private pension plan system.

We submit that the most pressing need in the pension area today is the need for an expansion of the private sector to cover additional individuals who are not participants in the private pension plan system. In many cases such individuals are employees of small employers who have yet to institute a qualified plan.

Despite the much publicized growth of the private pension plan system, approximately 50 percent of the work force in this country are not covered by any private pension plan.[1] Indeed, as the private pension system relates to the small employer, the field is in its infancy. Moreover, we are now at a crossroads in the retirement field, where either the small employer will be encouraged to provide pension benefits or such benefits will be replaced by social security. Individuals, whether employees or self-employed should also be encouraged to provide pensions for themselves and in the case of self-employed individuals with employees, their employees.

A. Exemption for Small Employers

The experience of our members with qualified plans is principally in the area of plans of small employers. We submit that the small employer has already done an outstanding job in providing actual benefits to plan participants. It has been our experience that participants under plans of small employers, generally have a greater chance of receiving their benefits than do participants under plans of larger corporations.

[1] Message of the President transmitting recommendations for pension reform (4/11/78).

In the spring of 1972, in support of this view, we presented charts illustrative of the favorable experience of the testifying witness[2] with qualified plans of small employers, to the House Ways and Means Committee and the Senate Labor Subcommittee. The charts, which are attached to this statement as Appendix B, illustrated, for example, that, with respect to the plans tested, 82 percent of the plans provided some benefit (i.e. transfer of cash value life insurance policy) to every terminated participant and 82 percent of the plans provided full vesting to all employees with ten years of participation.

Our contention that small employers are not guilty of the abuses which have provided the impetus for pension reform is now supported by a joint Treasury and Labor Department study of pension plan terminations commissioned by President Nixon and described in further detail later in this statement.[3] The report made a study of all plan terminations reported to the Internal Revenue Service in the first seven months of 1972. One of the principal findings of the study was that small plans have a smaller incidence of loss of benefits. The study states, in part, as follows:

"The majority of terminated plans are small. As shown in Table 4-4, 403 or 59 percent of the 6 plans in the survey to date had fewer than 10 claimants. But only 8 percent of all claimants and 8 percent of all claimants with losses were in such plans. The 40 plans with 100 or more claimants accounted for 58 percent of all claimants and 55 percent of all claimants with losses."

Thus, we submit, most small employers would be able to meet new requirements in the principal areas of vesting, funding, and plan termination insurance. However, proposed new reporting requirements would be particulalry burdensome to the small employer.

Administrative requirements under existing law, including the myriad of forms, reports and recordkeeping requirements (i.e., in connection with the new lump-sum-seven-year-averaging rule), have already forced the small employer to rethink the desirability of establishing a qualified plan. However, a number of the pension reform proposals would add new reporting requirements and in some cases require actuarial and accounting certifications annually. The small employer, who must often rely on outside help to meet reporting requirements, would be literally overwhelmed by paper.

For example, H.R. 2 would require an annual report to be published each year which would include a schedule listing all investments of the fund and a schedule of each receipt and disbursement from the fund during the year covered by the report. The plan administrator would have to engage an independent qualified public accountant, to audit the books and records of the fund each year and would also have to engage a "certified actuary" to comply with the requirements of actuarial disclosure. These requirements are simplified when applied to a fully insured plan. However, many small plans are split-funded plans containing an investment fund which funds a portion of the plan. The above requirements would be fully applicable to the investment fund. The reporting requirements of H.R. 2 would apply to plans with as few as nine participants.

Under the existing Welfare and Pension Plan Disclosure Act, and under the proposed Retirement Income Security for Employees Act (S. 4) all plans covering 25 or less employees are exempt. Moreover, under the existing Welfare and Pension Plan Disclosure Act, detailed annual reports (Form D-2) are required, only for plans covering 100 or more participants. This existing provision recognizes that requirements which are both costly and complex, should not and need not be made applicable to small employers.

We respectfully request, that any reporting requirements set forth in any bill recommended by this Subcommittee provide an exception for plans with fewer than 100 participants as an incentive for small employers to establish qualified plans.

B. Individual Retirement Plans

The private pension system and the tax laws which support it are deficient in a basic respect. An individual may receive coverage under that tax favored system only if he is self-employed or the coverage is provided to him by, or with the cooperation of, his employer. Individuals who are neither self-employed nor

[2] Marshall I. Wolper, C.L.U., Former Vice Chairman of the Committee on Federal Law and Legislation, The National Association of Life Underwriters (NALU), and President of the Association for Advanced Life Underwriting (AALU).

[3] *Study of Pension Plan Terminations 1972: Interim Report Presented by the Departments of Treasury and Labor.*

blessed with a cooperative and understanding employer are powerless to utilize the system.

H.R. 7157 and S. 1631, as did H.R. 12272, would provide a limited deduction of up to 20 percent of earned income or $1,500, whichever is less, for contributions to individual retirement plans. We have previously supported and continue to support, the concept of individual retirement plans. We submit, however, that the proposed $1,500 maximum deduction should be increased.

Our concern with the proposed $1,500 maximum deduction is based on our belief that this sum might be too low to provide a standard of living for retired persons which is comparable to the standard of living they enjoyed while working. The Administration estimates that contributions of $1,500 per year, beginning at age 40, over a period of 25 years, would provide a retirement income of $7,500 anually. In view of such factors as inflation, the rising cost of living, the income from the plan in the case of many individuals, commencing 25 years from now, even with Social Security and other income, may not be enough to provide an adequate standard of living for the average American.

It should also be noted that many individual retirement plans would be funded over a period of much less than 25 years, which means that the eventual retirement income from such plans will be even less than $7,500 annually. It is to be expected that older workers will be more interested in contributing to a retirement fund than younger workers, since they are the ones who will need retirement income sooner. Thus, more individual retirement plans will be established by older persons who will have fewer years during which to contribute to the plan.

On the other hand, it may be undesirable to discourage owner-employee plans that benefit both owners and their employees. Such discouragement might occur if individual retirement plans are made as attractive for the owner-employee as the existing H.R. 10 plans.

We strongly support the proposal to raise the limits on the tax deductible contributions to H.R. 10 plans, but, at the same time, we think there is too much disparity between the $7,500 to be allowed in H.R. 10 plans and the $1,500 contemplated by the Administration's proposal in the case of individual retirement plans. We would suggest that these limits be more closely aligned. We believe that the $1,500 limitation could be raised, for example, to $5,000, to provide greater benefit to individuals, without unduly discouraging owner-employee plans.

C. Deductibility Limits on H.R. 10 and Subchapter S Plans

NALU and AALU support the provisions of H.R. 7157 and S. 1631 which would raise the limits on deductible contributions to a maximum of $7,500 for self-employed individuals and for shareholder-employees of Subchapter S corportions. While we question the need for special deduction limitations for these individuals as opposed to corporate employees, we believe that the limitations set forth in these areas are liberal enough to permit such individuals to provide minimum retirement benefits without imposing a severe strain on the Treasury and, therefore, represent a step in the right direction.

This liberalization of deduction limits is vitally necessary in both the H.R. 10 and Subchapter S areas, but each for a different reason. In the area of H.R. 10 plans, despite prior liberalizations, a large percentage of self-employed individuals are not yet covered by any qualified retirement plan. The higher deduction limits will encourage self-employed individuals to provide adequately for their retirement, and, more importantly, to provide adequately for the retirement of their employees.

In the area of Subchapter S corporations,[4] the Subchapter S election is designed to permit a corporation *which is a corporation* to be *taxed* as a hybrid corporation-partnership. The fact that such corporation executes a Subchapter S election does not in any way detract from its legal characterization as a corporation. Thus, we feel that there is no reason why retirement plans of such corporations should be treated any differently from retirement plans of any other corporation.

Moreover, a serious inequity has resulted in the case of existing retirement plans of Subchapter S corporations. Many of these plans cover a large number of employees and are well established. Termination or curtailment of such plans, to avoid the impact of section 1379, is not desirable from the standpoint of

[4] Technically, under the special rules for shareholder-employees of Subchapter S corporations, deductions and contributions are not limited, but rather the excess amount is included in the shareholder-employee's current income.

encouraging private pensions. At the same time, thr employer may have many valid considerations which require him to maintain his Subchapter S corporation election regardless of the penalties he must suffer as an individual under section 1379. The liberalization of the amount which may be deducted on behalf of a shareholder-employee would encourage the maintenance of such plans at current contribution levels.

II. ELIGIBILITY AND VESTING

We support the concept of minimum eligibility and vesting requirements. The bulk of plans with which NALU and AALU members are associated, are plans for small employers. In large part these plans already meet most of the eligibility and vesting standards which have been proposed.

A. Eligibility

In the area of eligibility, we ask only that any minimum standard which is proposed by this Subcommittee allow an employer to exclude low age and low service employees who are traditionally in the high turnover group—to avoid the administrative cost of including employees who will not stay long enough to receive benefits anyway. Any reasonable standards of eligibility consistent with the above considerations would be acceptable to us.

With respect to a maximum age, the provisions of H.R. 7157 and S. 1631, would limit the maximum age under a plan to an age not less than the normal retirement age reduced by five years. In most cases, therefore, the earliest maximum age would be 60. Many plans presently provide a maximum age of 55 so that a minimum period of ten years is provided to fund the benefit prior to normal retirement. While a maximum age of 60 can be used, we submit that it will discourage the employment of individuals between ages 55–60, and may place a strain on the ability of the employer to fund benefits for individuals who are hired in this age category.

B. Vesting.

With respect to vesting we support the imposition of reasonable vesting requirements as a means of providing uniform requirements for all employers.

We submit that the small employer has already done an outstanding job in this area. As previously alluded to, it has been our experience that participants under small plans generally have a greater chance of receiving their benfits than do participants under plans of larger corporations. To a large extent this is due to a combination of rapid vesting and adequate funding which exists in many small plans.

In testimony before the House Ways and Means Committee last year on H.R. 12272, there was attached to our statement, charts which illustrated favorable experience with qualified plans for small employers. Those same charts, referred to at the beginning of this statement, are attached hereto as Appendix B. We again wish to point out that our own findings to the effect that loss of benefits are not high in small plans was borne out by the recent study of plan terminations undertaken jointly by the Treasury and Labor Departments.

Of the various proposals respecting vesting, our preference, however, is for a formula which permits an employer to defer any vesting for a short minimal period of time, with graduated vesting thereafter. Thus, for example, a requirement of no vesting in the first five years, with graduated vesting thereafter at the rate of ten percent a year so that full vesting after 15 is achieved would be satisfactory to us. By the same token, the proposal in S. 4 of 30 percent vesting after eight years, with graduated vesting at the rate of ten percent per year with full vesting after 15 years is also satisfactory. While we believe the "rule of 50" vesting requirement would discourage the hiring of older employees, this vesting standard is also acceptable to us, provided a minimal requirement of participation is inserted (i.e. five years) before any vesting is achieved, so that the employer is not saddled with a large vested liability at the time the participant enters the plan.

III. FUNDING AND PLAN TERMINATION INSURANCE

We support the concepts of new minimum funding requirements and plan termination insurance. With respect to funding we believe that any of the major funding proposals, including those in S. 1631 and S. 4, would provide much needed minimum funding standards. Most insured plans, by their nature, already meet these standards.

As applied to the small employer, a need arises, however, for variances in contributions. The profit of a small employer will traditionally fluctuate, with the resultant desire of the small employer to contribute large amounts in good years and small amounts in poor years. The current deduction limitations tend to frustrate this desire.

The present deduction limits preclude an employer from deducting pension plan contributions for past service liability at a rate greater than one-tenth of the original unfunded past service liability,[5] irrespective of a more rapid rate of contributions in fact. As a consequence, employers simply do not fund their pension plans at rates greater than would coordinate with the permissible deduction.

The ten percent limitation is clearly antithetical to the public policy which would encourage the earliest possible funding. Not only is this Code provision inconsistent with modern needs with respect to pension funding, on examination it emerges as one of those historical anomolies whose birth was predicated upon an original misconception and whose continued existence has been fed by inertia.

In 1928, when Congress first enacted the ten percent provision, it did so on the understanding that under the law it was not possible to obtain any deduction for a single year funding of past service credits.[6] Congress' understanding was based on the 1927 Board of Tax Appeals opinion in the *Ox Fiber Brush Co.* case which concerned the taxable year 1920.[7] Thus, Congress intended the original enactment to serve, not as a *limitation* on deductions, but as an *expansion*, since it enabled taxpayers to deduct amounts that were otherwise nondeductible.

However, in 1930 the Supreme Court affirmed the Fourth Circuit's 1929 overruling of the Board of Tax Appeals and held that the taxpayer in *Ox Fiber Brush Co.* was indeed entitled to a full 100 percent deduction in 1920 of that single year's funding of past service liability.[8] Since the 1930 Supreme Court decision provided 100 percent deductibility for a 1920 contribution (i.e., a pre-1928 year), from the point of the Supreme Court decision forward, commentators have assumed incorrectly that the 1928 enactment of the 10 percent rule was a limitation on what otherwise may have been a larger deduction.[9] It was, as we have seen, in fact, an expansion. Unfortunately, this misreading of history has permitted the unquestioned perpetuation of a bad rule premised on an incorrect predicate.

This Congress now has an opportunity not only to cleanse the technical record, but to add its efforts in encouraging prompt funding of pension obligations. If a corporate employer in fact contributes cash to the pension fund, it should be entitled to a deduction, irrespective of the fact that that contribution may have been with direct reference to service over a number of prior years. The public interest in the earliest possible funding will thus be served.

We support the general concept of plan termination insurance to insure vested, but unfunded, benefits for plan participants. We recognize that funding requirements will not, by themselves, insure that a plan will have sufficient assets to pay vested liabilities on termination.

Both S. 4 and S. 1179 recognize, however, that certain types of insured plans are, by their nature, fully funded at all times and both of these bills have exempted these plans from the funding requirements of the bill. By exempting these plans from the funding requirements, it is recognized that these plans will provide full benefits on termination and consequently the plan termination insurance premiums will be inapplicable to these plans.

Section 210(e) of S. 4 provides, as follows:

"(e) Where an insured pension plan is funded exclusively by the purchase of individual insurance contracts which—

(1) require level annual premium payments to be paid extending not beyond the retirement age for each individual participant in the plan, and commencing with the participant's entry into the plan (or, in the case of an increase in benefits, commencing at the time such increase becomes effective); and

[5] Section 404(a)(1)(C) IRC 1954.

[6] Section 23(q) of the 1928 Revenue Act. See S. Rept. No. 960, 70th Cong., 1st Sess. 21–2; H.R. Rept. No. 1882, 70th Cong., 1st Sess. 12.

[7] 8 B.T.A. 422 (1927).

[8] 281 U.S. 115 (1930), aff'g 32 F. 2d 42 (4th Cir. 1929).

[9] See Goodman, *Legislative Development of the Federal Tax Treatment of Pensions and Profit-Sharing Plans*, PH Pension and Profit Sharing Service 19, 799 at 19, 801.

(2) benefits provided by the plan are equal to the benefits provided under each contract, and are guaranteed by the insurance carrier to the extent premiums have been paid,

such plan shall be exempt from the requirements imposed by subsections (b)(2) and (3), (c), and (d) of this section. [funding requirements]"[10]

The rationale for the above exceptions are documented by a study[11] of plan terminations which President Nixon directed the Treasury and Labor Departments to undertake in his Message to Congress accompanying the introduction of H.R. 12272 in December, 1971. The study also recognized that loss of benefits in plan terminations of small employers were substantially less than in plans of large employers.

The study examined all plan terminations reported in the Internal Revenue Service during the first seven months of 1972. In terms of basic statistics, the report found that "[a]bout 8,400 claimants in 293 plans lost benefits out of 20,700 claimants in 683 terminated plans. Claimants losing benefits represent about four one-hundredths of one percent of all workers covered by private pension plans. Of the 8,400 claimants, about 8,100 claimants with losses were retired, eligible for retirement, or vested."

The study made several breakdowns of its statistics. One of the principal findings of the study, as referred to in the beginning of this statement, was that small plans have a smaller incidence of loss of benefits. With respect to plans funded exclusively through individual annuity contracts, the study states, in part, as follows:

"The incidence of benefit loss was particularly low for plans funded exclusively through individual annuity contracts.

"A plan funded exclusively through individual annuity contracts has, by its nature, no unfunded past service liabilities. Scheduled benefits are guaranteed to the extent premiums are paid. Except for the earliest years (particularly the first year) when the sales commission element of premiums is high, pension plan losses can occur only if premium payments lapse prior to formal termination or if the employer borrows a portion of the cash values of the policies. As shown in line 1 of Table 4–5 only 24 of the 130 plans funded exclusively through individual annuity-type contracts showed benefit loses. Only 18 percent of all claimants in all plans so funded lost benefits as opposed to an overall figure of 40 percent."

One of the basic concepts of plan termination insurance is that the employer would be obligated to make up the insured amounts to the extent he was solvent. In testimony before both the House General Subcommittee on Labor and the Senate Labor Subcommittee, we have asked that the plan termination insurance provisions should not be structured in such a way that an employee who has had business reverses, would be faced with the choice of either going out of business or continuing his plan through the use of funds desperately needed as a means of reviving his profits.

S. 4 has responded to this problem by providing in Section 405(b) of the bill, that in no event will an employer's liability for reimbursement in the event of a plan termination, exceed 50 percent of the net worth of such employer. We support this limitation in connection with the plan termination concept. Alternatively, or in conjunction with the 50 percent test, a company might be excused from the repayment obligation where the payment of the obligation in the year of termination would cause the net worth of the company to fall below some minimal figure, such as $500,000.

IV. PORTABILITY

We have supported and continue to support the concept of portability on a voluntary basis. The concept of portability is a new and exciting one but also one with many potential problems in practice. We believe that the best way to test the concept of portability is through a voluntary program. In addition, the need for portability will be decreased as new rules are established for vesting, funding and plan termination insurance. Moreover, portability already exists in many fully and partially insured pension plans which provide for the distribution of deferred annuities upon termination of employment. Such annuities, if kept till age 65, will provide retirement benefits for the individual as contemplated through the portability program. In these circumstances the porta-

[10] Substantially identical language is contained in section 323 of S. 1179.

[11] *Study of Pension Plan Terminations 1972: Interim Report Presented by the Departments of Treasury and Labor.*

bility program would simply add a "spendthrift" clause prohibiting the employee from spending his retirement benefits before age 65. Therefore, the use of the portability program fund is unnecessary in most insured plans.

V. NEED FOR UNIFORM RULES

Requirements for qualification of pension and profit sharing plans vary from district to district of the Internal Revenue Service. Moreover, the Internal Revenue Service generally requires more stringent rules with respect to small employers than large employers. These variances occur primarily in the areas of coverage and vesting.

We applaud the provision of H.R. 7157 and S. 1631 which would permit the exclusion of union employees. In our testimony before the House Ways and Means Committee on H.R. 12272, We supported the Section of Taxation of the American Bar Association proposal to allow the exclusion of union employees who did not wish to participate in a qualified plan. Where union employees turn down pension benefits, the employer may be unable to institute a qualified plan[12] since he cannot qualify his plan without including the union employees and to do so, against their wishes, would be a violation of Federal Labor law requirements.

H.R. 7157 would amend section 401(a)(3)(A) to allow the so-called 70-80 percent mechanical test for determining acceptable coverage to be applied after excluding certain employees including "employees who are included in a unit of employees covered by an agreement which the Secretary or his delegate finds to be a collective bargaining agreement which does not provide that that such employees are to be included, . . ." We support this proposed change and request that it be included in any bill which this Subcommittee endorses.

However, H.R. 7157 does not carry over the new minimum and maximum age requirements to existing section 401(a)(3)(A), under which, as described above, non-discrimination in coverage is determined on a percentage of employees after excluding certain categories of employees. Consequently, there is no assurance, for example, that a plan with a minimum age of 30 would qualify.

Since the proposed new requirements respecting age and service would indicate that the exclusion of certain employees by reason of years of service, minimum age, and maximum age is nonobjectionable, we suggest that section 401(a)(3)(A) be amended to permit an employer to exclude the categories under proposed new section 401(a)(11), before applying the percentage test of section 401(a)(3)(A). We believe that the incorporation of these rules into the automatic formula in section 401(a)(3)(A) would provide a more objective test of nondiscrimination in the coverage area and would eliminate arbitrary determinations by the Internal Revenue Service in this area as to whether or not the coverage requirements have been met. Proposed language to accomplish this change under section 401(a)(3)(A) is attached to this statement as Appendix A for the record.

VI. LUMP SUM DISTRIBUTIONS

For many years prior to 1970, virtually all amounts distributed as lump sum payments to beneficiaries of qualified pension and profit sharing plans on separation from service were subject to tax at capital gains rates. The theoretical predicate for the application of the capital gains rate was, and still is, the necessity of avoiding the high tax rate effect of the bunching of income in a single year resulting from the distributions of a lump sum which was actually earned by the performance of services over a number of years.[13]

Through the Tax Reform Act of 1969, the Congress removed a portion of the lump sum distribution from qualification for capital gains treatment and subjected that portion to taxation at ordinary rates under a special income averaging device.[14] Support for the change was found in the contention that there was an excessive differential between the capital gains rate, which, before the enactment of the 1969 Tax Reform Act, was a maximum of 25 percent, and the substantially higher ordinary income rates (particularly at the upper end of the ordinary income rate spectrum).[15]

[12] See Rev. Rul. 66-14, 1966-1 C.B. 75; Rev. Rul. 66-15, 1966-1 C.B. 83. See also: *George Loevsky*, 55 T.C. 1144 (1971), aff'd 471 F. 2d 1178 (1973).

[13] H.R. Rept. No. 91-413 (Part 1), 91st Cong., 1st Sess. (1969) 154.

[14] Section 515 of the 1969 Tax Reform Act. See Sections 71(a), 402(a)(2) and 403(a)(2), IRC 1954.

[15] H.R. Rept. No. 91-413 (Part 1), *supra*.

Whatever one may think of the reasoning supporting the Congressional action in 1969, the practical results of that action have not been what was originally envisioned.

1. The rate differential for that portion of lump sum distribution which remained subject to capital gains rates has been substantially reduced by the increase in the capital gains rate which was effected by the 1969 Tax Reform Act.

2. In some cases the income averaging approach produces the anomolous result of an effective rate which is not greater than the capital gains rate and, theoretically, may be lower. Consequently, the approach often makes no dent in the rate spread which so concerned Congress in 1969.

3. The Revenue Service has issued an extremely complex set of rules by which taxpayers must allocate between the capital gain and non-capital gain portions of a single lump sum distribution.[16] Most taxpayers are totally confused and are unable to understand the rules.[17]

4. Those employers who attempt to comply with the rules have large burdens of time and expense. Many employers, particularly small businesses, are overwhelmed by the complexity of the rules or the cost of compliance and simply cannot or do not comply.

5. In a not insignificant portion of cases, revenue agents have avoided auditing the adequacy of compliance with the new rules. The agents understandably do not comprehend those rules. In realistic terms they cannot audit.

6. The difficulties of the problem are strikingly illustrated by the fact that today, more than three years after enactment of the legislation, the Revenue Service has been able to develop rules in proposed form only. The final rules have not yet been adopted.

7. The revenue gains, if any, to the Federal Government have been insignificant, particularly in comparison to the massive confusion which now reigns.

No other recent legislative enactment has elicited from our members and their clients so much comment and complaint as this change in the capital gains rule for lump sum distributions. We are constantly asked to present to the Congress a plea for simplicity.

There should be some recognition of the income bunching problem. The simplest way to provide that recognition is to return the full application of the capital gains rate to lump sum distributions. Furthermore, if, in any tax reform legislation which may emerge from this Congress, you increase the capital gains rate (as widely anticipated), the fear of an excessive spread between the capital gains rate and ordinary income rates should no longer exist at anywhere near the strength or validity it once may have had.

The return to a capital gains structure for lump sum distributions is a simple, inexpensive way to return understanding and, indeed, in some situations, sanity, to this matter.

VII. CURATIVE PLAN AMENDMENTS

Section 401(b) was originally enacted to permit an employer to amend retroactively his plan during the two and one-half month period following the year in which the plan was initially established. However, under present conditions, it is normally impossible for an employer to actually amend the plan during such two and one-half month period. In many District Director's offices even if a plan were submitted on the last day of the year, the District Director would not be able to review the plan until the two and one-half month period had elapsed. Generally, the District Director will permit retroactive amendments to prevent disqualification if the plan has been submitted within the two and one-half month period although the amendment itself may occur several months later. This administrative rule is not, however, binding on the Service and even the authority of the Service to permit curative amendments on a retroactive basis is questionable.[18]

[16] Prop. Regs. under sections 72, 402 and 403, 36 Fed. Reg. 11442–11451 (June 12, 1971).

[17] The difficulties of computing how much of a lump sum distribution is subject to capital gains treatment is only part of the problem. The variations in the ways in which lump sum distributions can be taxed are manifold. At least five (and perhaps more) ways of taxing such distributions have been isolated. See Sherman, *Deferred Compensation—Qualified and Nonqualified: A Legislative Perspective Through the Tax Reform Act of 1969*, 11 William and Mary Law Review 870, 884–5 (Summer 1970).

[18] The IRS confirmed that section 401(b) requires curative amendments within two and one-half months after the close of the year in a news release issued on December 15, 1971.

Moreover, section 401(b) applies only to the initial qualification and not to amendments, many of which are objectionable to the Internal Revenue Service when they are submitted. After a careful study of this problem, the Section of Taxation of the American Bar Association approved a legislative proposal which would permit curative retroactive amendments to obtain qualification on either the initial plan or an amendment thereto, at any time up to the fifteenth day of the fifteenth month following the close of the taxable year of the employer in which the subject plan or amendment was put into effect, "or ending with such later date as the Secretary of his delegate may designate."[19] AALU supports this proposal and urges the Subcommittee to adopt it as part of any tax measure it may endorse this year.

VIII. GRACE PERIOD FOR ORIGINATION OF AND CONTRIBUTIONS TO QUALIFIED PLANS

Section 404(a)(6) permits an accrual basis taxpayer to make payment of amounts properly accrued during the year to his plan within two and one-half months following the end of the year (or longer, if an extension is granted for his tax return). Existing section 401(b), discussed above, permits retroactive amendments to a new plan respecting discrimination within the two and one-half months following the close of the year in which the plan is instituted.

Both of the above provisions are recognition of the difficulties associated with properly establishing a plan and making contributions thereto by year-end. These problems are particularly acute as they relate to small and medium-size employers. Such an employer normally does not have the accounting talent available to the large corporation, which can give him reasonably accurate estimates of profits and payroll prior to year end. This situation has caused particularly acute problems in the H.R. 10 area.

H.R. 7157 and S. 1631 would amend section 404(a)(6) to permit both cash and accrual basis taxpayers to make their contribution for a year within two and one-half months after the end of the year (or longer, if the employer secures an extension for his tax return). This provision will allow the cash basis taxpayer to make his contribution after he has determined his profits, and thus insure an accurate contribution. We support this provision and suggest that it be included in any bill which this Subcommittee endorses.

IX. ADMINISTRATION OF NEW REQUIREMENTS

The major pension reform proposals to date have provided for various governmental agencies to administer the provisions of these proposals. From our experience with pension plans, we submit that the Treasury Department is best equipped to deal with most of the reforms, including, in particular, eligibility, vesting and funding. Moreover, we submit that the Internal Revenue Code is the best vehicle for providing proper sanctions for failure to meet new requirements in these areas.

The existing benefits of tax qualification of pension and profit sharing plans have been largely responsible for the growth of the pension industry. Loss of qualification is a strong deterrent against violation of existing Internal Revenue Code provisions. Moreover, the necessity of tax qualification has resulted in an elaborate system of approval of new plans and amendments by the Internal Revenue Service. Revenue Service technicians dealing with qualification problems have developed expertise in broad aspects of pension plans. Finally, the Revenue Service can be called on for its audit abilities, as was recently done in connection with new wage-price controls, to effectively police the new requirements.

In the area of fiduciary disclosure and reporting, the Labor Department has developed significant experience through the Welfare and Pension Plan Disclosure Act. We would have no objection therefore, to a split of responsibility, as recommended by the Administration, wherein fiduciary responsibility and disclosure would remain with the Labor Department and other aspects of new requirements would be handled by the Internal Revenue Service. Some system should be developed, however, to avoid a duplication of reporting requirements to the Treasury and Labor Departments. Copies of reports to one agency might, for example, be deemed to satisfy similar reporting requirements to the other agency.

All of the above is not to say that provisions which have been developed by, for example, the Senate Labor Subcommittee should be discarded simply because S. 4 recommends administration by the Labor Department. For example, we have sup-

[19] Vol. 24, The Tax Lawyer No. 4 (Summer 1971), at p. 921.

ported both the vesting and funding requirements of S. 4, although we would prefer to see them administered by the Treasury Department. If provisions are enacted regarding portability and plan termination insurance, it appears to us that a new governmental agency, similar to the existing Federal Deposit Insurance Corporation in the savings and loan area, should be instituted to administer these programs.

We thank the Subcommittee for this opportunity to present the views of NALU and AALU on pension reform. If we can be of any further help to the Committee or its staff, our services and the services of our counsel are, of course, available.

Thank you.

APPENDIX A TO STATEMENT OF BUCKLEY HUBBARD ON BEHALF OF NALU AND AALU

PROPOSED LANGUAGE OF SECTION 401(a) (3) (A)

(a) REQUIREMENTS FOR QUALIFICATION—A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

* * * * * * *

(3) if the trust, or two or more trusts, or the trust or trusts and annuity plan or plans are designated by the employer as constituting parts of a plan intended to qualify under this subsection which benefits either—

(A) 70 percent or more of all the employees, or 80 percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of all the employees are eligible to benefit under the plan, excluding in each case employees in each of the following categories—

(i) employees who have been employed not more than a minimum period prescribed by the plan, not exceeding ---- years;

(ii) employees who have not attained a minimum age prescribed by the plan, not exceeding age ----;

(iii) employees who have attained a maximum age prescribed by the plan not later than an age (as of the first time when an employee is otherwise eligible to participate) which is not more than ---- years less than the earliest age under the plan at which an employee may retire and receive benefits which are not actuarially reduced;

(iv) employees who are included in a unit of employees covered by an agreement which the Secretary or his delegate finds to be a collective bargaining agreement which does not provide that such employees are to be included; and

(v) employees whose customary employment is for not more than 20 hours in any one week, and employees whose customary employment is for not more than 5 months in any calendar year,

or

* * * * * * *

APPENDIX B TO STATEMENT OF BUCKLEY HUBBARD ON BEHALF OF NALU AND AALU

SUMMARY OF RESULTS OF SURVEY OF 500 PENSION PLANS BASED ON SAMPLE OF APPROXIMATELY 100 PLANS

1. *Immediate Benefits on Termination of Employment.* (*See Chart No. 1, Attached.*)

(a) 82% of all plans provided some benefit (i.e. Transfer of Cash Value Life Insurance Policy) to every terminated participant.

(b) 99% of all plans provided some benefit to every terminated participant with 7 years of participation in the pension plan.

(c) 100% of all plans provided some benefit for every terminated participant with 10 years of participation in the pension plan.

2. *Full Vesting on Termination of Employment.* (*See Chart No. 2, Attached.*)

(a) 22% of all plans provided full vesting to all participants terminating after designated periods of participation of up to 5 years.

(b) 38% of all plans paid full benefits to all employees terminating after designated periods of participation of up to 10 years.

(c) 82% of all plans provided full vesting to all employees with 10 years of participation.

(d) 94% of all plans provided full vesting to all employees with 15 years of participation.

CHART #1

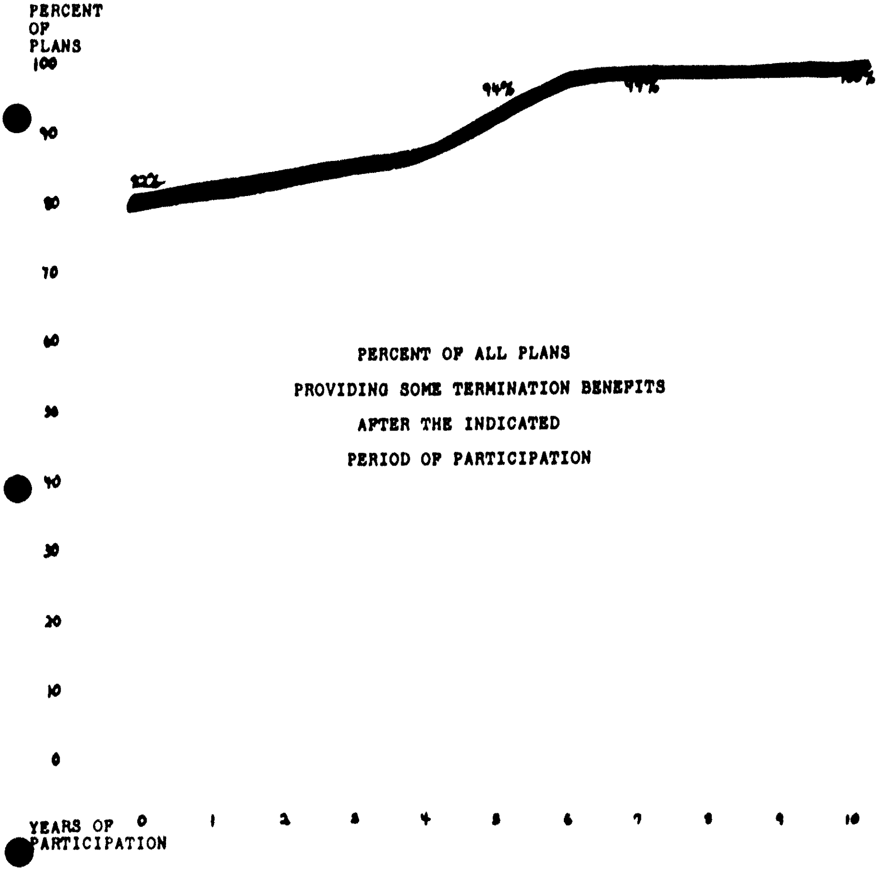
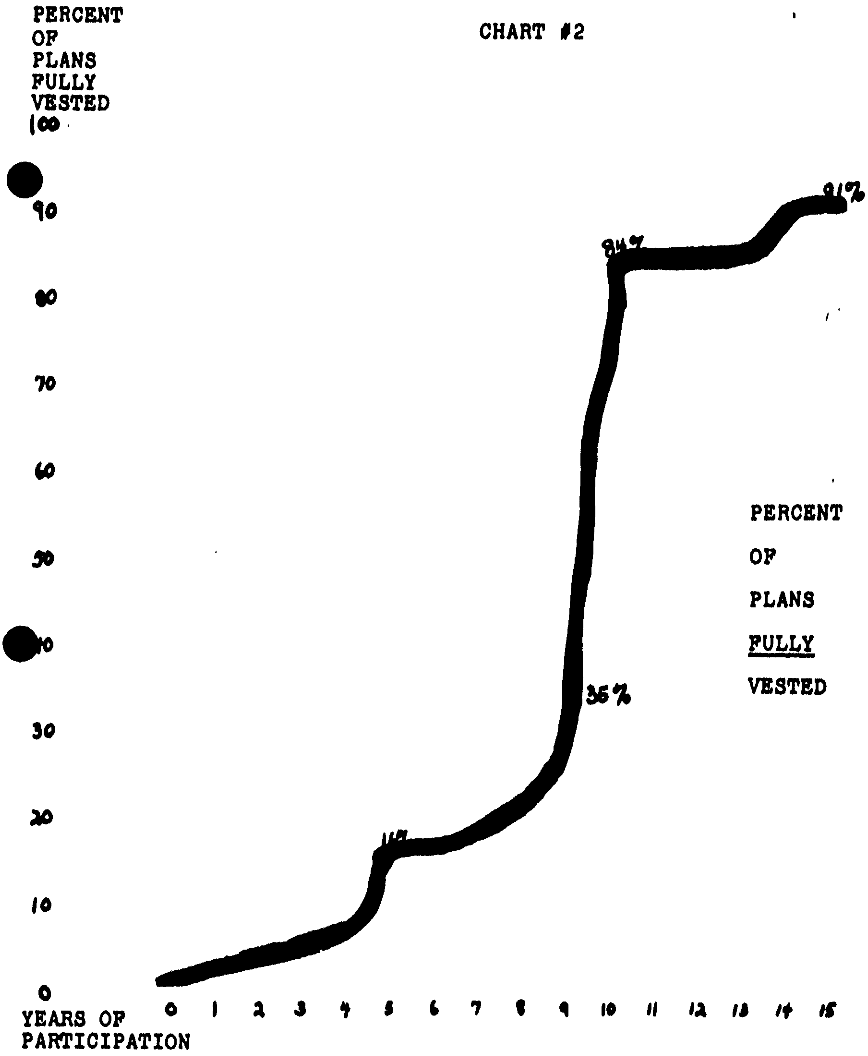


CHART #2



Senator NELSON. Mr. Richard Backe, chairman, Engineers Joint Committee on Pensions, accompanied by Johan Benson, American Institute of Aeronautics and Astronautics; James A. Scheeler, The American Institute of Architects; Walt R. Earley, American Institute of Chemical Engineers; Wilson Binger, American Institute of Consulting Engineers; Bill Miller, American Society of Mechanical Engineers & Engineers Joint Council; Paul Robbins, Executive Director, National Society for Professional Engineers; and Frank Cummings, counsel for Institute of Electrical and Electronics Engineers.

Go ahead. Do you have a prepared statement?

STATEMENT OF RICHARD BACKE, CHAIRMAN, ENGINEERS JOINT COMMITTEE ON PENSIONS, ACCOMPANIED BY JOHAN BENSON, AMERICAN INSTITUTE OF AERONAUTICS; JAMES A. SCHEELER, AMERICAN INSTITUTE OF ARCHITECTS; WALT R. EARLEY, AMERICAN INSTITUTE OF CHEMICAL ENGINEERS; WILSON BINGER, AMERICAN INSTITUTE OF CONSULTING ENGINEERS; CHARLES STEVENS, AMERICAN SOCIETY OF CIVIL ENGINEERS; BILL MILLER, AMERICAN SOCIETY OF MECHANICAL ENGINEERS; PAUL ROBBINS, NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS; LARRY SPILLER, CONSULTING ENGINEERS COUNCIL

Mr. BACKE. Thank you.

Senator NELSON. May I start by asking the witnesses that accompanied you to identify themselves?

Mr. ROBBINS. Paul Robbins, executive director, National Society of Professional Engineers.

Mr. CUMMINGS. Frank Cummings, a member of the law firm of Gall, Lane & Powell, counsel for the Institute of Electrical and Electronics Engineers.

Mr. EARLY. American Institute of Chemical Engineers, Walt R. Early.

Mr. STEVENS. The American Society of Civil Engineers. I am Charles Stevens.

Mr. MILLER. Bill Miller, American Society of Mechanical Engineers & Engineers Joint Council.

Mr. BACKE. Mr. Chairman, there are several other societies that have joined us in this. Some of them are not with us, but they are identified in the statement you just read.

Mr. Chairman, the engineers and scientists and architects of the United States would like to direct your attention to what we feel is a problem that may be unique to the highly qualified technical professionals that represent our country.

We have perhaps a unique problem because the changes in technology in the United States, which have been occurring very rapidly in the decades past, and the changing national priorities, have forced the average engineer to move from job to job pursuing these technologies, on the average every 5 years.

In examining the pension plan for the average engineer we find the vesting requirements run between 10 and 15 years minimum, and as a result we find that most engineers, scientists, and architects are constantly forfeiting all of their accrued pension credits as they move from one job to the next. Looking ahead——

Senator NELSON. I am sorry, but you are talking about current plans? You said 10 or 15 years——

Mr. BACKE. Yes, the current plans.

As we surveyed the members of the various professional societies we represent here, we find that our typical member has been working about 20 years in the profession, and in that length of time he has had about four different employers, and therefore, on the average he has worked for 5 years for each employer.

Senator NELSON. How does the vesting provisions of the three bills, that is, the bill report by the Labor and Public Welfare Committee and the two bills pending here, handle the problem?

Mr. BACKE. The rule 50 bill would not help, certainly, the younger engineers. The provision for individual retirement accounts would address part of the problem. In other words, if each employed engineer were allowed the same privilege that self-employed professionals have now, that would somewhat help the problem because he could start taking some of his own money and put it in a tax deferred plan.

Senator NELSON. Wouldn't the vesting provision of S. 4, and Senator Bentsen's bill help?

Mr. BACKE. As you recall, the provisions of S. 4 begin to vest the engineer or any other employee at 8 years. What we are saying is, the average engineer stays no more than 5 years.

Senator NELSON. Senator Bentsen's plan is 5 years.

Mr. BACKE. At that point, if the engineer has left his job, he would have accrued some credits under Senator Bentsen's plan but not in proportion to his service to the employer.

In this regard the engineer is no different from any other highly mobile worker in the work force, but in one regard the Internal Revenue Code does discriminate against the engineer or any other similar professional, in that he is not permitted to set up a plan of his own, run by his own professional society, which might provide him with immediate vesting. He can't do this because he is part of the group of people we call the higher paid employees. The engineers are willing to accept a lower annual benefit from a plan which they would run themselves. They would accept the exact same contribution from employers as they make to their own plan, if we can just have this in our own plan. And therefore, we would vest it immediately in our own plan.

What we are talking about is similar to what the teachers have now in their teachers annuity plan, but we are unable to get a satisfactory ruling to enable us to set up a plan like that. Failure to get that, the individual retirement account amendment would help us, but the engineers that did not vest with their employers would be constantly foregoing those credits they are accruing. It doesn't seem fair to ask them to forego that and have to use all of their own money to set up a pension plan.

We are really asking for a twofold thing: one, allow us to set up an engineers only plan which will not be discriminatory as to employer costs. We are only asking the same money from the employer that he is presently attributing to any other employee he has, but he would put it in a plan or plans run by the professional society in the same way that the teachers annuity plans run and vest the person immediately so he would carry with him from job to job the pension credits he has. That could be done by administrative ruling, but failing to get the proper administrative ruling, we would need enabling legislation.

Second, we would like an extension of the Keogh plan; extension of the limits of it both to help the self-employed engineer and the employed engineer. And the provisions of the bill before this committee in large part satisfy that requirement, but there are some exceptions I would like to note.

Senator NELSON. You would extend the provisions of Keogh to all other employees?

Mr. BACKE. That is correct, and some parts of the bills do that. The bills before you now do provide that for all employees, and we are only asking that the same thing be given to all other employees.

We would like to note the following: The entry salary of an engineer now, who has completed his training of 4 or 5 years, is around $10,000 a year. At the highest point in his career an engineer might be earning between $15,000 and $20,000. In one of the bills before you now, the Curtis bill, S. 1631, there is a limit of $1,500 for an engineer who is corporately employed; that is the maximum that he can invest in an individual retirement account, and, further, there is a provision that that amount will be reduced by the amount of the employer's contribution to an employer's plan for him.

Now, since most employer's plans are level benefit plans, the costs are difficult to determine. So the bill further provides that if there is no definite attributable amount, the offset must be 7 percent of the person's salary. Well, it doesn't take a whole lot of arithmetic to show an engineer making $20,000 a year, offsetting by 7 percent of his salary would only have $100 a year that he could put away in his individual retirement account. But the whole purpose of extending the Keogh plan is to encourage initiatives of private pension planning. The FICA base is $10,800 a year. That is bedrock. There is really no initiative to the higher paid employee whether self-employed or employed.

At least one bill provides adequate limits. It has a limit of 20 percent and $7,500. So the concepts of the Keogh plan are good, but the limits would have to treat the professional employee in terms of his salary or there would be no incentive for him to do anything under that bill.

There are only a couple of other points we would like to emphasize. It is possible that, if an engineer or any other professional has funds in a private account or private pension plan, and is forced because of changes in his profession, or job, or assignment to move those funds from one plan to another, under present law he is taxed in that year when the funds are taken out of one qualified account to move to another.

Provisions in a couple of the bills allow lump sum disbursements, in any 1 year as long as the funds are redeposited in another pension plan, without taxation that year. In other words, the tax can be deferred.

We favor many of the reforms of S. 4 and other bills before this committee. The general reform aspects are not uniquely required by us—we need them the same as any other employee. We would like to see speedy action on these.

We had incorporated into S. 4 an amendment which would insure that, if some of the problems of engineers and scientists are not properly treated by the bills before the Congress this year, the Congress would direct a special study to look into the problems not only of engineers and scientists but also any other highly mobile workers, and determine if they are in fact properly taken care of by this legislation. If not, we ask that an amendment be drafted to present legislation to insure that they are taken care of.

In closing, Mr. Chairman, I would just like to point out that the tremendous degree of mobility that engineers have now in their professions is not a matter of their own choice. It is a requirement of the changing technologies and priorities of this country, and it would be bad for this country if we did not encourage a continuation of that mobility because it is only by having that mobility that this country can make best use of its technical resources.

I suggest if the pensions were properly taken care of for engineers and scientists, they would be able to concentrate on the job in front of them and do a better job and worry a lot less about their own retirement program.

Senator NELSON. Thank you very much. Do any of you wish to add anything?

Mr. CUMMINGS. Mr. Chairman, I would like very briefly to explain to you the technicality which has hung this up.

Section 401 of the Internal Revenue Code provides that a plan may not discriminate in favor of a highly compensated employee. Now, I won't get into the statistics, the average income of an engineer—and Mr. Backe is very fond of explaining that he worked his way through engineering school as a plumber and figured out he would have netted at his age right now more money as a plumber than as an engineer. Still and all, the engineers are, for statutory purposes, highly compensated employees. That means that the statute prohibits the plan from "discriminating" in their favor.

Now, we go to the IRS and we say to the IRS, we don't want a plan to discriminate in our favor. Here's what we want. We want a plan where the contribution rate is such that we can say to the employer, "take us out from under your plan; we are not getting anything from your plan anyway; and figure out what the contribution to your plan was with respect to each year of our service; and make the same contribution rate to our plan. The only difference is going to be that we will take a lower benefit level in our plan, in exchange for 100 percent immediate vesting."

What we are saying is, we will take the same pie and slice it differently for us, but it won't cost the employer any more. The contribution rate by definition won't be discriminatory.

But the IRS now takes the position that no such plan can qualify for "highly compensate" engineer employees. What this means is that we are now doomed to stay under plans without the kind of vesting we need, and, even though we would take a lower benefit level to get a plan with the kind of vesting we need, the IRS says that the minute you do that, you disqualify the whole thing.

Now what this does is create a situation whereby a section of the code, 401, which was designed to prevent discrimination in favor of highly compensated employees, makes it absolutely certain that the code is interpreted to guarantee discrimination against higher paid employees.

That is not only discrimination, but a complete forfeiture, by the highly compensated employees, of what they are entitled to.

The IRS only litigated this question once, and they lost, and the case is cited in our prepared statement, *United States* against *Hall*, eighth circuit. And notwithstanding the fact they lost in the eighth circuit, they adhere to the position they took before then.

We are confident that, if the eighth circuit sees fit to interpret this code in a way that would be equitable to engineers, then the IRS could quite legaly interpret it that way. We solicit your support and the support of your committee on behalf of an application which has been sitting at the IRS for quite some time on the qualification of such a plan, because they will not say yes and they will not say no.

In the meantime, we are stuck with a series of rulings which are grossly unfair to us and anyone else similarly situated.

So, if you could see your way clear to use your good offices to move the IRS a little, that would be nice. And, if so, if we fail then, we solicit your support for a change of the law.

Senator NELSON. Well, you make some very good points, and I will ask our staff experts to take a look at the issue that you raise so that we can consider it in full committee. Thank you very much, gentlemen.

[The prepared statement of Richard Backe follows:]

PREPARED STATEMENT OF RICHARD BACKE

Mr. Chairman, members of the committee, good afternoon. My name is Richard Backe. I am delighted to have been invited here today to testify in behalf of several technical/scientific/professional societies which together represent more than 424,000 architects, engineers, and scientists in the United States.

Supporting by appearance today, and joining in this testimony, are the following societies:

The American Institute of Aeronautics & Astronautics (AIAA) represented by Johan Benson.

The American Institute of Architects (AIA) represented by James A. Scheeler, AIA.

The American Institute of Chemical Engineers (AIChE) represented by Walt R. Earley.

The American Institute of Consulting Engineers (AICE) represented by Wilson Binger.

The American Society of Civil Engineers (ASCE) represented by Charles Stevens.

The American Society of Mechanical Engineers (ASME) represented by Bill Miller.

The National Society of Professional Engineers (NSPE) represented by Paul Robbins.

The Engineers Joint Council represented also by the ASME representative Bill Miller.

The Consulting Engineers Council (CEC) represented by Larry Spiller.

I represent the Institute of Electrical and Electronics Engineers (IEEE) in addition to being the spokesman of this group. I am also accompanied by Frank Cummings, Esq., special counsel to IEEE.

Our statement urges certain improvements in the private pension system. These are *absolutely required* if the Congress wishes to provide adequate protection for the pensions of our technical work force. We are authorized to speak only for those societies listed above. However, we are confident that the problems and proposed solutions are equally applicable to the vast majority of the million and a quarter engineers, architects, and scientists in the United States.

Bearing witness to the universality of this problem is the text of the Employment Guidelines, formally endorsed by 15 technical societies which together represent over 406,700 engineers and scientists and presented to major employers at several engineer-industry conferences. A copy of the guidelines is attached.[1]

THE PROBLEM

In the past three decades, the changing interests of the United States, as well as rapid advances in technology, have forced a new way of life on American engineers. As a result, their careers are punctuated by frequent transfers to

[1] Appendix A.

other companies with attendant forfeitures of all retirement credits. Since future technology changes are likely to be even more frequent and since present law *discriminates against* the engineer, architect, and scientist, we are faced with the prospect of increasing numbers of retired technical personnel becoming burdens on the public welfare systems—

This, despite the fact that engineers, architects and scientists will have dedicated their entire 40-year career to the public's best interests as dictated by their professional ethics.

This, despite the fact that the great majority of these individuals are marked by strong traditions of independence and self-reliance, and are quite willing to be provident in their own behalf.

This, despite the fact that many are "covered" by private pension plans which were conceived by employers of the highest repute and with the best of motives.

And this, despite the fact that the Government has codified many requirements dealing with private pension systems to *ensure* equitable treatment *to all* workers.

PROFILE OF AN ENGINEER

The studies of many technical societies,[8] supported by post censal surveys, provide us with the following facts about a typical engineer or scientist:

(1) He or she is employed, *normally* by private industry and frequently in a manufacturing concern with other non-professional employees (although a significant *minority* work for public agencies, are self-employed, or are members of consulting firms.)

(2) He or she is about 40 years old, has at least a bachelors degree, and is earning $15,000 to $20,000 per year.

(3) He or she has worked for 20 years, changing employers on the average *every 5 years.*

(4) He or she has been and still is covered by pension plans *with 10 to 15 year vesting* requirements. As a result of his mobility, the individual professional has *forfeited all or most retirement credits* associated with his prior employment and *is likely to continue this pattern* (albeit at a lower mobility rate).

Although a profile of an average U.S. architect is not available, it would be undoubtedly similar to the characteristics listed above. All averages, medians and modes are debatable and disputable (particularly among engineers and scientists). And, in fact, there are many individuals in these professions who have acquired significant vested interests in retirement plans—*but* these *are not typical.* They are simply winners of the pension lottery.

THE SOLUTION

Although voluntary action on the part of U.S. employers, coupled with mandatory response to legislation pending before this Congress, will begin to attack the vesting problem for the average U.S. employee, a majority of these reforms do *not* deal with the problem of the *typical engineer, architect or scientist.* The solution to our problem depends on *immediate or early vesting* in any plan that purports to provide retirement security for engineers, architects and scientists.

Our members *can* achieve immediate vesting if this Congress will:

(a) Provide for all engineers, architects and scientists (as well as all other U.S. workers) the opportunity to invest a portion of their own salaries in tax-deferred, qualified individual retirement accounts (i.e., the extended "Keogh" plan for common law employees), N.B. It also follows that the amount the individual should be permitted to invest must be sufficiently high to provide a reasonable pension fund, whether that person is a corporate employee or is self-employed.

(b) Provide to all engineers, architects and scientists (as well as other similarly affected professional employees) the opportunity to run an "engineers-only", or "architects-only" multi-employer pension system similar to the well known university teachers' plan (i.e., TIAA/CREF), with immediate vesting—consistent with the requirements that the *employers* cost be the same.

QUALIFIED INDIVIDUAL RETIREMENT ACCOUNTS

Allowing *each employed* engineer/architect/scientist to invest his or her own money in an individual retirement program and to defer taxes until these funds

[8] Appendix B.

are used in consistent with the treatment presently afforded the majority of other professionals—that is, to most doctors and lawyers, as well as to those architects, engineers and scientists who are self-employed.

Such extension of the Keogh concept will encourage individual thrift. This approach also has the advantage that all engineers/architects/scientists can immediately participate (as soon as enabling legislation is passed—they need not wait for action by their respective employers).

In the ideal, the invested amount that would be tax-deferred should be limited to no less than an annual amount which will result in accruing a fund sufficient to provide a retirement income reasonably related to the individual's pre-retirement salary. Such limits should apply equally to the employed and self-employed engineer, architect and scientist. It is reasonable that an allowed individual deferral could be offset by an *employer's* contribution, *but* only to the extent that such contribution *vested* to the employee in the year in question.

Such tax deferrals are provided for in section 8 of S. 1631, the Curtis bill, and its companion House bill, H.R. 7157. The provisions of S. 1179, the Bentsen proposal, provide a similar option through a tax credit.

There is no comparable feature in S-4, the reform bill now on the Senate calendar, nor could there be in that bill, given the Constitutional requirement that tax measures originate in the House.

In whatever bill, and through whatever Parliamentary technique, the Congress finally takes action, we urge you to consider extending Keogh plans to employed individuals ("common law employees") while considering:

(a) that tax deferral amounts should be high enough to provide reasonable income but should otherwise be proportionately equal for all individuals—professional and tradesman, employed or self-employed

(b) that no employer "offset" be mandated unless the employer's contribution is vested in the year of such offset

(c) that provision be made for tax-deferred, lump-sum disbursements from such plans when employment circumstances require transfer from one qualified plan to another.

ENGINEERS/ARCHITECTS/SCIENTISTS-ONLY PLANS

Complete reliance on qualified, individual retirement accounts would mean the employed engineer/architect/scientist would forego, for all practical purposes, any reasonable chance of collecting a pension based on contributions presently being invested in his behalf in his company's plans. This problem could be solved by *permitting* the individual's employer to invest this *same* amount of money in an "*engineers-only plan run by the professional/technical societies.* Such plans would feature *immediate vesting* and maximum portability as between different societies' plans. Participation by both employer and employee would be voluntary.

This treatment is consistent with that afforded to teachers (under the TIAA/CREF plan) and, in one respect, to highly compensated airline pilots.

Such multi-employer funds are also common among many craft unions. Bricklayers, carpenters, plumbers, electricians, and laborers all have some degree of "portability" when they move from employer-to-employer as dictated by the needs of their work. (Engineers, architects, and scientists contemplate no move to collective bargaining to solve their problems, but even if they did, it would not solve their problems with respect to IRS qualification of an immediate vesting, engineers-only plan.)

Unfortunately, the IRS has been taking the position that no such engineers/architects, scientists-only, immediately-vested, multi-employer pension plan can qualify, if the employer's own Corporate pension plan does not also provide immediate vesting—*even if* the engineers/architects/scientists are prepared to accept the same rate of contribution to their plan as the employer was making to his own plan, *and even if* the consequence is that the engineers/architects/scientists plan generates a *lower annual benefit accrual* (although vested) for each year of service.

The IRS stated this position in the 1960's in Revenue Rulings 65-266, 66-15. But in the only case in which the issue was litigated, the IRS *lost*. United States v. Hall, 398 F.2d 383 (8th Cir. 1968). And yet the IRS *continues* to adhere to this position. Revenue Rulings 71-503, 71-150. And the result is that a section of the Code designed to prohibit discrimination *in favor* of "highly compensated" employees guarantees that the private pension system will discriminate *against* them, when they are engineers/architects/scientists.

We do not ask for discrimination in our favor. We ask only for equal treatment—which the IRS presently denies us.

We have an application pending at the Treasury Department on an informal basis, but it has been pending quite a while, and it seems to be "stuck" at the moment.

If that application receives no favorable treatment soon, then we would urge that enabling legislation be enacted to prevent loss of additional time in setting up the kind of a pension plan—the only kind of a pension plan—which will do professional engineers/architects/scientists any real good.

We emphasize that we are willing to accept a contribution rate no greater than the employer's contribution rate for his own plan, and we are willing to be excluded from his plan, in favor of ours.

We emphasize that we are willing to accept annual benefit accruals *lower* than the benefit accruals under the employer's own plan, if the accruals under our plan are immediately vested (providing inherent portability).

And we emphasize that we are not asking a "loophole' 'to enable us to "get away with something". We simply urge that the Code either be interpreted or amended to permit us to do what any group of craftsmen can already do—design a pension plan which will provide a decent chance for our members to get *something* because present rulings too often leave us with nothing.

IMPROVED OPPORTUNITIES FOR SELF-EMPLOYED

Self-employer engineers/architects/scientists who invest in pension plans for themselves and their employees must be given a more generous tax deduction than they now receive. Under present law, self-employed persons may establish pension plans covering themselves and their employees. However, deductible contributions are limited. There are no such limits to contributions made by corporations on behalf of their employees.

To achieve greater equity, we propose that the annual limit for deductible contributions by the self-employed be raised. The limit suggested in S-1631 for self-employed individuals would be acceptable. This provision would encourage and enable the self-employed to provide more adequate benefits for themselves and for their workers.

Of course, by this we do not mean to urge that the limit on contributions be higher for self-employed than for corporate employees and whatever limit is adopted should be the same for both.

OTHER REFORM ISSUES

As a group, engineers/architects/and scientists are very interested in other features of legislative proposals. We strongly favor early eligibility, proper fiduciary standards, full disclosure, realistic enforcement provisions, proper funding schedules and practical and adequate insurance provisions. The concept of voluntary portability is attractive (although the best portability rests in immediate vesting and deferred-tax, lump-sum transferability).

Since these are problems we share in common with the other thirty million U.S. employees covered by the private pension system, we do not advance any unique reasons for these reforms. We also have no strong, unanimous convictions about the choice of the cognizant agency(ies) to administer any new laws, believing our interests will be well served by whatever group this Congress selects.

Our only recommendation regarding these aspects of reform legislation is to urge *speedy* action. The problem has been studied long enough.

PROPOSED ACTION

We ask this Congress to consider our specific needs in the bills already before it. If *both* the *Keogh extension* and the *multi-employer, engineers/architects/scientists—only plans* cannot be obtained by legislation (or Administrative ruling) in this session, we ask for an amendment that will ensure that the problems of all high mobility workers are further analyzed *this year*. Such a proposal is already included in section 101(c)(1)(B) of S.4, and we urge its enactment as part of *any* bill which Congress approves.

Such provisions will do much to allay the fears of our Nation's professional and technical work force that pension reform will end with the passage of current legislative proposals, and that the economic welfare of scientists, architects and engineers will be ignored.

CONCLUSION

In summary, we ask only for *equity* under the law, and for the opportunity to exercise more individual initiative in providing for our retirement. We ask for the opportunity to turn our exclusive attention to the problems that confront this Nation and the world. We ask this Congress to re-examine the value of pension plan provisions that retard proper application of one of this Nation's greatest assets, namely, its professional and technical ingenuity.

If we as professionals must continue to worry excessively about our families' welfare—

If we must stay in jobs long after our unique contributions as architects, scientists or engineers have been made—

If we cannot go where the "action" and challenge is—

—Then, the cost to this Nation will be measured in inefficiencies that will greatly outweigh deferred tax revenues. It may be measured in continued human suffering, less progress in pollution abatement, and loss of world technological and economic leadership.

We ask your help to ensure our Nation does not pay this price for inaction in required reforms.

APPENDIX A

GUIDELINES TO PROFESSIONAL EMPLOYMENT FOR ENGINEERS AND SCIENTISTS

SUPPORTED AND ENDORSED BY THE FOLLOWING SOCIETIES

American Association of Cost Engineers.
American Institute of Chemical Engineers.
American Institute of Industrial Engineers.
American Nuclear Society.
American Society of Civil Engineers.
American Society of Mechanical Engineers.
Engineers Council for Professional Development.
Engineers Joint Counsel.
Institute of Electrical and Electronics Engineers.
Institute of Traffic Engineers.
Instrument Society of America.
National Institute of Ceramic Engineers.
National Society of Professional Engineers.
Society of Fire Protection Engineers.
Society of Women Engineers.

This document is subject to periodic review by the participating societies for the purpose of keeping it current. Suggested amendments will be considered collaboratively in connection with future revised editions.

FOREWORD

This publication is a guide to mutually satisfying relationships between professional employees and their employers. In this document, professional employees are defined as engineers and scientists. These Guidelines cover factors peculiar to professional employment, and omit many generally accepted precepts of personnel relations which are common to all classifications of employees.

These Guidelines are applicable to professional employment in all fields and in all areas of practice (including both non-supervisory and supervisory positions), and are based on the combined experience and judgment of all of the endorsing societies.

It must be stressed in the implementation of these Guidelines that they represent desirable general goals rather than a set of specific minimum standards. Wide variations in circumstances and individual organizational practices make it inappropriate to judge any given employer on the basis of any single employment policy or fringe benefit. Rather, attention should be devoted to evaluating the entire employment "package", including such intangibles as opportunity for future advancement or participation in profits, location, local cost of living, and other factors which may be important to professional employees.

Observance of the spirit of these Guidelines will minimize personnel problems, reduce misunderstandings, and generate greater mutual respect. It is anticipated that they will be of use to employers in evaluating their own practices, to professional employees in evaluating both their own responsibilities and those of their employers, and to new graduates and other employment seekers in obtaining a better picture of prospective employers. Where differences in interpretation occur, they may be referred to the headquarters office of any of the endorsing societies.

OBJECTIVES

The endorsing societies, with their avowed purpose to serve the public and their professions, recognize clearly that in order to make a maximum contribution, It is necessary for professional employees and employers to establish a climate conducive to the proper discharge of mutual responsibilities and obligations.

Essential and prerequisite to establishing such a climate are:

1. Mutual loyalty, cooperation, fair treatment, ethical practices, and respect are the basis for a sound relationship between the professional and his employer.

2. The professional employee must be loyal to the employer's objectives and contribute his creativity to those goals.

8. The responsibility of the professional employee to safeguard the public interest must be recognized and shared by the professional employee and employer alike.

4. The professional growth of the employee is his prime responsibility, but the employer undertakes to provide the proper climate to foster that growth.

5. \Factors of age, race, religion, political affiliation, or sex should not enter into the employee/employer relationship.

Effective use of these Guidelines is accomplished when the employer provides each present and prospective professional employee with a written statement of his policies and practices relating to each of the items covered. Adherence to these guidelines by employers and professional employees will provide an environment of mutual trust and confidence. Local conditions may result in honest differences in interpretation of, and in deviation from, the details of these guidelines. Such differences should be resolved by discussions leading to understanding which meets the spirit of the guidelines.

I. RECRUITMENT

Employment should be based solely on professional competence and ability to adequately perform assigned responsibilities, with employee qualifications and employment opportunities represented in a factual and forthright manner. The employer's offer of employment and the employee's acceptance, should be in writing, including a clear understanding with regard to relocation assistance; past, present and future confidentiality and patent obligations; salary; expected duration of employment; and other relevant employment conditions and benefits.

Professional Employee

1. The professional employee (applicant) should attend interviews and accept reimbursement only for those job opportunities in which he has a sincere interest. The applicant should prorate costs for multiple interviews during a given trip on a rational basis. The guiding principle should be that the applicant receives neither more nor less than the cost of the total trip.

2. The applicant should carefully evaluate past, present, and future confidentiality obligations in regard to trade secrets and proprietary information connected with the potential employment. He should not seek or accept employment on the basis of using or divulging any trade secrets or proprietary information.

8. Having accepted an offer of employment, the applicant is morally obligated to honor his commitment unless formally released after giving adequate notice of intent.

4. The applicant should not use the funds or time of his current employer for the purpose of seeking new employment unless approved by the current employer.

Employer

1. The policy of the employer regarding payment of expenses incurred by the applicant in attending the interview must be made clear prior to the arranged interview.

2. The applicant should have an interview with his prospective supervisor in order to understand clearly the technical and business nature of the job opportunity. This prospective supervisor should ethically be responsible for all representations regarding the conditions of employment.

3. Applications for positions should be confidential. The expressed consent of the applicant should be obtained prior to communicating with a current employer.

4. Employers should minimize hiring during periods of major curtailment of personnel. Hiring of professional personnel should be planned at all times to provide satisfying careers.

5. Agreements among employers or between employer and professional employee which limit the opportunity of professional employees to seek other employment or establish independent enterprise are contrary to the spirit of these guidelines.

6. Having accepted an applicant, an employer who finds it necessary to rescind an offer should make adequate reparation for any injury suffered.

II. TERMS OF EMPLOYMENT

Terms of employment should be in writing, in accordance with the applicable laws, and consistent with generally accepted ethical professional practices.

Professional employee

1. The professional employee should be loyal to his employer. He should accept only those assignments for which he is qualified; should diligently, competently, and honestly complete his assignments; and he should contribute creative, resourceful ideas to his employer while making a positive contribution toward establishing a stimulating work atmosphere and maintaining a safe working environment.

2. The professional employee should have due regard for the safety, life, and health of the public and fellow employees in all work for which he is responsible. Where the technical adequacy of a process or product is involved, he should protect the public and his employer by withholding approval of plans that do not meet accepted professional standards and by presenting clearly the consequences to be expected if his professional judgment is not followed.

3. The professional employee should be responsible for the full and proper utilization of his time in the interest of his employer and the proper care of the employer's facilities.

4. The professional employee should avoid any conflict of interest with his employer, and should immediately disclose any real or potential problem which may develop in this area. He should not engage in any other professional employment without his employer's permission.

5. The professional employee should not divulge technical proprietary information which he is employed. Furthermore, he should not divulge or use this information for an agreed upon period after employment is terminated.

6. The professional employee should only sign or seal plans or specifications prepared by himself or others under his supervision, or plans or specifications that he has reviewed and checked to his personal satisfaction.

7. The professional employee should not accept payments or gifts of any significant value, directly or indirectly, from parties dealing with his client or employer.

Employer

1. The employer should inform his professional employees of the organization's objectives, policies and programs on a continuing basis.

2. The professional employee should receive a salary in keeping with his professional contribution which reflects his abilities, professional status, responsibility, the value of his education and experience, and the potential value of the work he will be expected to perform. The salary should be commensurate with the salaries of other employees both professional and nonprofessional. Sound indirect compensation programs should be provided. The most important are retirement plans, health and life insurance, sick leave, paid holidays and paid vacations.

3. The employer should establish a salary policy, taking into account published salary surveys, and provide equitable compensation for each employee commensurate with his position and performance. The salary structure should be reviewed annually to keep the assigned dollar values adjusted to the current economy.

4. Each individual position should be properly classified as to its level in the overall salary structure. The evaluation of each position should consider such factors as the skill required for acceptable performance, the original thinking

required for solving the problems involved, and the accountability for an action and its consequences.

5. Economic advancement should be based upon a carefully designed performance review plan. Provisions should be made for accelerated promotions and extra compensation for special accomplishments. At least annually, performance evaluations and salary review should be conducted for the individual professional employee by his supervisor. Performance evaluations should include discussion on how well he has performed his work and what he can do to improve. The professional employee should be clearly informed if his performance is considered unsatisfactory. All promotions in salary and responsibility should be on an individual merit basis.

6. For the professional employee whose aptitude and interests are technical rather than supervisory, equivalent means of advancement and recognition should be provided.

7. It is inappropriate for a professional employee to use a time clock to record arrival and departure, particularly since situations may arise which require unusual effort on his part. However, if the work demanded of a professional employee regularly exceeds the normal working hours for extended periods, the employer should compensate him for this continuing extra effort according to a clearly stated policy.

8. The professional employee should be included in an adequate pension plan which provides for early vesting of rights in safeguarded pension funds. Vesting should be so scheduled that it does not seriously affect either the employer's or the professional employee's decision as to continued employment. As a goal, eligibility for participation should not exceed one year after employment, maximum full vesting time should be five years, and the minimum pension upon reaching retirement should be no less than 50% of the average best five year's salary (based on a forty-year working career with a single employer). If a pension plan is not provided, or the benefits are less than outlined above, other compensation should be increased proportionately.

9. The employer should provide office, support staff and physical facilities which promote the maximum personal efficiency of the professional employee.

10. Duties, levels of responsibility, and the relationship of positions within the organizational herarchy should be clearly defined and should be accurately reflected in position titles.

11. The employer should not require the professional employee to accept responsibility for work not done under his supervision.

12. The employer should provide formal assurance through organizational policy that it will defend any suits or claims against individual professional employees employed by the organization in connection with their authorized professional activities on behalf of the employer.

13. There should be no employer policy which requires an engineer to join a labor organization as a condition of continued employment.

14. It is the employer's responsibility to clearly identify proprietary information.

III. PROFESSIONAL DEVELOPMENT

The employee and the employer share responsibility for professional development of the employee—the employee to establish the goals and take the initiative to reach them, and the employer to provide the environment and attitude which is conducive to professional growth.

Professional employee

1. Each professional employee is responsible for maintaining his technical competence and developing himself through a program of continuing education.

2. The professional employee should belong to and participate in the activities of appropriate professional societies in order to expand his knowledge and experience. Such participation should include the preparation of professional and technical papers for publication and presentation.

3. The professional employee should achieve appropriate registration and/or certification as soon as he is eligible.

4. The professional employee should recognize his responsibility to serve the public by participating in civil and political activities of a technical and nontechnical nature. Such participation, however, should be undertaken solely as a responsibility of the individual without interfering with the timely execution of his work and without involving the employer.

Employer

1. The employer, as a matter of policy, should provide an atmosphere which promotes professional development. This will include, among other programs, encouraging and supporting membership and attendance at professional society meetings and at formal courses of study which will enable the employee to maintain his technical competence.

2. The employer should consider compensated leaves of absence for professional study as a means of enabling the employee to improve his competence and knowledge in a technical field.

3. Consistent with employer objectives, the employee should be given every opportunity to publish his work promptly in the technical literature and to present his findings at technical society meetings.

4. It is in the best interest of the employer to encourage continuing education to broaden the qualifications of employees through self-improvement, in-house programs, formal education systems in the institutions of higher learning, and meetings and seminars on appropriate subjects.

5. The employer should encourage and assist professional employees to achieve registration and/or certification in their respective fields.

IV. TERMINATION AND TRANSFER

Adequate notice of termination of employment should be given by the employee or employer as appropriate.

Professional employee

1. If the professional employee decides to terminate his employment, he should assist the employer in maintaining a continuity of function, and he should provide at least one month's notice. When termination is initiated by the employee, no severance pay is due.

Employer

1. Additional notice of termination, or compensation in lieu thereof, should be provided by the employer in consideration of responsibilities and length of service. As a desirable goal, permanent employees (after initial trial period) should receive notice or equivalent compensation equal to one month plus one week per year of service. In the event that the employer elects notice in place of severance compensation, then he should allow the employee reasonable time and facilities to seek new employment.

2. Employers should make every effort to relocate terminated professional employees either within their own organizations or elsewhere. Consideration should be given to continuing major employee protection plans for some period following termination, and to their full reinstatement in the event of subsequent reemployment.

3. If a professional employee is involuntarily terminated on the basis of early retirement, the employer should consider an equitable provision for an adequate income for the period remaining until the employee receives his pension at his normal retirement age.

4. In a personal interview, the employer should inform the employee of the specific reasons for his termination.

5. The employer should provide an adequate transfer-time notice, with due consideration to the extent of personal matters which the professional employee must settle before moving. All normal costs of the transfer should be paid by the employer including moving expenses, realtor fees, travel expenses to the new location to search for housing, and reasonable living expenses for the family until permanent housing is found. Unusual moving expense reimbursement should be settled in a discussion between the employee and employer.

APPENDIX B

LIST OF CURRENT ARTICLES AND STUDIES ON ENGINEERS PENSION PLANS, FRINGE BENEFITS AND EMPLOYMENT CONDITIONS

1. *IEEE 1972 U.S. Salary and Fringe Benefit Survey*, the Institute of Electrical and Electronics Engineers, 345 East 47th Street, New York, New York 10017.
2. R. J. Backe, "Pension Reform, On the Way Needs Pushing," *SPECTRUM*, November 1972.

3. Pension Questionnaire, *SPECTRUM*, November 1972, op cit.
4. Engineer Mobility and Pension Survey, Sacramento Chapter, California Society of Professional Engineers, 1971.
5. Superior Pension Plan Helps Attract Employees, by Jack J. Schoustra and Richard Summerhays, *CIVIL ENGINEERING*, January 1972.
6. Guidelines: Employer-Engineer Relationship by the ASCE Committee on Employment Conditions, *ENGINEERING ISSUES*, October 1972.
7. Retirement Plan Study, by Arnold Olitt, Journal of Professional Activities Proceedings of the American Society of Civil Engineers, September 1970.
8. Needed: Practical Pension Plans for Engineers, by Janet Kotel, *MECHANICAL ENGINEERING*, December 1972.
9. Characteristics of America's Engineers and Scientists, 1960 and 1962. (Study in Cooperation with NSF), The Posteinsal Survey, Technical paper 21, U.S. Department of Commerce, Bureau of the Census.
10. Backe, R. J.; "You and Your Pension;" *SPECTRUM*; May 1973 and June 1973; the Institute of Electrical and Electronic Engineers, 345 E. 47th St., New York, N.Y. 10017 (Reprint No. X73-053, $1.50, available after June 1973).

Senator NELSON. Tomorrow we will meet at 10 o'clock in this room. The witnesses will be Senator Bentsen, Secretary Shultz of the Treasury, Mr. Seidman, director of Social Security Department of AFL-CIO, and also Mr. Robert A. Albright, vice chairman, Employee Benefits Committee of the National Association of Manufacturers, and chairman, vice president, administration, United States and Carnegie Pension Fund.

We will also have John R. Lindquist, Chicago law firm of McDermott, Will, and Emery on behalf of Profit Sharing Council of America, and also Robert G. Skinner, chairman, Division of Federal Taxation, American Institute of Certified Public Accountants.

[Whereupon, at 4:05 p.m. the subcommittee recessed to reconvene at 10 a.m., Tuesday, May 22, 1973.]

PRIVATE PENSION PLAN REFORM

TUESDAY, MAY 22, 1973

U.S. SENATE,
SUBCOMMITTEE ON PRIVATE PENSION PLANS,
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 a.m., in room 2221, Dirksen Senate Office Building, Senator Gaylord Nelson [chairman of the subcommittee] presiding.

Present: Senators Long [chairman of the full committee], Nelson, Ribicoff, Byrd, Jr. of Virginia, Bentsen, Bennett, Curtis, and Dole.

Senator NELSON. Our first witness this morning was to be Senator Bentsen. He has deferred to the Honorable George Shultz, Secretary of the Treasury.

Mr. Shultz, the committee is very pleased to have you here today.

I have an opening statement concurring these hearings and pensions legislations but, in order to save time, I will, instead of reading my statement, insert it in the record.

[Opening statement of Senator Nelson follows:]

STATEMENT BY SENATOR GAYLORD NELSON, CHAIRMAN, SUBCOMMITTEE ON PRIVATE PENSION PLANS

The Subcommittee on Private Pension Plans of the Senate Finance Committee yesterday commenced hearings on Private Pension Plans. These hearings will continue today and Wednesday of this week. Next week, on May 31, we begin the first of two panel discussions with the second panel to be held on June 4. These hearings and panel discussions are designed to present a full and objective review of all the pertinent legislative issues involving pension plans and the tax treatment for retirement savings. The witnesses and panel members have been selected to include, to the extent possible, all interested parties and viewpoints.

These hearings are taking place at, I hope and believe to be, a propitious time for the enactment of substantial pension legislation. For the past several years, members of Congress have learned about the workings of private pension plans from knowledgeable experts, from those who initiate and operate such plans, and also from individual employees who have found themselves deprived of pensions they had every right to expect on the basis of their employment. A consensus has developed, not only in Congress but by all interested parties, that certain legislated minimum standards are necessary to strengthen the private pension system.

Much of this consensus can be attributed to the hard work and leadership of the Chairman of the Labor and Public Welfare Committee, Senator Williams and its ranking minority member, Senator Javits. The culmination of this work, S. 4, now reported to the Senate by The Senate Labor and Public Welfare Committee represents a thoughtful and comprehensive approach to the problems of private pension plans. As previously announced, the principles and policies of S. 4 will be among the subjects before this Subcommittee along with bills introduced by two of its members, Senator Curtis (S. 1631) whose bill represents the thinking of the Administration, and Senator Bentsen (S. 1179). Also before the Subcommittee is Senator Griffin's bill (S. 75), one of the first proposed to deal with private pension plans.

Private pension plans have experienced a dynamic growth in the last 30 years. In 1940, only four million employees were covered by private pensions: today about 30 million employees participate in private pension plans. Total assets of pension plans have grown from $2.4 billion in 1940 to $151.8 billion in 1973.

This rapid growth of the private pension system has been directly attributable to the favorable tax treatment of employer contributions. The current tax code includes a number of regulatory provisions affecting the tax qualifications status of pension trusts. These hearings will explore for the first time possible changes in the tax code which may be necessary to strengthen the private pension system. In addition, a number of other tax issues have been presented to the Subcommittee, including, for example, tax deductions for retirement savings and the tax treatment of lump sum distributions from retirement plans.

We want to make certain that these hearings consider all viewpoints and we are interested in moving forward in the legislative process as promptly as possible so that the early consideration of these questions will be assured. It is our hope to complete consideration of pension legislation in time for Senate action prior to the August recess.

It seems to me that pension legislation should accomplish the following:

A minimum vesting standard that will assure private pension participants a retirement benefit after a reasonable period of service.

At present, only one out of every three employees participating in employer-financed pension plans has vested right to benefits. Moreover, 58 percent of covered employees between the ages of 50 and 60, and 64 percent of covered employees 60 years of age and over, do not have vested pension rights. As a result, even employees with substantial period of service may lose pension benefits on separation from employment. Extreme cases have been noted in which employees have lost pension rights at advanced ages as a result of being discharged shortly before they would be eligible to retire. In addition, failure to vest more rapidly is interfering with the mobility of labor, to the detriment of the economy.

A strengthened funding requirement that will assure continuing accumulation of funds to meet private pension obligations.

The available evidence suggests that many pension plans are adequately funded—but that a significant proportion of the plans have not been adequately funded. This is indicated, for example, by a survey made by the Senate Labor Subcommittee of 460 trustee-administered pension plans covering 7.1 million employees. In 1970, about one-third of the plans covering one-third of the participants reported a ratio of assets to total accrued liabilities of 50 percent or less; while 7 percent of the plans covering 8 percent of the participants reported a ratio of assets to accrued liabilities of 25 percent or less.

In general, the older plans are better funded than the newer ones. Over one-half of the plans covered by the study which were 6 years old or less had an assets-liability ratio of 50 percent or less, while 85 percent of the plans in existence for for 17 years to 21 years had 50% or more assets-liabilities ratio.

A system of plan termination insurance to protect the vested benefits of private pension participants.

Concern has also been expressed over the possible loss of pension benefits as a result of termination of pension plans. The Studebaker Case, which has been widely publicized, illustrates how pension benefits can be lost as a result of termination of a plan. When Studebaker closed its South Bend, Indiana, plant in 1964, the employees were separated and the pension plan was terminated. The plan provided fairly generous vested rights and the funding apparently would have been adequate had the firm remained in business and the plan continued in operation. However, at termination, the plan had not yet accumulated sufficient assets to meet all obligations. As a result, full pension benefits were paid only to employees already retired and to employees age 60 or over with 10 years or more of service. Little or no benefits were paid to large numbers of other employees, many of whom had vested rights.

A joint study by the Treasury Department and the Department of Labor indicates that there were 683 plan terminations in the first 7 months of 1972. These terminations resulted in the loss of $20 million of benefits (present value) by 8,400 pension participants in 293 of the terminated plans. The average loss of benefits for participants amounted to $2,400.

Serious consideration of procedures to assist the transfer of pension credits among different pension plans.

Strong provisions setting fiduciary standards and eliminating conflicts of interest in the management of pension funds.

Added requirements for private pension plans to report their financial and operating status to public authorities and above all to their individual participants.

Provisions to ensure that any new pension laws or regulations are not a burdensome problem to the participants, especially the small businessmen.

New tax provisions to improve the tax treatment of retirement plans of self-employed individuals and of employees not covered by pension plans.

Finally, these desired changes in the law regarding private pension plans will not weaken or destroy the private pension system. Quite the contrary, the system has proved a most useful mechanism for meeting the retirement needs of a large part of the working population. Our task is to reinforce this function by legislating certain key minimum standards so that the system itself can serve an even broader purpose in the years ahead.

Senator NELSON. Secretary Shultz, you have a prepared statement which will be printed in the record. You may present it any way you desire. I trust you have no objection to being interrupted for questions?

STATEMENT OF HON. GEORGE P. SHULTZ, SECRETARY OF THE TREASURY, ACCOMPANIED BY FREDERICK HICKMAN, ASSISTANT SECRETARY FOR TAX POLICY

Secretary SHULTZ. Thank you, Mr. Chairman.

Mr. Chairman, I do have a fairly lengthy statement that I would like to file for the record and we also have a fair amount of backup technical material that the Treasury will submit later for the committee.

Mr. Chairman, I sat down, after talking with you, and I see what is pasted to the desk here and it says that witnesses are not to read written statements, but to confine themselves to 10-minute oral presentations and then underneath it, it has "10 minutes" written and it is underlined twice with two arrows pointing at it. So, I will take the gentle hint and try to stick within that limit.

Senator NELSON. Mr. Secretary, that does not apply to you.

Secretary SHULTZ. Well, I believe that the rule should be applied impartially to everybody and I will do my best to live within that framework.

Senator NELSON. Mr. Secretary, we are permitting Senator Bentsen to take longer and we are permitting Senators Javits and Williams to take longer. They have all introduced bills and you are speaking for the administration so you may take all of the time you need.

Secretary SHULTZ. Thank you.

Senator NELSON. We don't give that to anybody but you four people.

Secretary SHULTZ. Well, I appreciate the privilege of being put in the category of such eminent Senators, and I will do my best to live within the rules.

First let me note that the administration has two bills before you that deal with pensions, the Retirement Benefits Tax Act and the Employee Benefits Protection Act.

The Tax Act deals with the types of things that the Treasury and the Internal Revenue Service has historically been administering having to do with the status of such matters as vesting and funding and things of that kind. That will be the act on which I will concentrate my remarks.

The Employee Benefits Protection Act deals with disclosure and fiduciary responsibilities and there has been a considerable expertise developed in the Department of Labor on that and I believe you have scheduled a Labor Department witness who will testify on that act.

Let me concentrate my attention on five points:

(1) The subject of vesting;

(2) The subject of funding, and some related comments about termination insurance;

(3) The question of self-employed;

(4) The question of employee deductions and their status; and, finally,

(5) A word or two about portability.

First on the subject of vesting. Let me ask you to look at chart No. 2 which appears at the back of the testimony that you have. This chart is label "Effect of rule of 50 on vesting" but I want to call your attention to the first column which lists percent now vested. Have you got that? And the striking think about this chart is that it shows for all age groups, 32 percent have vested rights and you can see that even as you go up to the higher age group, the 40 to 50 age group, it is 38 percent; the 50 to 60 group, 42 percent; 60 or more, 46 percent. You are still under half who have vested rights, however.

Now, vesting being such an important element of the general security afforded by a private pension plan, because of that it seems to us to be a set of figures that cries out for doing something about it, and for providing a requirement for vesting as part of the qualification aspect of pension plans.

What we have sought is a vesting rule that does effectively provide vesting and which particularly structures the incentives so that it works better and better as people get older and older. So, if you compare again on chart 2 the second column with the first, you can see that under the rule of 50, as we propose it, at the very young age group, you don't have any change in the number vested but as you move up and get to the 40 and 50 year-olds, you have 82 percent vested. As soon as you hit 50, it is 100 percent vested.

So the rule of 50, we think, works well and provides vesting where it is most needed.

Now in chart 1, you have a somewhat more detailed explanation of how the rule of 50 would work, that is, how it would work in operation, and it is charted according to the age at entry, and then the age, as you go along, it shows where you would hit 50 percent vesting and where you would hit full vesting under the plan that we propose.

Now, chart 3 deals with the costs and I think, as we address changes in the private pension plans, which represent very large commitments and judgments made by employers and unions and employees, one must do what we think is right about them that is necessary to do and, at the same time, we have to be conscious of the cost. I think this chart shows that the costs under the rule of 50 are moderate costs.

Finally, in arguing (a) for vesting and (b) for the rule of 50 approach to vesting, let me call your attention to chart 3—no, it is chart 4—well, let me make a point without the chart in terms of the question of the impact of pension plans on the employers' willingness to hire an older worker. It seems to me this is one thing we must have on our minds. Do we, by virtue of the private pension system, and what we may do to it, tend to lead the employer in the direction of being unwilling to hire older workers or not, or what effect are we going to have?

The way in which this particular plan is structured, it implies a somewhat higher cost for the employer for a younger worker than it does for an older worker, and the reason for that is that the younger worker tends to have higher turnover at a particular employer's location than the older worker does once the older worker is hired. So, if a vesting requirement is imposed and the younger worker is vested and he leaves and goes to another employer, if he, in other words, does not stay until retirement, that is more costly to the employer than if you have a worker that stays all of the way to the end and winds up drawing retirement benefits.

Senator NELSON. Why is that more costly?

Secretary SHULTZ. It is more costly because when you have turnover, the employee who leaves, in effect, takes that vested right out of the system. Whereas an older worker who on a probability basis tends to stay employed all of the way to the end doesn't start drawing his rights until he actually retires. That is the situation now.

You don't change the situation as much by requiring vesting say, for a 55-year-old as you would for a 35-year-old.

Senator NELSON. Just so that it is clear for the record, the cost factor you are discussing has nothing to do with the inherent provisions of the pension proposal? It has to do with the fact that young people are more likely to leave the job than older people?

Secretary SHULTZ. Right. You say that, all right, here is a situation where whatever degree of vesting there is—and say the degree of vesting is in chart 2, the first column that I have called attention to—now, let's say that is the situation in an individual plan and then by virtue of a law that you enact, you change, in effect, how that plan is going to operate by requiring vesting. And then you ask yourself how much additional cost has been imposed on the employer for, let us say, a 30-year-old worker and how much additional cost has been imposed for a 55-year-old worker.

The older worker will have a lesser additional cost, mainly because you haven't changed the plan as much for that older worker because he is going to stay there until retirement anyway, probably.

Am I making myself clear at all?

Senator BENTSEN. Let's get to this point, though. You talk about the young employee leaving who has stayed long enough to have some of his pension vested. By the same token, generally, he has the major portion of his pension invested so you have forfeitures to ameliorate the situation and he is customarily replaced by another young worker and it takes some time for eligibility to accrue again?

Secretary SHULTZ. Right. But that is the case now, as it is now. The point I am trying to make and perhaps it is not worth this amount of emphasis, but if you ask yourself the impact of the additional cost imposed, assuming the system is going to work as it has and people are going to leave and so on, at the pattern that they left before, I think that the type of rule at 50 approach that we have does have the effect older worker than the younger worker. So it will mitigate somewhat of imposing a lesser incremental cost for the employer and for the the general effect of pension plans on employer hiring processes; namely, to be a little reluctant to hire the person who is closer to retirement age.This will mitigate that.

Senator BENTSEN. Well, we are in agreement then that there is a hindrance in the hiring of older workers?

Secretary SHULTZ. Yes, sir.

Senator BENTSEN. You are talking about a man who is 49 years of age and he would only have to work several years before he had 50-percent vesting. Now that is a much more expensive situation.

Secretary SHULTZ. Not in the rule of 50 and maybe I had better read it——

Senator BENTSEN. Then if you hired a 30-year-old, because you wouldn't have any vesting there for 10 years. It is much more expensive, in other words, to fund a pension for an older person who is hired.

Secretary SHULTZ. In the rule of 50, as we put it forward, there has to be a 3-year length of service, however old you are, and you can see on chart 1—if you have chart 1 there—column 6 lists the years of service it takes at various age categories. Obviously at age 30 in order to hit 50, you would have to have 20 years of service and so on down the line.

The person who came in at 50, would have to have 3 years of service before vesting.

So I understand your point but——

Senator BENTSEN. If you choose the example of 3 years, you still have the same problem; that is, you are going to have an extra burden on the employer in funding that more rapidly than you would someone who was 30 years old who was hired.

I think it discriminates against the older employee.

Secretary SHULTZ. We have a chart somewhere on that. It tries account of that fact and, at the same time, account of the fact that there is turnover and put those two things together in a cost calculation. I guess chart 4 is the one you should take a look at.

As we have computed it, we have a line showing without vesting, we have a line with vesting, we have the increase in cost as we compute it due to vesting and the percentage increase in cost.

Senator BENTSEN. Well, doesn't the fact remain that the annual pension cost of hiring an employee at age 55 would be $585 per $100 of retirement income, as opposed to $155 per $100 of retirement income for an employee age 35? Doesn't that clearly show the greater expense of hiring an older employee?

Secretary SHULTZ. Yes, sir, and that is the situation as it exists. My point was to ask in what way would the imposition of this rule change that and it changes it somewhat in favor of the older worker. That is all. It does not change the basic fact that the existence of a pension plan by its members, I mean, that it is more expensive to hire an older worker than it is a younger worker.

Then the question is, if you put a vesting requirement on top of it, how does that change—how does that vesting requirement by itself change the situation? And my point was, this particular rule tends to favor the hiring of the older worker.

You may want to come back to this point but let me summarize in saying, first, that we believe that the evidence is strong that a vesting requirement of some kind should be added to the list of requirements for eligibility that we now have and, second, that we think that the rule of 50 as we have outlined it here in the chart and in the testimony, is a good way to go about that; that it tends to provide the greatest proportion of coverage for older workers and, at the same time has moderate costs. And then on an incremental basis—and I recognize the point you made about the overall impact—but on an incremental basis it does not discriminate further against the older worker or lead to possible discrimination and so it helps a little bit.

I have already run way over my 10 minutes, Senator, and I am afraid——

Senator NELSON. Are you still on the vesting question?

Secretary SHULTZ. I was going to go on to funding.

Senator NELSON. Before you do that in your chart No. 2 you show that at age 50 to 60, 42 percent of the people now are vested out under the rule of 50, 100 percent would be vested at that age level.

It seems to me that is kind of misleading because the fact of the matter is they are vested all right, but it is a percentage of nothing. There is no credit for service performed prior to the law.

Secretary SHULTZ. Well, obviously, you are going to have to provide credits according to service in some manner.

Senator NELSON. Prior service credit?

Secretary SHULTZ. If somebody has very little service, he doesn't have very much to be vested in but, at least, he can be vested in that.

Senator NELSON. Does the administration proposal provide that if somebody has 20 years of prior service credit and he is age 40 that he is going to get the 20 years of prior service credit?

Secretary SHULTZ. Sure.

Senator NELSON. You do? That is news to me.

Secretary SHULTZ. Senator, are you speaking about retroactivity?

Senator NELSON. Yes.

Secretary SHULTZ. Oh, well, we are talking about a rule that is prospective and applies to what is going to happen from here on out. If you went back and vested all of what now exists in private pension plans, then the cost would become very, very high.

Senator NELSON. Well, if my memory is correct, the cost of the administration bill under the rule of 50 ranges up to seven-tenths of 1 percent of payroll. If you eliminate service credits from S. 4, its cost would be 1 percent of payroll. However, giving prior service credit S. 4 cost ranges up to 1.4 percent of payroll.

Secretary SHULTZ. The Williams-Javits, as I understand it, was not retroactive but I gather it has recently been changed retroactive. We think that is a big cost step to impose at this time.

The CHAIRMAN. May I ask a question at this point because I am a novice at this thing. I am just learning, Mr. Secretary, and have a great deal to learn about this I am sure. But do I understand that if a worker, age 20, let us say, goes to work where they have a pension plan that meets the requirements we are setting forth here in rule of 50. He works for a period and then leaves, then he wouldn't be vested with anything? And if he works with somebody else from age 25 to 35, and for another 5 years, let us say, he still wouldn't have anything, is that correct? And then if he goes along to where he is age 49, and he works for 1 year, that would give him the 50—the 49 plus the 1 year of coverage service, which he needs to meet the rule of 50—and he would be vested for only 1 year of contribution. Is that the way it will work?

Secretary SHULTZ. This is a new employee now.

The CHAIRMAN. I understand that. If he works for first one company and then another company so that he moves from place to place, he has, in effect, lost out on all of his rights under his previous employers. Thus, what he earned would benefit somebody else in the pension fund, but not him, is that correct?

Secretary SHULTZ. That is correct.

The CHAIRMAN. So when this worker finally got vested, assuming he didn't become vested until he was working for his final employer when he reached age 50, this worker would only be vested for 1 year if that is all of the time he worked for that one employer?

Secretary SHULTZ. That is correct.

The CHAIRMAN. Well, then, I don't know why this is not done—and there must be some reason—but from the point of view of the national interest, why don't we try to work out a way—what with computers and all of that sort of thing being what they are—whereby if a person works for 5 years for the first employer and earns a certain amount of contribution in the pension fund, then that person would just transfer that over to whatever pension fund the employee goes to thereafter. What the man has earned with employer (A) would be added to the fund of employer (B) when he moves over there, and then added to the fund of employer (C), and so the employer would just transfer that right across the board. Why don't we do something like that, so that a worker's years of meritorious service and contribution would follow him wherever he goes. It could just be pushed over to the next pension fund when he goes to another employer. Why don't we do something along that line?

Secretary SHULTZ. Well, it is technically possible to impose a requirement that any pension plan to qualify must provide for immediate full vesting of all rights, but that is very costly and you are constantly balancing in these things between providing something like immediate full vesting, on the one hand, and the level of benefits you are going to offer the people who stay with the employer for some reasonable period of time and then retire on the other hand.

The CHAIRMAN. Well, if we just set up some kind of fund to hold the assets and put you in charge of that and let you have somebody sitting around running the computer, I don't know why you can't just push some numbers on the computer and just add this $100, which this worker earned working for employer (A) and put that in the fund he earns when he goes to employer (B)? If we had an arrangement of this sort, it would seem to me that rather than this man working from the time he is 20 to the time he is 50, and have 29 out of 30 years of his efforts go to add to somebody else's pension fund, everything he earned would be added into his own pension fund.

Now, what kind of equity is there in a situation where you have a company, which because of normal turnover of personnel, has an employee who stayed with the company for 30 years and then left, and the company picks up the pension that he left. Not only that pension but the pension that perhaps 50 other people earned.

What kind of justice is that?

Secretary SHULTZ. First, let me point out we do have a system like that except it goes further than you are suggesting, that is, it says, whether or not the employer and his employees agree on a pension plan or not, they are going to have one and it is called the social security system. It is immediately fully vested and the rights are transferred around. That is the basic underpinning we have, and——

The CHAIRMAN. This inequity just beats the daylights out of what we are talking about here. The poor devil should at least get the benefit of having worked these years.

You are talking about an arrangement where he might not get 5 cents of benefit out of a lifetime of hard work. It would seem to me if we are considering pension reform now, we ought to try to move in the direction of social consciousness and responsibility and equity and justice for the poor fellow who worked and put so much money into the pension fund.

Have you made efforts to try to pursue that idea? Have you tried to find the mechanics to allow the short-term worker to get the full benefits of his hard work under a pension plan rather than leaving it for the other employees who don't change jobs?

Secretary SHULTZ. These cost benefits have been weighed and are weighed every day in collective bargaining as unions and employers try to work out the nature of the pension plan they want and the higher benefits they want with some given cost that they are willing to pay. So there is a tradeoff here. People have to make a judgment about the nature of the plan they want to agree to. I think to a degree we have to say in the government that if the unions and management want to make an agreement of some kind and it is satisfactory to them and it is full and open and above board, then we should think twice about putting ourselves above their judgment in this tradeoff that they have.

Now, in imposing a rule of vesting of some kind—and I have no doubt this is the reason why Congress has not done it up to this point—you are imposing a governmental judgment on these private plans. And we think that it is appropriate to do that but not to go so far as to basically destroy the cost basis of the gigantic private pension plans we have.

The CHAIRMAN. The thing that concerns me—and this is sort of new to me, I guess—but the thought occurs to me, here is a negotiation between the United Auto Workers and the General Motors Co., for example. Now, General Motors is interested in the people who work in that General Motor plant, and so is the United Auto Workers interested in the same thing, so they negotiate an amendment and we give them a tax deduction on the theory that it is good for the people to work in that plant. But then to say that the problem is solved by the collective bargaining, even tough it works out in such a fashion that 50 percent of the people who work in that plant don't benefit from this thing at all, well, I think that as a representative of the public, we have written a very poor law. We have fixed it up so that the business agent took care of the business agent, so that General Motors took care of General Motors, but half of those working people suffered very badly.

Now, I am not interested in trying to dethrone any labor people or trying to dethrone the General Motors people, but in the poor devils who work in that plant.

Why don't we work it out to their benefit?

Secretary SHULTZ. Presumably we have representative institutions and collective bargaining is an elected representative institution and the people who are elected try to represent the people who are there.

I might say, as we get on to the administration's proposal I have a partial answer to your question, but let me leave that somewhat now. Anyway, I think we do have to say that in the structure of our collective bargaining process, there is representativeness and people are trying to look after the interests of people as a whole but peoples' interest vary. That is one of the problems in collective bargaining; namely, to somehow strike some balance among the divergent interests that different people have.

The CHAIRMAN. Do I understand, Mr. Secretary, we are talking about a situation where, let us say, a worker at age 20 goes to work in the General Motors plant and we are talking about letting General Motors negotiate an agreement with United Automobile Workers whereby after he works for 20 years in that plant and puts his share of the money into the retirement fund and certainly generates his share of the income that goes into it, then if he leaves at that point, he has absolutely nothing and takes nothing with him.

Secretary SHULTZ. Well, it depends upon the situation—and I don't know enough about the General Motors situation to talk about that specifically——

The CHAIRMAN. Well, take any plant.

Secretary SHULTZ. But, let us say situation A where the plant is entirely employer financed—that is, all of the contributions to the plant come from the employer—which is the case for most plants, and under the situation that is right; to the extent that you had any employee contributions, then the employee contribution belongs to that employee. He gets back what he puts in.

Let me just point out that in our organization and in our practice, we have many ways in which length of service, seniority, and so on is recognized in society. Now, we say "A rolling stone gathers no moss." Now, let's take this discussion out of the vesting area completely, the pension area, and just talk about vacations. In most plants, the longer you work there, the longer vacation pay you have; is that wrong? Should we say everybody should have the same?

There are things that come to people who are able to stick with something over a long period of time, and even in the U.S. Senate where seniority counts for something.

The CHAIRMAN. If you are trying to persuade me, Mr. Secretary, I would add, I am for seniority properly used.

Secretary SHULTZ. Well, now we have the principle taken out and we can go on.

The CHAIRMAN. I am not for it improperly used.

Secretary SHULTZ. OK, I am with you there, Senator.

The CHAIRMAN. Now, Mr. Secretary, if you are trying to persuade me that I ought to vote for a law that will let two men get together and negotiate a contract, theoretically, for the benefit of the third guy, whereby after that third man puts in 20 years of hard work and either because he had a falling out with his employer or makes a mistake of cutting out the business agent, he finds himself out of a job, and then none of the benefits of that 20 years of hard work which have found their way into the pension fund follow him to the next job, then I think he can find something better than that. And so can we.

Secretary SHULTZ. If you were to vote for the rule of 50, that fellow who put in 20 years of hard work would be vested because it is hard to conceive he could have worked there for 20 years and not be 30 years old.

The CHAIRMAN. Well, I see what you are talking about.

Secretary SHULTZ. Look at chart 1.

The CHAIRMAN. In computing the rule of 50, the worker counts his age plus the number of years he worked?

Secretary SHULTZ. Right. That is how you sum up rule 50.

The CHAIRMAN. If he started at 20 and worked 10 years, he wouldn't have it, though. If he started at 20 and worked 10 years, that would make him 30 and 30 plus 10 would be 40, so he wouldn't get the benefit of it or, if he worked until age 34, 34 plus 14 wouldn't give him the benefit of it.

So he could work for 14 years and not have anything to take with him then?

Secretary SHULTZ. You can think of example after example that add up to less than 50 under which he wouldn't be given anything by the rule of 50, but the chart tells you where you would be given something—and, particularly, on chart 2, do you have that? If you look at the difference it would make as you move up in the age structure, by the time you get to the 40- to 50-year-old bracket, you are 82-percent vested and by the time you get to the 50-year-old bracket, you are 100-percent vested. It seems to us that the age category that you want to be concentrating on, particularly when you are talking about security of a private pension annuity, then, is that age group.

Senator NELSON. You mentioned social security a few moments ago.

Secretary SHULTZ. Yes.

Senator NELSON. Isn't it correct for all practical purposes that when we adopted social security we gave prior service credit? If you were 63½ years old at the time social security was adopted, you worked 1½ years and retired and had full benefits of social security?

Secretary SHULTZ. Well, I would——

Senator NELSON. Or whatever it was.

Secretary SHULTZ. I would have to recollect but I don't think so. There is a minimum amount of contribution and the extent of your contributions interplay in the amount of benefits you draw. Everybody doesn't draw the same amount under social security. But we have the table somewhere on that.

Senator NELSON. But——

Secretary SHULTZ. The point about social security is—and it does do what Senator Long was suggesting, namely, that wherever you work, as long as it is covered employment, the contributions that you make and that your employer makes go into a common fund. I wouldn't say that the contributions come from that fund. We are on a current cost financing basis now. But, at any rate, it has that spirit of that to it——

Senator NELSON. But when we adopted social security—I had forgotten the number of quarters but anyway, when we adopted it I think it was 1½ years and after that you got the full benefits of social security. If you were age 63 and worked 1½ years and retired, you retired with the same benefits, with the full benefits that anybody would get if they worked 35 years?

Secretary SHULTZ. I am not sure just how that breaks down but if you say so, I will accept that.

Senator CURTIS. I think I can clarify the record. A worker cannot of his own volition choose to stay out of the labor force until he is 63 or so and then go in and earn his social security retirement in a year and a half.

There was a long time where the self-employed such as farmers, your unincorporated business and the like, weren't covered by the social security law and when the program was extended to their occupation it was provided that they could earn their benefits in a lesser time.

The individual worker doesn't have the right to voluntarily stay out of covered employment until he is 63 and get social security benefits.

Secretary SHULTZ. Correct. There is as we know, and the schedule is available but I can't find it. I just don't have a copy of it in my hand, but there is a provision wherein in order to draw the maximum you have to be earning so that contributions are at the maximum for some period of time and your social security benefits are keyed to that. And then there is a scaling from that. At any rate, the point having to do with vesting is that you are immediately fully vested under the social security system, but I suppose the overall point here is that we are talking about one element of the American system for providing retirement benefits; the social security system is a big piece of underpinning that goes throughout the society.

Now, about half of the labor force is covered by private pension plans of various kinds. Half are not covered at all by the kind of plans we are talking about. We are talking about a piece of legislation that would alter the private plans as they now exist and as they unfold. And then, of course, individuals have all sorts of savings and investments and private annuity plans of their own which they try to provide for their retirement. So we are talking about an element in a total system.

Senator BENNETT. Mr. Chairman, social security is not complete vesting. You must have worked within the last 10 years. You can work in your early life and then take an occupation outside of social security and you lose social security.

Senator NELSON. That wasn't my point. We are discussing changing pension plans and the question of vesting. What the administration proposal says is that you can start to work at age 20 and work until you are age 34, and you don't have any vesting whatsoever. What it also says is that you can be 50 years old and work somewhere 30 years and when it vests you get no prior service credits at all.

What I am saying, is that right? Is it right to have no prior service credit at all?

Secretary SHULTZ. You are speaking about the question of whether or not you should consider enacting a retroactive law?

Senator NELSON. That is what I am using the phrase prior service credit to cover.

Secretary SHULTZ. I think that is pretty tough going and you have to be careful you don't disrupt the costs of these plans too much.

Senator NELSON. I wanted to get to that in a moment. I wanted to make it clear, and I believe I am correct that when social security was adopted, the statute was drafted that—and I don't have the phrasing of it—but if you were 62 years old, you worked 3 years, and, if you were working at the maximum salary or coverage, you retired at the end of 3 years with the maximum social security coverage just as though you had worked 35 years. And then as each new group came under, that is, you brought the salesmen under in 1947, it was administered so that if you had a man who was a salesman and out on the road and he was now 63½, he worked 1½ years and had total full coverage, the equivalent of prior service credits. And when you brought the farmers under, if the farmer was 63 years old, he worked 2 years and he had full total coverage as though he had worked 30 years. And when you brought the lawyers under, you had the same.

At every single stage right up to modern times we gave, in effect, total prior service credit and all you had was a minimum of whatever it was—and I think it was six quarters. And all I am saying now is, we are starting with a plan here and you are going to be saying to somebody that he can work 14 years and be age 34, and then move to another job and he has no vesting and gets no credit for the 14 years at all.

Secretary SHULTZ. You say this as though either we or you can wave a magic wand over the American economy and make a change in these plans without affecting the costs. What I am trying to point out is that all around the country unions and managements have sat down with each other and they have constructed these private plans and they have said that we are going to put 10 cents an hour into our pension plan. Now, that is part of their bargaining. Now and then they have said to each other, "how are we going to spend that 10 cents an hour? We could spend it all on vesting if we wanted to or we could say we want to raise the benefits so those who work here until they are on retirement will get, at least, some amount which we think added to social security is what is needed to get along on, and so we will spend our dime that way."

And so different plans have made different compromises on that. What we are talking about here is in whatever vesting requirement that is put in, is the imposition of a Federal governmental judgment overlaying all of this visualized judgment which has been made the right way? We think that no matter how you want to spend that dime that you have to spend a portion of it at least for this amount of vesting. Now, to go back retroactively and second-guess all of the decisions, I think that is taking quite a step.

Senator RIBICOFF. Will the chairman yield for a second? Couldn't your point of view be reconciled with the chairman's by having a meaningful portability provision in the law so that you could transfer from one place of employment to the other and you could carry your pension rights with you? You could protect the employee's rights in that way. You are not having an undue burden on the employer then because the employer is paying his portion into an overall fund.

Secretary SHULTZ. I think that the portability is an issue that deserves exploration. It is pretty complicated largely because the structure of plans vary so tremendously one from the other. And we are trying to approach the portability question by a combination of vesting, funding, and the rollover provision in the administration's proposals, but we haven't set up a portability fund as such, as I believe the Williams-Javits bill does.

Senator RIBICOFF. Well, I think what is bothering Senator Nelson, and certainly what is bothering me, and as I listen to the questioning of the chairman, is bothering him, is how are you going to make this overall provision fair for the worker who changes jobs, in situations where the factory perhaps closes down and he has to get another job and he has had 10 or 15 years with one employer? Does he lose that?

In all fairness, could we have something comparable to social security where there is an overall fund?

I think what the chairman was driving at is there is no reason why this committee can't wrestle with this portability question to insure that the individual employee is protected. I don't think it is so complicated that between the Treasury and the committee and the staff we can't work out a system and protect the individual worker.

Secretary SHULTZ. Well, if I could, Senator, let me try to distinguish here for you the distinction between vesting and portability. As I would see it, portability has to do with your ability to take something that is yours with you and move it from employer (A) to employer (b), whereas vesting has to do with what it is that you have and, if you had nothing to take with you, portability isn't an issue. It is only once you have some vested right, some amount of money, that portability becomes meaningful.

Now, we have tried to meet it in part through the rollover provision, which I wanted to discuss. That makes it easier for people to do that and, in other words, they would not be taxed on a lump sum payment the way they are now.

Senator RIBICOFF. It isn't just a question of taxes. I think they do both go together, Mr. Secretary, both vesting and portability. I mean, individually, I would feel that no pension plan that didn't have vesting and portability would give the protection that the workers of this country need and, my personal feeling is, there have to be provisions to make both meaningful and they should be tied together, both vesting and portability, in order to have a pension that has some meaning.

Senator CURTIS. Mr. Chairman, I think it would be well if we called attention to the fact that we cannot compare the overall plan of social security with these voluntary pension plans. Social security is not funded; it never has been. It does not work that way now.

Second, it is based upon the premise of taxing the young and middleaged to pay the benefits for those retiring. That is the way we are paying benefits currently. In other words, I am not trying to argue about the administration of social security but merely point out the vast difference.

Secretary SHULTZ. That is correct. I was just pointing out Senator Long was, in effect, saying we don't have a decent system unless there is immediate full vesting. That is not stating your view exactly, Senator Long, but the social security system has an element of that in it, and Senator Bennett pointed out in a sense that is not true but, by and large, that is the nature of the beast.

Anyway, should I go on and summarize some of these other points or do you want to stick on this?

Senator NELSON. Why don't you summarize the other points and we will withhold further questions until you finish if the committee doesn't object?

Secretary SHULTZ. I will hit them very fast.

I think, just as we have talked about vesting being an important element of protection of private pension rights, so funding is an essential thing in order to be sure there is money there to meet the obligations, whatever they are, whether they are a vested right or a right at retirement.

Now, this problem is acute when a plan terminates. Say a plant closes or something like that. Here I would have to say we have studied the termination problem hard. We find that, for example, in the first 7 months of 1972, approximately 3,100 employees lost $11 million through plan terminations. Now that is to be compared to say, roughly, $6 million paid out in the first 7 months of 1972 and $10 billion over the year. So, in terms of the total, it is not large but for the employees who lose their rights it is a tragedy. And we would like to be able to figure out how to deal with that problem. I have to say to you that we haven't felt we found a solution, a satisfactory solution. We have looked at termination insurance. Termination insurance, it seems to us, would draw the Government into a posture where it is present at every collective bargaining table and at every employer decision on a pension plan because, once you are insuring those plans as the fiduciary, you must protect the rights of all of the other people in the insurance plan, with respect to what anyone does. So you get yourself drawn more and more into this and, therefore, it seems to us that is quite a danger in the termination approach. So we have not recommended this. We have studied this carefully. We think the problem is important. We think something ought to be done about it and we would like to work with the committee to find an answer but we come to you not having an answer in hand except to the extent that funding over a period of time will do the job. So, what we have proposed is that in addition to the requirement that any new liability be funded, that we require at least 5 percent of the unfunded vested liability as plans move on from here on out. So that after a period of time has passed, we would have handled the funding problem properly and that would eventually take care of the termination insurance problem, because the money would be there. But at the present time, when the money isn't there, there is a problem. We don't know the answer to that problem.

Let me just say a word about the self-employed. We now allow the self-employed to take free of tax 10 percent of income or $2,500 whichever is lower as a rate of contributing to their own annuity. It must be noted there are no limits to the amount that can be contributed under employer financed plans, and that looks like an inequity to us and we would propose you change those limits to 15 percent or $7,500, whichever is lower in order to get the self-employed to make a contribution to their own retirement on a tax basis comparable to what is done in the corporate plans.

We think that if something like this isn't done, we will provide a terrific incentive to incorporate. There is no particular reason why we should force self-employed individuals to incorporate just to get this particular tax benefit.

We have talked a little bit about portability and the relationship of vesting to it and the relationship of funding to it. And then I think an essential agreement—and I recognize, Senator, this doesn't go the full distance but I think it is a necessary condition, if not a completely sufficient condition—namely, the rollover provision that we have proposed. At present, if an employer takes a lump sum payment out of a plan, that is taxable. So he gets his lump sum and tax is taken out of it, and then if he wants to put that lump sum into some new fund, into some portability provided fund, he has already had the tax taken out and, therefore, he has been distinguished from somebody who just stayed in a pension fund or stayed in a particular employer's fund.

Our proposal is that if he transfers this lump sum that has been provided for his annuity into another annuity-like setting, that you would not take on that transaction but you would wait until he starts drawing the annuity so that it is easier to, in effect, rollover. And I think this is a necessary condition for portability plans to operate. And it may be that if this were provided, there would be some development of pools of various kinds that would reflect the varying circumstances people find themselves in.

Finally, let me talk about the question of the tax status of employee deductions; that is, of employee contributions to their own annuity. This is not a self-employed person; this is an employed person. Remember now, that half of the labor force is not in private pension plans at all and many are in private pension plans which perhaps they personally consider inadequate and would like to take more of their income in terms of an investment for the future than they do now. Our present law provides that if a contribution to a plan is made by the employer, then the employee pays no tax on that until he starts receiving benefits in the form of an annuity. On the other hand, if the contribution is made by an employee on his own behalf, he has to pay a tax on the income before he can make the contribution.

So our tax law has biased the system against the individual and the exercise of individual choice on pension systems. That is why, of course, practically all of our private pension plans are entirely employer financed. It would be silly to do it otherwise, given the tax system.

So, what we are proposing is that individuals be allowed to have contributions to a tax system put in the same tax status as an employer contribution up to 20 percent of income to a maximum of $1,500. Now, that would allow an individual, not in a private plan, a better chance to develop his own retirement annuity. It would also allow a person in a private plan to the extent that the employee contribution is less than satisfactory, to supplement that if he wants. It could very well be developed right within the framework of the collective bargaining or employee established plan.

And we think this provides a better element of individual choice. It also, I believe, would help a great deal in many collective bargaining situations, where you have an older group and you have a younger group and you have a lot of pensions in the collective bargaining situations as a result of that. The younger people are not all that interested in pensions. The older people are. So, going back to this 10 cents an hour we were talking about, the older people in the work force want that 10 cents an hour or as much of it as possible to go into the pension and to go into the benefits at retirement. The younger people have a different view, so there is a terrific fight and then some kind of resolution takes place.

Well, if you were to change the law in this respect, it would be possible to say "all right, here is our basic plan, it provides something that everybody must have. On the other hand, if you, the older worker, want to put more of your current income toward your retirement, right within the framework of our collective bargained plan, we figured out a way for you to do it and the tax status is the same as the employer contributing."

And so we think this would be helpful to both those who are in plans and those who are not in plans, and would help relieve some of the tension in society that comes from the difference in interests, really, of the older worker and the younger worker and it would give some outlet for that. So we would urge you to consider this modification in the tax rules.

I might say that by structuring it in terms of 20 percent of income to a maximum of $1,500, we are aiming this at the low and moderate income person. It is not a bonanza for the rich person. It is aimed at low and moderate income. It is low enough so that it isn't going to interfere with the basic private employer-financed plan where contributions much higher can be made should the employer and the union, whomever is collectively bargaining, choose to do so.

Well, this is a summary, Mr. Chairman. I have taken a lot more time than I was allowed. You will bear with me because you did have some questions as we went on into this.

Senator NELSON. Thank you.

Let me call on, first, those in the committee who haven't asked a question.

Senator Dole?

Senator DOLE. No questions right now.

Senator NELSON. Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

Mr. Secretary, on that point you have just been discussing, the $1,500 or 20 percent of a person's income, that means that an employee who earns, let us say, $30,000, he could take 20 percent of that or $1,500, and, now, does he turn that over to the employer for safety? What does he do with that $1,500?

Secretary SHULTZ. He could establish an annuity himself with it or, if he were in a plan, a private plan, with that employer and the plan was set up to allow individual supplementation, which would be very simple in this day and age of computers, he could simply add it in there. It would be administratively much easier for him.

Senator BYRD. Or he could do it on his own?

Secretary SHULTZ. Or he could do it on his own. If he is not in any plan he doesn't have any plan to contribute to, but insurance companies are ready to provide plans of this kind.

Senator BYRD. Then he would take a deduction of $1,500 on his income tax?

Secretary SHULTZ. That is right. Just as the employer contribution to a plan is not shown on your income tax. You make the tax statute for an individual trying to do something for himself the same as when it is done on a collective basis. That is all.

Senator BYRD. Is there much basic difference between your plan and Senator Bentsen's plan?

Secretary SHULTZ. Well, I always prefer—well, Senator Bentsen can speak for himself; he is right here. I won't argue with the interpretation.

Senator BYRD. Well, let me put it this way——

Secretary SHULTZ. We both have the same objective, I know, of trying to make these plans operate more equitably.

Senator BYRD. Let me put it this way: I assume there is a greater basic difference between your plan, that is, the administration's plan and the William-Javits proposal than there is between your plan and Senator Bentsen's plan?

Secretary SHULTZ. I think you have to go down the items one by one and argue the merits or demerits of it. Let's assume we are talking about vesting. What should we have in vesting? Now, there are differences of how one should approach it.

Then there is the question of retroactivity which I think is very important. You will want to think hard about that. There is the question also of funding and how far to go. This particular thing on the tax status of individual employee efforts is something that we have put forward. I don't know whether others have the rollover in it or not.

Senator BENTSEN. I would say that I am scheduled to testify next and rather than impose on the Secretary's time, I would prefer you deferred those questions to my time, as to the differences between my bill and the administration's.

Senator BYRD. All right.

Secretary SHULTZ. We have a tabular presentation that goes down the line on different issues. It doesn't pro and con them. It states what the differences are.

Senator BYRD. I have that before me. What I was really trying to understand is, if the committee did not accept your proposal and was planning to accept one of the other proposals, which would be the more acceptable to you; the Bentsen proposal or the Williams-Javits proposal?

Senator BENTSEN. I would like to hear that also.

Secretary SHULTZ. Well, Senator, I think that what needs to be done is to look at the various incremental questions. First, what about vesting? That is a subject that to some extent stands on its own feet. What about funding? What about the rollover? What about employee contributions? What about the self-employed?

So I would suggest you take each one of these subjects and consider them. They are interrelated, but they also each have a certain life of their own and not just say that we have only three alternatives. We probably have 500 alternatives when you put all of these combinations and permutations together.

Senator BYRD. Thank you.

Senator BENTSEN. Senator Dole, do you have any questions?

Senator DOLE. No.

Senator BENTSEN. Senator Bennett, do you have any questions of the Secretary?

Senator BENNETT. Way back when we were talking about vesting and we were agreeing about the fate of employees who came in at different stages, well, I think this question might set this in perspective. The proposed rule of 50 permits exclusion of new employees who are within 5 years of normal retirement; correct?

Secretary SHULTZ. Correct.

Senator BENNETT. In order to qualify, you have to have worked 3 years?

Secretary SHULTZ. Right.

Senator BENNETT. So, in effect, anyone who works for less than 8 years may be excluded; any person with just 8 years before the retirement date, he may be excluded?

Secretary SHULTZ. I didn't hear that—if a person came in at——

Senator BENNETT. In other words, if the retirement age is 65 and you can exclude the last 5 years, then if he comes in at 60, plus 1 day, he can be excluded?

Secretary SHULTZ. Excluded?

Senator BENNETT. If he comes in at 57 plus 2 days and has not worked 3 days, can he not be excluded?

Secretary SHULTZ. If he comes in at 57. If he was a new employee at age 57?

Senator BENNETT. That is right, 57 plus. So that he cannot complete 3 calendar years.

Mr. HICKMAN. He can be excluded if he is 57 years old if the plan so provided.

Senator BENNETT. In effect, when you put these two things together, the effect is that a person who has less than 8 years to go at retirement age, can be excluded. Is he automatically excluded?

Secretary SHULTZ. No, it is just that this is a minimum retirement plan that can provide immediate full vesting if they want. That is up to the people designing the plan.

Senator BENNETT. This condition being as it is, what is your impression of the impact of this particular feature on the employment of older employees from the point of view of the employer? Would it be largely that he would find men who have less than 8 years to go, because he doesn't have to take them into the system? Is that an advantage, where a man is looking for immediate opportunity to get a job? Is that an advantage to the employer?

Secretary SHULTZ. Oh, I don't think this would be a dominant consideration to employers to look in that direction, but it is a factor that protects against the existence of a private pension plan having such an economic cost for the hiring of an older worker that employers wouldn't do so. And that kind of gets back to a little different point that we were talking about previously.

Senator BENNETT. It protects the private pension plan from the situation that was described at the beginning with Social Security, where a man may work for a year, or a year and one-half, and automatically retire?

Secretary SHULTZ. If you had a situation, say, where you had a man and somebody is hired at the age of 61 and works for 2 years and then is going to draw all of the pension benefits, if you had that situation, you are going to certainly discourage the hiring of people because it imposes too high a cost on the system. That is the basic problem. And as you all know better than I, it is a very tricky area. You can make what seems like are small changes and they can cost a lot, and there needs to be a constant interplay between the benefits you achieve and the cost of achieving them and whether that is the right benefit given the cost that you may pay.

The general caution that I was offering here was that when we talk about Federal legislation, we are talking about the exercise of some common standard throughout the country that limits the exercise of the tastes of people in our particular line of employment to develop whatever they think is right for themselves. And we recommend going this far, but we would hesitate to go too far with it.

Senator BENNETT. I am aware that there is a practice in some parts of the educational system, for instance universities, to hire retired professors from other institutions and give them 2 or 3 years more of earnings but to be free of the responsibility of their pension. This, I think, is quite common among universities.

That is all I have, Mr. Chairman.

Secretary SHULTZ. You mentioned the university setting, and if I could just take a minute, Mr. Chairman. I first started thinking about this question of the tax status of an individual contribution when I was a professor at the University of Chicago and we had a system—and this is allowed for the nonprofit institutions, where you are allowed to have a system like this—and we had one like this and you could make your individual contributions. And I was involved in a very heavy mediation in a labor collective bargaining situation and met with the union people involved at length, and the principal hangup was the pension plan, and the thing that they just couldn't see how they could come to grips with was the terrific difference of opinion between the young workers and the older workers. They couldn't find a common blanket to throw over the whole situation. And not being aware of this different tax treatment, I said, "Why don't you put something in like they have at the University of Chicago?" And then we found out that it was against the law for private employers to do it. So this has been a little bit of a crusade with me ever since, and here I am.

Senator NELSON. I notice it is 11:15, and we have five more witnesses. I don't want to cut anybody off, and I wouldn't because I have taken more time than anybody else. I have a number of questions that I am not going to ask you, Mr. Secretary, but I assume if we send them to you, you will respond to the questions for the record?*

Secretary SHULTZ. Yes, sir; be delighted to do that and we would be delighted to come and meet with you individually or in groups to try to work out answers to these questions. They are complicated.

Senator RIBICOFF. I just had one question: Mr. Secretary, you seemed to indicate that there was some difficulty in your mind as to what the Government role would be in the termination of a plan. You felt that the Government would become involved. But if you set up the equivalent of the Federal Deposit Insurance Corporation for banks and have some sort of protective insurance device, where the employers would pay a small percentage of insurance, wouldn't that protect employees from a company that went bankrupt or a plan that went broke?

Secretary SHULTZ. It could.

Senator RIBICOFF. Would that be such a burden after all? FDIC isn't a burden on the Federal Government, is it?

Secretary SHULTZ. Well, I think that you have to ask yourself, if you have an insurance program of that kind administered by the Federal Government and then you name some Federal official as the fiduciary or the trustee for that insurance program, that means that all of those insured have a stake in what is agreed to in any individual

*See appendix A, volume 1.

plan and, if something crazy is agreed to in that plan that they can't begin to meet, then as a trustee you better get in there and tell them that they can't agree to that, and so you must ask yourself whether you want to do that. In other words, you develop a need to get in and regulate and be part of the process of what is going to be the structure of these plans.

Senator RIBICOFF. Yes, but if there are basic standards—to protect the liquidity of the funds and to protect the employees—you could give the protection needed. I think probably the most famous of all or infamous, was the termination of the Studebaker Corp. in the mid-1960's where many thousands of employees, because of financial difficulties of Studebaker, lost their rights. Now, here it is important to protect the rights of the individuals and a general insurance program of some sort in which a small premium was paid, which would build up a very large fund would definitely be worthy of our consideration.

Secretary SHULTZ. Let me say to you that we agree with you that there is a problem that deserves attention there and we would like to see an answer develop to it. We have worked quite hard on the termination insurance question and we finally decided not to recommend it to you because of the considerations that I have mentioned, but we are continuing to work on it. We are wondering if there isn't some way the private sector can come up with something that would be helpful. And I have stimulated quite a few people to get after it and we will continue to work at it but I would just urge on you to be cautious about some of these implications that are not apparent on the surface. Maybe there is a good answer to them. If there is, that would be great because we think there is a problem here and we would like to see it get solved.

Senator RIBICOFF. Thank you.

Senator NELSON. Senator Bennett?

Senator BENNETT. Just one comment. The FDIC absolutely supervises and can control the management of the banks which it guarantees. It can remove the management, if it needs to, and in the case of a pension trust, it may be that the management of the company destroys the value of the trust and not the management of the fund.

Senator RIBICOFF. Well, on that, that wouldn't bother me. In other words, if you have all of these vast sums of money in the hands of a trustee, whether he be the trustee of a bank of insurance company or a union or a company, there is no reason why a fiduciary should not be subject to supervision in the event of mismanagement of any type and I am not worried about that and don't think that the banks complain about that. I would say that the overwhelming number of banks in this country are very pleased with FDIC and I don't see why we can't set up something comparable with this because of the vast sums of money involved and the rights of millions and millions of people involved.

Secretary SHULTZ. The Studebaker case you mentioned may provide an example of the kind of problem you would be drawn into and, presumably, you would do something about it if you were the trustee of a Federal insurance plan. As I understand, the Studebaker Co. made a substantial increase in the benefits of employees and then terminated the plan. Now if they did that, you would, in effect, say they were trying to milk the insurance plan and you wouldn't let them do it. So, there you would be in there with both feet somehow or other trying to say you can or you can't increase benefits according to some standards.

Senator RIBICOFF. Well, Mr. Secretary, I am unwilling to feel that the labor unions and the employers wouldn't realize their responsibility. I am sure that they would much rather have security for the plan and assurance to every worker that at a given time his rights were protected, and he was going to get his pension rights than to try to force some outlandish term that would break a plan because there is, obviously, a realization that social security is insufficient to take care of the needs of the average American once he retires. It is still not much different than the poverty line. So all of this thrust is an effort to assure security for the middle class and lower middle class employee, especially, and to try to work out standards. I would feel there would be a correlative responsibility on the part of those negotiating for the unions, the companies and the fiduciary to get a sound plan. Maybe that would be a great contribution for stability. And I don't think I am afraid of that.

Senator NELSON. Senator Curtis?

Senator CURTIS. Mr. Secretary, could you provide the committee with any background information as to what the cause of those plans terminating?

Secretary SHULTZ. Yes, sir. I think this information was as a result of a study that the Treasury and Labor Departments did and we can provide copies of this study.

Senator CURTIS. I think that would be quite helpful.

Now, I would like to ask you this one further question. If a plan is fully funded, it should be able to terminate without a loss to employees, shouldn't it? So that proper funding can be the answer to termination?

Secretary SHULTZ. Yes, sir, but at least in our recommendations, we don't see how you could suddenly require 100 percent funding and so we have this 5 percent funding. Over a period of time you are going to get there but the question is what about the interim. And I think that the question Senator Ribicoff was concentrating on is a question what about the interim?

Senator NELSON. Thank you, Mr. Secretary.

Secretary SHULTZ. Thank you, Mr. Chairman. I appreciate the opportunity to discuss this question with you. I think it is very important in its own right and I think it is also important in relationship to many other things we are considering such as the trade bill, where the question of what happens if somebody is out of a job is something I am sure will be discussed when it comes before your committee.

Thank you.

Senator NELSON. Thank you, Mr. Secretary.

[The prepared statement of Secretary Shultz with back-up material follows:]

PREPARED STATEMENT OF THE HONORABLE GEORGE P. SHULTZ, SECRETARY OF THE TREASURY

Mr. Chairman and members of this subcommittee, I am pleased to be with you this morning to discuss pension reform, and to support S. 1631, the "Retirement Benefits Tax Act." This bill embodies the President's proposals for reforming and expanding the private means for assuring retirement security for older Americans.

The fundamental concept of savings for retirement is embodied today in the Social Security system. Our Social Security system is the largest system of its kind in the world and one of the most effective and progressive. However, Social Security in itself provides only a floor of income security. In order to assure a more adequate income for older Americans, social security benefits must be supplemented with benefits provided by the private pension system and by individual retirement savings.

In general, the private pension system has served us well. However, the system is not perfect. Abuses exist. Reasonable expectations are not always met and only half of our work force is covered. Furthermore, there is room for substantial improvement in the federal laws dealing with private retirement savings.

President Nixon's pension Reform Message of April 11, 1973, calls for the enactment of two bills which would substantially strengthen the private pension system—the "Retirement Benefits Tax Act", S. 1631, and the "Employee Benefits Protection Act", S. 1557. These bills would go far to accomplish the needed improvement.

The Federal government provides a substantial incentive to qualified private retirement plans by means of special tax treatment in the Internal Revenue Code. This special tax treatment results in a major revenue loss, amounting to $4 billion per year, or almost 2% of total tax collections. As a consequence, the government, and the American public, have a strong interest in assuring that the private pension system does the job it is intended to do, and that the system is extended broadly throughout the American work force.

Traditionally, since 1942, the bulk of Federal pension regulation has been accomplished by the Internal Revenue Service. Presently, the basic provisions governing qualified retirement plans are found in sections 401 through 407 of the Internal Revenue Code. In addition, since 1958 the Department of Labor has had an important role in connection with the Welfare and Pension Plan Disclosure Act, which requires reporting and disclosure by welfare and pension plans, including qualified pension plans, which cover more than 25 individuals. The SEC has also played a role, in connection with the securities aspects. However, the bulk of the regulation of pensions has been by the Internal Revenue Service, which now has a large staff of highly experienced and qualified pension experts located in IRS offices throughout the country. These are the experts in the subjects currently discussed today in connection with pension reform; such subjects as eligibility requirements, vesting, funding, plan terminations, and so on. The Labor Department has a staff of experts in both Washington and in the field who are familiar with the subjects of reporting, disclosure and bonding.

The approach of the Nixon Administration has been to build on the existing expertise of the Treasury and Labor Departments, using the Treasury Department in the area of its current knowledge and the Labor Department in the area of its current familiarity. We believe it would be a serious mistake to attempt to transfer jurisdiction in either area to the Department which currently lacks the expertise, personnel, and experience to handle matters traditionally within the province of the other department. For this reason, speaking as one who has headed both departments in question, I cannot concur in the proposals which have been made to give jurisdiction to the Labor Department over vesting, funding, eligibility requirements, or the like.

I will limit my discussion today to the areas which we feel are appropriate for administration by the Treasury Department and which are dealt with in S. 1631, the "Retirement Benefits Tax Act." I understand that Paul Fasser, Jr., Assistant Secretary of Labor (for Labor-Management Relations), will discuss with you tomorrow the "Employee Benefits Protection Act."

Briefly, S. 1631 would:

(1) Provide minimum standards for vesting and funding of benefits under qualified pension and profit-sharing plans, and for participation in those plans,

(2) Raise the limits on deductible contributions that may be made to retirement plans established by self-employed individuals,

(3) Provide an income tax deduction for retirement savings by employees who are not covered by employer-financed plans or who participate in plans with inadequate benefits, and

(4) Make a variety of other improvements in the present functioning of the private pension system.

We have previously prepared and distributed a general explanation of S. 1631 which we will submit for the record in slightly revised form. We are preparing a technical explanation of the bill and a set of proposed technical amendments to the bill, which we will also submit to you in time for the publication of the record of these hearings.* In my testimony today I would like to review briefly each of the principal topics of the bill.

1. VESTING REQUIREMENTS AND THE PROPOSED RULE OF 50

Under existing law, many employees now covered by pension plans and expecting retirement benefits will lose these benefits if they leave their jobs, either voluntarily or involuntarily, prior to retirement. The loss of expected retirement benefits accompanying termination of employment represents a grievous personal tragedy. Vesting—defined as the right to receive retirement benefits even though the employee terminate employment before retirement—would prevent this tragedy. Under present law, vesting is required under the Internal Revenue Code only in plans covering self-employed individuals who are owner-employees and certain other plans where vesting is required to prevent discrimination in favor of officers, stockholders, supervisory, and highly compensated employees.

Overall, in the United States, 68% of plan participants have no vested rights—which means that, if they terminate employment, they will receive no pension. This percentage, of course, includes many young employees with short service. Many of them will remain with their current employers and later obtain vested rights. Many of them, because they are young, will have an opportunity to obtain vested rights as they move on to other employment and participate in other pension plans. However, an uncomfortably large number of older workers do not have vested rights. With respect to the age of employees participating in qualified retirement plans today, we find that—

62 percent of participants between ages 40 and 50 have no vested rights;

58 percent of participants between ages 50 and 60 have no vested rights; and

54 percent of participants who are 60 or more have no vested rights.

The degree of vesting among older workers is particularly critical, since if older workers terminate employment, they will not have the same opportunity to obtain pension rights elsewhere as younger workers.

The lack of adequate vesting and consequent hardships from forfeitures have led to a clearly felt need for a minimum vesting standard. We have studied many different possibilities in depth and have developed and recommend to you for adoption a standard known as the "Rule of 50." Under this rule, an employee's benefit must be at least 50 percent vested when the sum of his age and years of plan participation equal 50. In the following five years, the percentage vested must increase at least 10 percent per year to achieve 100% vesting. The new standards would apply to newly-accrued plan benefits as they accrue, starting with plan years after 1974.

As an illustration, a worker who begins to participate in a plan at age 30, would become 50 percent vested when he reached age 40, because his then age (40) plus years of participation (10) would equal 50; and his accrued benefits would be fully vested 5 years later when he reached age 45. Further illustrations are given in Chart 1.

To complement the vesting proposal, the bill provides minimum service and age standards for eligibility to participate in a qualified plan. In general, an employer would not be permitted to exclude from plan participation any employee who has attained age 30 and has worked for the employer for at least 3 years. However, an employer would not be required to cover an employee who would first become eligible to participate after he has attained an age within 5 years of normal retirement age under the plan. Thus, if normal retirement age is 65, employees who are over 60 when they first satisfy the other eligibility requirements would not have to be allowed to participate.

The "Rule of 50" would be a major step in assuring pension benefits, particularly among older workers. Overall, it would raise the number of participants with vested rights from 32 percent of all participants to 61 percent of all participants. But more important, among participants age 40 and over, the percentage with vesting would rise from 40 to 92 percent. Thus, the "Rule of 50" would assure vesting of retirement benefit rights for virtually all older plan participants. See Chart 2.

Because it concentrates particularly on the vesting problem of the older employee, the cost of the Rule of 50 is reasonable. We estimate it would raise over-

*See appendix B, volume 1.

all pension costs by 2.4% in contributions or 0.15% of covered payroll. Even in the extreme case of plans currently providing no vesting before retirement, we estimate it would increase plan costs by 7.6% in contributions or only 0.38% of covered payroll. In terms of average cost per hour per covered employee, the costs would be increased by three-quarters of a penny per hour on the average for all plans, and 1.86 cents an hour on the average for plans with no vesting now. See Chart 3.

The Rule of 50 also holds cost down because it applies only prospectively. The limited cost involved in this solution to the vesting problem is extremely important because, to the extent employer contributions must be allocated to the cost of vesting, the level of retirement income that can be provided under the plan would be reduced for those who remained employed until they retire. A balance must be struck among the various considerations. We believe the Rule of 50, which protects primarily the older worker without increasing cost unduly, strikes the proper balance. We have studied carefully other vesting proposals that have been advanced but have found that they may be more costly, may not concentrate as well on the problem of the older worker, or may not benefit the employee who works in short term employments throughout his work career.

We have carefully considered whether the Rule of 50 would seriously affect the hiring of older employees and have concluded that it would not do so. We find that the discounted single-premium cost of providing $100 of retirement income at age 65 for a worker who begins to participate at age 55 is $570 if no vesting is provided, and the cost rises only $15 to $585 if the Rule of 50 is operative.

The net increase due to vesting is actually greater for younger workers; for example, at age 35 the cost of the retirement income is $125 without vesting and $155 under the Rule of 50. The reason why the cost increase due to vesting is greater for younger workers is that the employee turnover rate is considerably higher at the young age levels than at the older. There would actually be no cost for vesting if all employees stayed until normal retirement age.

Thus, the net effect of the Rule of 50 is to reduce, rather than increase, the existing pension cost disparity which might tend to favor the hiring of younger workers. However, even for younger employees the cost is not excessive. See Chart 4.

Vesting for Self-Employed Plans. Under present law, a plan benefiting a self-employed person who is an owner-employee must include any employee with at least 3 years of service, and his rights must be fully vested. The vesting and participation rules result in vested rights for many young workers who have short periods of service. Their benefits are generally small, and the administrative costs of handling these cases are relatively high. We recommend some relaxation of these requirements.

The proposed legislation would provide that, in self-employed retirement plans covering owner-employees, an employee would become 50% vested when he qualified under a "Rule of 35", that is, when his age plus years of participation total 35. As in the case of the Rule of 50, his vesting would have to increase by at least 10% a year to 100% over the next five years. Such an employee could be required to have as much as one year's service before being eligible to participate in the plan, or two years' service if he is between age 30 and age 35, or three years' service if he is under age 30.

Thus, under present law, in the case of plans established by self-employed persons who are owner-employees, an employee hired at age 20 must begin to participate and become fully vested at 23. Under the proposed legislation, he must begin to participate at 23, must become 50 percent vested at 29, and fully vested at 34. An employee hired at 35 would become 50 percent vested at 36, when he begins to participate, and fully vested at 41.

Definition of Accrued Benefit. For any vesting requirement to be effective, there must be a definition of "accrued benefit." Vesting is relevant only when an employee leaves his job prior to retirement. Vesting refers to the percent of the employee's accrued benefit which he receives if he leaves his job prior to retirement. However, a high percentage of vesting can be small comfort if the accrued benefit is a small amount.

For a profit-sharing plan and a money purchase pension plan, the accrued benefit is easy to define; it is the balance in the account at that time. However, for a defined benefit pension plan, the question is a more difficult one. Other vesting proposals would leave the definition of accrued benefit to regulation. However, we believe that the matter is so fundamental that it should be specified in the statute. We have developed a definition which calls for essentially a straight line accrual. The rule is that an employee's accrued benefit, as of any applicable date prior to normal retirement age, is expressed as a fraction of the annual benefit commencing at normal retirement age which the employee would receive if he continued employement at his current rate of compensation until normal retirement age. The numerator of the fraction is the total number of his years of service with the employer.

The denominator is the total number of years of service he would have performed as of normal retirement age if he continued to be employed by the employer until normal retirement age. However, the denominator would not be less than 15 nor more than 40. For example, an employee who is hired at age 35 and loses his job at age 50, halfway to a normal retirement age of 65, would be deemed to have accrued one-half of the benefit he would have received under the plan if he had remained employed at the same salary until he was 65.

2. MINIMUM FUNDING STANDARD

The basic expectation of a participant in a defined-benefit pension plan is that when retirement age arrives, pension benefits will be paid out according to the terms of the plan. To give this assurance, it is essential that an employer contribute to the plan the money that will eventually be needed to pay the benefits. Most plans today are adequately funded, and the amount of benefit losses on plan terminations is minor in relation to the overall volume of pension benefits paid out. During the first seven months of 1972, for example, 3,100 employees lost $11 million of vested benefits as a result of termination of underfunded plans. While this is a small fraction of $10 billion of benefits paid out in 1972, this is small consolation to the affected employee, who had been promised a pension and found that the promise was not to be fulfilled.

Federal law at present provides no explicit statutory funding standard, although a funding standard has been developed administratively for use in determining whether or not a complete discontinuance of contributions has occurred.

The bill would augment this minimal protection by an additional requirement to fund annually at least 5% of the unfunded vested liabilities under the plan. This is similar to the standard required by the accounting profession for financial statements.

This provision of the bill would be effective for plan years beginning after December 31, 1973. Because of problems some plans—particularly collectively bargained multi-employer plans—may have in meeting this standard, it may be advisable further to delay this effective date until the end of the term of the current collective bargaining agreement.

Other proposals have been made to require all past service costs, whether or not vested, to be funded over a fixed period, or to require the funding of vested liabilities to have attained specified percentages at specified times. We believe that the government should insist on the funding of liabilities as they become vested, since these vested liabilities represent promises to the employees which should be backed up with cash. We do not believe the government should insist on the funding of all liabilities in view of the larger additional costs thereby imposed, which may be reflected in less adequate pensions. We further believe that a funding standard should be simple in concept, simple to administer and should not be so inflexible as to require waivers of the standard in those cases such as declining industries where the standard is most needed.

3. INCREASE IN CONTRIBUTION LIMITS FOR THE SELF-EMPLOYED

Present law limits contributions to qualified pension and profit-sharing plans made by self-employed individuals. The self-employed are subject to a limit of the lesser of 10% of earned income or $2,500 per year on deductions for retirement savings. No such limits apply to employer contributions on behalf of corporate employees. As a consequence, corporate employees have substantial tax benefits as compared with self-employed individuals. This and other disparities have discouraged the formation of self-employed plans and have encouraged many self-employed individuals to incorporate their business to avoid these limitations.

The tax law should not require self-employed individuals to incorporate merely to obtain greater retirement deduction benefits. For a small business, incorporation can be expensive and uneconomic and may lead to unnecessary administrative difficulties. And once incorporation has taken place, qualified plans will frequently involve deductible contributions of greater than $7,500 per year for the owner-employees, thereby leading to substantial revenue loss.

To reduce the existing inequity between unincorporated and incorporated businesses, the bill would raise the deduction limit for the self-employed to the lesser of 15% of earned income or $7,500 per year. The limitation on excludable contributions on behalf of shareholder-employees of Subchapter S corporations contained in section 1379(b) of the Internal Revenue Code would also be increased to this level.

We estimate that this proposal would involve a maximum revenue cost of $70 million in the first year of operation, rising to $140 million in subsequent years. However, because this proposal may forestall incorporations and the establishment by such corporations of plans with deductible contributions in excess of $7,500 per year, this estimate may be overstated. In fact, there even may be an actual revenue gain.

The proposal would reduce the tax motivation to incorporate where insufficient business reasons exist for such incorporation. In addition, it would promote the growth of self-employed plans and have a beneficial impact on the coverage of employees of nonincorporated enterprises and on their level of benefits.

4. EMPLOYEE DEDUCTIONS FOR VOLUNTARY RETIREMENT SAVINGS

About half of the full-time private non-agricultural adult work force is covered by private retirement plans, and the average annual private pension benefit is about $1,700. Unfortunately, the other half of this adult work force is not covered today, and many of those covered do not have sufficient retirement benefits. We believe it is of prime importance to offer a remedy for the millions of employees who are not covered or are inadequately covered by employer plans. The Retirement Benefits Tax Act would do this by providing income tax benefits to encourage and assist these employees to save for their retirement.

Under present law, employer contributions on behalf of an employee made to a private qualified retirement plan, and the investment income on these contributions, are generally not subject to tax until paid to the employee or his beneficiary. Yet, compensation set aside for retirement by an individual employee independently, as well as investment earnings on those savings, are taxed currently as they are earned. As a consequence, present law discriminates against those individuals who do not participate in employer-sponsored qualified plans or who participate in plans providing small benefits. Under the Retirement Benefits Tax Act, employees not covered by employer plans would be allowed to establish their own qualified retirement accounts and take an income tax deduction for contributions up to 20% of their earned income, with a maximum deduction of $1,500 per year. The proposal would extend also to employees who are covered by employer-financed plans to assist those employees if the employer contributions are not adequate to provide sufficient retirement earnings. To accomplish this, the limit on the amount deductible by the employee would be reduced to reflect pension plan contributions made by the employer. For this purpose, the employee could assume that employer contributions amount to 7 percent of his earnings, but he would be permitted to show, under regulations that would be provided, that the employer contributions were in fact a lesser amount, if such were the case.

In the case of employees who are not covered by social security (such as certain government employees), the deductible contribution limit would be further reduced by the assumed amount of employee's social security tax that would have been imposed had the employment been covered by social security. This reflects the fact that social security tax is not deductible. To permit a deduction of retirement contributions without an assumed social security tax offset for those not covered by social security would discriminate against those covered by social security.

Individuals would be permitted to invest their retirement savings in a broad range of assets, including stocks, corporate or government bonds, savings accounts, mutual fund shares, annuity contracts, and life insurance contracts. Participants in qualified employer-sponsored retirement plans could make their investment for retirement savings by contributing to these plans.

The proposed limitations on the amount of deductible contributions direct the tax benefit primarily to low and moderate income workers. Yet, the permitted contributions would provide substantial amounts of retirement income. For example, contributions of $1,500 annually beginning at age 40 would produce an annual pension of $7,500 per year beginning at age 65, assuming a 5% interest rate. See Chart 5.

The permitted contributions level is not so high, however, as to undermine the incentive in existing law for the creation and maintenance of employer-financed retirement plans that cannot discriminate in favor of employees who are officers, shareholders, or supervisory or highly compensated employees. The employer-financed non-discriminatory plan is the heart of the present private pension system and should be maintained.

The bill provides for a deduction from income, rather than a credit, in order to put the employee who establishes his own plan in approximately the same position as the employee who participates in an employer-financed plan.

We propose that the employee deduction provision should be effective beginning in 1973. However, we have revised upwards our revenue estimates with respect to this proposal on the basis of better data. Because of the budgetary impact, and because the year is almost half over, we propose that the deduction for 1973 be limited to one-half the full year's deduction available for subsequent years. The technical amendments we are submitting would make this adjustment. We estimate that approximately 15 million individuals would be eligible to benefit from this proposal for deductible employee contributions. The revenue cost of the proposal is estimated at $375 million in the first year of operation and at $800 million in the second year. It is estimated that 56% of the tax benefits will go to persons with income below $10,000 and 88% will go to persons with income below $15,000.

5. ROLL-OVER PROVISION

Under existing law, if a lump sum distribution is made under a qualified retirement plan, the distribution is subject to income tax. The distribution is taxed even if received by an employee before his retirement and set aside by him for his future retirement security. Often, if an employee leaves his employer for a new job under circumstances where he has a vested right to retirement benefits from his first employer, his retirement benefits will be distributed to him in a lump sum at the time he leaves his first employer. This is convenient for, the employer, because he thereby avoids continuing to administer funds for the benefit of a former employee. However, because of the income tax payable at that time, the employee will have a smaller fund available for his retirement years. On the other hand, an employee who, throughout his working career, is employed by a single employer, will typically avoid any tax on his retirement funds until actual retirement. Such a result creates an inequity between employees who work for only one employer and employees who are more mobile.

Under the bill, an individual would not be subject to tax upon receipt of a lump sum distribution if he reinvests the funds in a qualified individual retirement account or a qualified employer-sponsored retirement plan within 60 days after the close of the employee's taxable year. If the individual receives the distribution in property, other than cash, he would have to contribute the same property in order to take advantage of this tax deferral opportunity. The proposal would encourage retirement savings by enabling an employee to defer taxation of this amount until retirement.

6. PROHIBITED TRANSACTIONS

Under present law, a trust maintained under a qualified private retirement plan is denied exemption from taxation if it engages in a prohibited transaction. Prohibited transactions are defined in section 505 (b) and (g) of the Internal Revenue Code. Generally, a prohibited transaction is a transaction between the trust and the employer or a related person which results in a diversion of assets from the trust to the employer.

If exemption from taxation is denied to the trust, special benefits affecting the employees are denied. The employees will be taxed on their vested interests in the trust before it is distributed to them, their retirement benefits will be decreased by taxes paid on the trust income, and the special averaging provisions with respect to lump sum distributions will no longer be available.

The denial of a trust's exemption from taxation has not been a satisfactory deterrent to participation in prohibited transactions. An employer, in need of working capital or in a failing financial condition, may find it advantageous to forego a deduction for any contribution made to a plan in order to divert trust assets to his own use. In far too many instances, the fiduciary of the trust acquiesces in the employer's demand to divert assets to the detriment of the employees. In many cases, the consequences of the denial of exemption fall upon innocent employees.

The sanction against prohibited transactions should be directed only against those who participate in such transactions. An employee who is a stranger to the transaction should not be penalized. Accordingly, the bill follows an approach similar to the approach of the Tax Reform Act of 1969 with respect to private foundations. Excise taxes would be imposed on the amount involved in a prohibited transaction. The taxes would be paid by any party in interest who is a participant in the prohibited transaction. An initial tax would be imposed at the rate of 5%. An additional tax would be imposed at the rate of 200% if the transaction is not corrected within 90 days after a notice of deficiency for such tax is mailed.

Under the bill, prohibited transactions would be defined in the same manner as acts which are prohibited by the Employee Benefits Protection Act. Thus, there would be a uniform application of the tax law and the law relating to fiduciary standards. Furthermore, the effect of this definition would be to extend the fiduciary standards of the Employee Benefits Protection Act to qualified private retirement plans that are not covered under that Act, for example, to qualified plans covering fewer than 26 participants.

7. EMPLOYEES COVERED UNDER COLLECTIVE BARGAINING AGREEMENTS

Under existing laws, a qualified private retirement plan must cover either such employees as qualify under a classification which does not discriminate in favor of officers, shareholders, or highly compensated employees, or specified percentages of employees. In addition, contributions or benefits under the plan must not discriminate in favor of those participants in the plan who are officers, shareholders, or highly compensated employees.

In many cases, employees covered under a collective bargaining agreement prefer current compensation or other benefits to the benefits provided under a qualified plan. Thus, many employers are unable to establish a plan for other employees because the percentage requirement cannot be satisfied if the bargaining unit employees are not covered. In other cases, the exigencies of the bargaining situation may dictate adherence to a union plan, and the benefits provided thereby will effectively preclude a better level of benefit for non-bargaining unit employees. This deprives the employer of flexibility in fashioning compensation packages tailored to meet the needs of the non-union employees.

Under the bill, employees who are included in a unit of employees covered by a collective bargaining agreement may be excluded for purposes of satisfying the coverage requirement, unless such agreement provides that the employees are to be included in the plan. Under the technical amendments we will submit, such employees may also be excluded for purposes of satisfying the discrimination requirement.

8. TRUSTEES AND CUSTODIANS

Under existing law, the trustee of a trust forming part of a retirement plan benefiting an owner-employee must be a bank, trust company or building and loan association. Furthermore, a custodial account may be treated as a trust if the custodian is a bank, trust company or building and loan association, and if investment of the funds is either solely in mutual funds or solely in annuity contracts.

Under the bill, any person who demonstrates that he will hold the assets consistently with the requirements for qualification may be a trustee for a plan benefiting an owner-employee or a custodian for any plan. The restrictions relating to investment by custodians would be eliminated. This provision is identical with the corresponding requirement the bill would establish with respect to qualified individual retirement accounts.

9. TIME WHEN CONTRIBUTIONS DEEMED MADE

Under existing law, a taxpayer who reports his income on the accrual basis may deduct contributions made after the close of the taxable year, if they are made prior to filing a tax return for that year. This rule is desirable since in many cases it is impossible to determine by the end of that year the amount which can be contributed under the plan for the year.

Under the bill, this rule would be extended to cash basis taxpayers.

10. INCLUSION OF CERTAIN EMPLOYER CONTRIBUTIONS IN GROSS INCOME

Under existing law, except in the case of a shareholder-employee of an electing small business corporation, there is no limit upon the amount which may be contributed under a qualified private pension plan on behalf of the employee and which may be excluded from gross income by that employee. Furthermore, there is no meaningful limitation on the deductible amount which may be contributed by an employer under a money purchase pension plan. Under the bill, an employee would be required to include in his gross income currently the employer contributions made on his behalf under a money purchase pension plan to the extent in excess of 20% of his compensation.

Before concluding, I would like to turn briefly to two other subjects being discussed currently in connection with pension reform—portability and termination insurance.

Portability

Proposals have been made to provide a national system of pension portability. The theory of portability is admirable. The idea is that when an employee leaves one employer for another, he should be able to transfer his pension rights from the first employer to the second employer. Unfortunately, the theory breaks down when one considers the vast differences between the various retirement plans which are being maintained today.

As a partial answer to this problem, it has been suggested that the portability system should be voluntary. I am afraid that gets us no further, since it is possible today for employers to agree voluntarily to allow pension rights to be transferred.

In our judgment much of what the advocates of portability want is, in effect, provided by two provisions in the Retirement Benefits Tax Act. First, the minimum vesting requirement of the Rule of 50 partially achieves the basic aim of portability—that pension credits not be lost when an employee transfers from one employer to another. Second, the roll-over provision of the bill provides the assurance that a lump sum pay-out from a former employer may be reinvested for retirement security without payment of extra taxes.

In addition, the provision for qualified individual retirement plans would permit an employee to set up his own plan which would move with him from one job to another, whether or not either employer maintained a retirement plan. And, under the qualified individual retirement plan provision, funds could be transferred tax-free from one investment medium to another—another element of portability.

Termination Insurance

It has been suggested that a government-sponsored termination insurance program should be established to assure that no workers or retirees suffer termination losses. We have given this proposal thorough consideration, but we have not recommended it.

In December of 1971 President Nixon directed the Departments of Labor and Treasury to undertake a study to determine the extent of benefit losses arising from pension plan termination. It was the purpose of the study to obtain the information needed to determine what Federal policy should be on funding, the nature of the employer's liability, and termination insurance. An Interim Report on this study was completed in February. This study found in general that there are significant losses upon plan terminations but that these losses are small in relationship to the benefits paid under the private retirement system. Considerable effort was exerted to study the insurance plans which have been proposed and to attempt to devise a better one.

It is not easy to develop an insurance plan which would reduce the benefit losses significantly without providing government regulation of pension plans, business practices and collective bargaining on a scale which is completely inconsistent with the amount of benefit losses now being experienced. We attempted to develop such a plan but found ourselves forced into provisions imposing regulatory requirements on all pension plans, the impact of which requirements would have been clearly disproportionate to the scope of the problem as actually experienced. To be truly effective, an insurance system would have to insure all vested benefits without limitation. However, such a system without any controls would be highly susceptible to abuse. As abuse controls are built into an insurance system, the degree of coverage decreases and the degree of governmental interference increases. Accordingly, we have concluded that, on balance, no insurance system is preferable to any insurance system we have studied or have so far been able to devise.

We have not abandoned the idea. We are continuing to study it, and would be happy to discuss the insurance problems with you and your staff in the days ahead.

I appreciate the opportunity to have appeared before you today to urge passage of the Retirement Benefits Tax Act. As I have explained, the Administration's pension reform program would strengthen the private retirement system by curbing abuses and encouraging the expansion of the system. It would increase the coverage of retirement plans to a greater number of employees and would provide for more equitable treatment between the self-employed and those employed by others. It is a very significant and important program which deserves the support of this Committee and of the Congress, and I commend it to you for your consideration.

Thank you.

Chart 1

RULE OF 50 VESTING STANDARD

50% vested when age plus years of participation in a plan equal 50; 10% more each year thereafter.

OPERATION OF RULE OF 50

Age				Years of Service	
(1) At entry	(2) At participation date*	(3) At 50% vesting	(4) At full vesting	(5) To acquire full vesting	(6) To acquire 50% vesting
20	30	40	45	25	20
25	30	40	45	20	15
30	33	42	47	17	12
35	38	44	49	14	9
40	43	47	52	12	7
45	48	49	54	9	4
50	53	53	58	8	3
55	58	58	63	8	3
60	63**	—	—	—	—

Minimum participation standard: Must participate at age 30 and three years service.

Need not participate if age is five years less than normal retirement age.

Chart 2

EFFECT OF RULE OF 50 ON VESTING

AGE	PERCENT NOW VESTED*	PERCENT VESTED* UNDER RULE OF 50
Under 25	19%	19%
25-30	23	23
30-40	26	36
40-50	38	82
50-60	42	100
60 or more	46	100
All age groups	32%	61%

Participants in plans who are at least 50 percent vested.

Chart 3

AVERAGE EMPLOYER COST INCREASE UNDER RULE OF 50

COST INCREASE AS:	ALL PLANS	PLANS WITH NO VESTING
% Increase in contributions	2.4%	7.6%
% Increase in payroll	0.15%	0.38%
Additional cost per hour per covered worker	0.75¢	1.86¢

Chart 4

COST OF VESTING AN OLDER WORKER IS MINIMAL

To provide a $100 annual pension at age 65 costs as a single payment...

t Age	Without Vesting	With Vesting	Increase In Costs Due to Vesting	
			Amount	Percent
25	$20	$30	$10	50%
35	125	155	30	24
45	310	340	30	10
55	570	585	15	3

Assumes straight life annuity for males, with assets invested at 5%.

Assumes typical employee turnover rate (for example, 85% of employees age 25 will leave their present employment before age 65; only 3% of those age 55 will leave.)

Chart 5

EMPLOYEE'S INDIVIDUAL RETIREMENT DEDUCTION AIDS MATURE WORKER WHO RETIRES AT AGE 65

Begins Contributing at Age:	Annual Pension* if He Contributes Annually		
	$1,500	$1,000	$500
40	7,500	5,000	$2,500
45	5,200	3,447	1,723
50	3,375	2,250	1,125
55	1,950	1,300	650
60	900	600	300

* Pensions are straight-life pensions for males payable in monthly installments. A 5 percent interest rate is assumed.

Senator NELSON. Our next witness will be Senator Bentsen.

STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM THE STATE OF TEXAS

Senator BENTSEN. Thank you, Mr. Chairman.

I have a prepared statement that I will submit for the record, but for the purpose of this meeting, if it is all right with the committee, I will do it more informally and summarize. Then we can get to some of the major points in my particular bill and how they compare with the administration's bill.

I think we ought to say, first, that private pension plans across this country, in the vast majority of cases, are performing well and doing a good job for employees. What we are trying to do here is to take care of some of the aberrations, take care of some of the people who have taken advantage of employees and to see that this is not done in the future. We are not really trying to establish an ideal pension plan, but we are trying to set up certain minimum standards to avoid abuses by pension plans. I think that is the objective.

Now, some of the things that have been said by the committee this morning I would be in total concurrence with as the ideal; things, that is, that we would like to accomplish. But we have to keep in mind that what we are dealing with are voluntary pension plans.

There has been a fantastic increase in the number of pension plans in the last 20 years and we want to see that trend continue as a supplement to social security. So that is why we talk about minimum standards that must be put in.

Now, let's get to this question of vesting. The administration proposed a bill with a rule of 50, which I feel is definitely discriminatory against the hiring of older employees.

Senator NELSON. Discriminatory against the hiring of older employees?

Senator BENTSEN. Of older employees, yes. This means the employer has to fund it faster. It means it is more expensive to him and that he will think a long time before he hires a man who is 48 or 47 as compared to one that is 30, because of the short time in which he has to fund the older employee's pension and take care of the liability.

Senator NELSON. The Secretary made just the opposite argument.

Senator BENTSEN. Well, I am not sure he made it without some equivocation.

Senator NELSON. I didn't notice any equivocation.

Senator BENTSEN. I think in his testimony he weighed his words very carefully.

Senator CURTIS. He referred to the individual in his sixties, and you are talking about the effect of people in their forties.

Senator BENTSEN. Correct.

In my proposal, we provide for 25 percent vesting after 5 years in the plan. Now he can be eligible for participation in the plan after 1 year of service or at 30 years of age, whichever comes later. We provide for additional vesting of 5 percent per year so that at the end of 20 years you will have full vesting. We do not tie it to age. S. 4 does not tie it to age. I think it is a serious mistake to tie it to age.

As to Senator Ribicoff's question on portability, you achieve some additional portability by earlier vesting. A pension plan participant has something that is his, and he owns it and my bill would allow, with the agreement of the employer and the employee, the tax-free transfer of the vested portion. Now, if there is no agreement, remember it is still vested anyway, so when he reaches retirement, even though he is working for someone else, he receives the pension from this plan where he had a vested interest anyway.

One of the other things I have done is to try to do something for the older man when this act is put into effect. And we do provide retroactive vesting for all men who are 45 years or older, when this goes into effect.

Now, we give current pension plans 3 years to change their provisions of funding and vesting to accomplish what we are talking about here.

One of the major points in this bill and the administration's, as opposed to S. 4, is the administration of the plan itself. Who does it? Under S. 4 the Labor Department does it. Under my bill and the administration's bill the Treasury Department does it. Where is the logic in this? Which really should be the administrator?

Well, at the present time, if you have a pension plan, IRS will come in and investigate it to see that it is nondiscriminatory and to see that you have reasonable vesting provisions. Now, if you go ahead and let the Labor Department also administer this, then you are going to have two agencies doing it and they are going to have two sets of employees coming in to check on the funding and vesting; IRS to see if it is nondiscriminatory and the Labor Department to see if it complies with S. 4. It is quite possible that you would have one set of Federal employees from one agency telling them that the plan was in concurrence with everything they wanted and the other agency telling them that it was not. And you would have a conflict there. So, insofar as avoiding duplication, insofar as avoiding expense to the taxpayers and insofar as having less confusion, less burden to the employer, I think we would be much better off in seeing the administration of this plan under IRS and under the Treasury Department.

Let's get to the question of termination insurance, which I have provided for in my bill and the administration has not. It is not an easy problem. It is a complex one but I don't think that means we ought to walk away from it. Each year only a small number of pension plan participant lose benefits because inadequately funded plans terminate. But to that small number of persons, they may lose 100 percent of their earned benefits. By the same token, only a small number of banks become insolvent as Senator Ribicoff indicated. The vast majority of banks are safe and they do provide protection for their depositors but that doesn't stop us for a minute from continuing FDIC so that people can feel safe about their bank deposits.

The Secretary said, each plan is a part of one big pool and if you have termination insurance on pension plans, you can be affected by the administration of other plans. I agree with that. But if you have a bank, for instance, you are a part of one big pool and you are also affected; that is, the FDIC is affected by what happens in those other banks. Would we say, by the same token, that somebody might be encouraged to make bad loans in the banks because we have FDIC insurance and the insurance would bail out your depositors? I don't think so at all.

It would be a reflection on the management. You would have problems with the stockholders and management. I think you would run into the same kinds of things on termination insurance for pension plans.

Senator DOLE. How do you handle termination insurance?

Senator BENTSEN. There are a number of ways to handle it. In my particular bill it is handled by imposing a premium on the unfunded vested liability of each plan. Now this a rather difficult thing to do and I am not wedded to that particular provision. Another way would be to impose the premium on all plans, for example as a percentage of yearly contributions to the plan.

Another thing that I have provided for is that prior service liabilities must be amortized over a 30 year period. That gives a reasonable period of time for the employer to accomplish it.

Senator NELSON. You said must be?

Senator BENTSEN. Must be.

So that would not be more than 30 years—

Senator NELSON. It can be less?

Senator BENTSEN. That is right. Remember, the plan can always be more generous than these minimum standards that we are talking about. But the one thing we must not do is to make the standards so tough that we discourage the installation of new plans.

My bill also has a provision relating to experience deficiencies. Actuaries make certain assumptions as to what your forfeitures will be, what your turnover of employees is going to be, what your investment return is going to be, and they unfortunately often err. It is not their fault because they just don't have the clear crystal ball it would take to precisely determine what the stock market is going to do and what interest rates are going to be. I believe that experience deficiencies should be funded over the average remaining working life of the employees covered by the plan. I think that is the most practical approach.

Another important decision I have made is to require even the smallest pension plans to comply with the minimum standards. S. 4, on the other hand, only covers pension plans down to 25 employees. Why not below that? Some of the worst abuses in vesting provisions and funding provisions occur in the very small plans. So I think they should all be covered.

Another thing I have provided is a tax credit for employees who make contributions for their own retirement. Instead of proposing a tax deduction, I have provided for a tax credit. In many instances, an employee would be permitted to contribute $1,500 and receive a 25-percent tax credit of $375. I think that a tax credit is more equitable than a tax deduction.

Mr. Chairman, I believe that covers in a very few minutes the major points in my pension reform bill and some of the major differences with the other bills that have been proposed. I would be pleased to try to answer any questions the committee might have.

Senator NELSON. What is the range of the credit you permit under your bill?

Senator BENTSEN. At a maximum, an employee can contribute $1,500 and receive a 25-percent tax credit.

Senator BENNETT. That is 25 percent at every level?

Senator BENTSEN. That is right.

Senator BENNETT. He puts up $100 and gets $25 back.

Senator BENTSEN. That is right.

Senator NELSON. Any other questions? Senator Byrd, do you have any?

Senator BYRD. I think not, Mr. Chairman.

Senator NELSON. All right, thank you. Senator Bentsen.

Senator BENTSEN. Thank you very much.

Senator NELSON. We now go to the 10 minute rule.

Senator BENTSEN. Well, then, I wasn't far off.

Senator NELSON. It didn't apply to the authors of proposals. That is the only exception that we have made; that those who are appearing on behalf of their own proposals are not limited on time.

[The prepared statement of Senator Bentsen follows:]

PREPARED STATEMENT OF SENATOR LLOYD BENTSEN ON BEHALF OF S. 1179

Mr. Chairman, I greatly appreciate the opportunity to testify here this morning on behalf of my private pension reform bill, S. 1179.

Over the past several decades America's private retirement system has expanded at a very rapid pace. For the tens of millions of American working men and women who have received their earned benefits in full, our private retirement system has performed very adequately. For these workers the private retirement system has proved to be an excellent example of the ability of our free enterprise system to respond to a vital need—the need to provide retirement security for our senior citizens. Unfortunately, in far too many instances retired workers have suffered tragic economic losses because they have been denied their earned benefits. In these instances America's private retirement system has not only failed to perform adequately, it has performed dismally.

It is essential that Congress act now to correct the inequities in our private pension system. I am hopeful that the Senate Finance Committee will take rapid action on pension reform legislation and report a bill to the floor quickly enough so that the Senate can complete action on pension legislation before the August recess.

Very briefly, S. 1179 would amend the internal revenue code to establish minimum standards of vesting and funding and to require all pension plans to obtain termination insurance.

These minimum standards would apply to all plans regardless of size. Only plans administered by the Federal or State and local governments would be exempt. S. 1179 would also allow a tax-free transfer of vested pension rights upon a change of employment but only if both the employee and employer consent to such a transfer. In addition, S. 1179 would provide a limited Federal tax credit for an individual's own contributions to either a qualified employer-sponsored plan or a qualified "individual retirement account." A tax credit would be much more equitable than a deduction in this situation.

I would now like to discuss in some detail four very important pension issues which presently face the Congress.

First, the most efficient and practical method to enforce minimum vesting, funding and termination insurance requirements would be through appropriate amendments to the Internal Revenue Code.

Second, the most equitable vesting formula would be a graded formula based solely on number of years of service. A formula tied to age would have the most undesirable effect of discouraging the hiring of older workers.

Third, while a minimum funding schedule is essential, a program of pension plan termination insurance is also needed.

Fourth, while legislation is essential to protect the earned benefits of those fortunate enough to be participating in retirement plans, Congress must also focus on the tens of millions of American working men and women who do not now adequately participate in the private retirement system.

SELF-ENFORCEMENT THROUGH THE INTERNAL REVENUE CODE

One of the major issues that Congress must decide is whether minimum standards of vesting, funding and termination insurance should be enforced by the Labor Department through mandatory injunctions or be enforced by the Treasury Department through a denial of favorable tax treatment. There is no question in my mind that these minimum standards can be most effectively administered and enforced by the Treasury Department through a denial of tax qualifications.

The favorable tax treatment granted to pension and other retirement plans has been a major stimulus for the growth of America's retirement system.

The Internal Revenue Code already imposes many restrictions on private retirement plans for the specific purpose of protecting those American workers who participate in these plans. The most practical method to impose additional (but related) restrictions would be to add them to our tax law.

It is now several decades since Congress decided to promote the growth of private retirement plans through federal tax incentives. The Internal Revenue Service which is a part of the Department of Treasury has been administering these laws since their enactment. Over the years the Internal Revenue Service has acquired the experience and expertise needed to administer the tax laws pertaining to the many complicated and diverse retirement plans currently used by private business. There is little justification to create a new federal agency or to divide jurisdiction between two seperate federal departments where an existing agency can adequately do the job.

NECESSITY OF A GRADED VESTING FORMULA BASED SOLELY UPON YEARS OF PLAN PARTICIPATION

A fundamental problem in our private pension system involves the loss of pensions by workers who leave their jobs before their pension rights become vested. Vesting occurs when an employee receives a nonforfeitable right to the money contributed to a pension plan on his behalf. Once an employee's pension rights are vested, he is entitled to receive his benefits even if he leaves the company prior to retirement. A vested employee retains his rights wherever he may go.

There have been countless examples of employees who have worked for a company for many years, but have lost all of their pension because they left their job before complying with unreasonably long vesting requirements.

These tragedies clearly demonstrate the need for Congress to require all private pension plans to adopt at least some minimum vesting standard to adequately protect the interests of plan participants.

The question naturally arises as to what vesting formula should be the minimum required.

There is no question in my mind that a graded vesting formula based solely on the number of years of plan participation is the best approach.

A formula which provides 100 percent non-graded vesting after ten years of service has several distinct drawbacks. Such a proposal provides no assistance to an employee who terminates employment prior to the ten year period. The proposal might also encourage employers to discharge workers just prior to ten years of service.

A formula such as the "rule of 50" which ties vesting to age also has distinct drawbacks. The "rule of 50" formula would have the very undesirable side effect of discouraging the hiring of older workers. Under this rule a 50 year old applicant would vest immediately while a 20 year old applicant would not vest for 15 years. This would be a substantial incentive not to hire the 50 year old applicant because the cost of funding a pension for anyone close to retirement age is comparatively high. In that older workers already face a great difficulty in finding employment, a vesting formula should not be adopted which would aggravate the problem.

A graded vesting formula removes all of these inequities. Such a formula is not an all-or-nothing approach and will not result in age discrimination.

TERMINATION INSURANCE IS ESSENTIAL TO REAL PENSION REFORM

Although adequate vesting and funding standards are vital components of any proposal to protect pension plan participants, any really meaningful reform must also include a program of pension plan termination insurance.

Only with a system of termination insurance can every American worker be guaranteed that he will actually receive the vested benefits that he has earned through years of long, hard labor.

There have been many examples of pension plans that have terminated with insufficient assets to meet all of the plan's obligations. Some of these terminations have involved plans that had been following very liberal funding schedules.

The Departments of Treasury and Labor recently indicated that during the first seven months of 1972 alone over 8,000 pension plan participants lost vested benefits. Over a ten year period we can anticipate that more than 50,000 plan participants will lose vested benefits.

This is certainly cause for concern. This loss of benefits constitutes a tragic hardship for the victims involved. In addition, this loss of benefits further undermines the confidence of the American worker in the ability of our private pension system to function effectively.

The concept of termination insurance is certainly nothing new. In fact, it is well established and has proven to be very effective in protecting millions of Americans from substantial economic losses due to such financial mishaps as the failure of banks, and savings and loan associations, or the financial difficulties of brokerage houses.

We have all heard of the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation. Just two years ago Congress added a new system of termination insurance with the creation of the Securities Investor Protection Corporation.

The existence of the FDIC and the FSLIC for close to 40 years in addition to the recent creation of SIPC, provides substantial precedent for and demonstrates the feasibility of a program of pension plan termination insurance.

The structure and organization of SIPC was used as a model for my proposed Pension Guarantee Corporation (PGC) which would be a non-profit membership corporation composed of all private pension plans.

NECESSITY OF EXPANDING PENSION PLAN COVERAGE

While legislation is essential to safeguard the pension rights of those American who now adequately participate in private retirement plans, Congress must give equal attention to two very related problems. First, there are tens of millions of American working men and women who do not now participate in any retirement plan whatsoever. Currently about one half of our non-agricultural work force—about 30 million workers—are not covered by retirement plans. Second, many employees who do, in fact, participate in retirement plans will not receive adequate benefits because employers are simply not making adequate contributions into the plan on behalf of the employees.

It is clearly discriminatory for Congress to provide special tax benefits for the 30 million participants of private retirement plans while *totally denying* any tax benefits to the tens of millions of workers who are not able to participate in these plans. These persons certainly deserve equitable treatment from Congress.

We must remember that when a consumer purchases an item such as a television or car a portion of the price will be used to create the pension of the electrical worker or auto worker. It is inequitable that many persons who indirectly contribute to the pension plans of others can not even establish a tax qualified pension plan for themselves.

Congress must now provide a mechanism for the millions of workers who do not currently participate in the private retirement system to save on their own. One method to do this would be to offer individuals a federal tax credit for a portion of their current income placed in a retirement fund. S. 1179 includes such a tax credit.

A tax credit is much more desirable than a deduction in this particular situation. A tax credit would provide a greater economic benefit to persons in a relatively lower income bracket than would a deduction. Those workers with lower incomes have a greater need for a monthly pension to provide financial security during their retirement years.

FIDUCIARY RESPONSIBILITY AND DISCLOSURE

Although S. 1179 contains no provisions relating to fiduciary responsibility and disclosure, I will most certainly support proposals to enact stringent fiduciary responsibility and disclosure laws. This can be most effectively accomplished by amending the Welfare and Pension Plan Disclosure Act. S. 1179 contains only those provisions that I believe should be included in the Internal Revenue Code.

Senator NELSON. Our next witness is Mr. Bert Seidman, director, social security department, AFL-CIO.

Would you identify yourself for the record, and the gentlemen accompanying you?

STATEMENT OF BERT SEIDMAN, DIRECTOR, SOCIAL SECURITY DEPARTMENT, AFL-CIO, ACCOMPANIED BY RICHARD SHOEMAKER, ASSISTANT DIRECTOR, AND KENNETH A. MEIKLEJOHN, LEGISLATIVE REPRESENTATIVE OF AFL-CIO

Mr. SEIDMAN. Thank you, Mr. Chairman. My name is Bert Seidman and I am the director of the Department of Social Security of the AFL-CIO and with me to my right is Mr. Richard Shoemaker who is assistant director of that department and to my left, Mr. Kenneth Meiklejohn, who is a member of the legislative department of the AFL-CIO.

Mr. Chairman, I will keep to your 10-minute rule, but we do have a more detailed statement and I would appreciate it if the detailed statement would be included in the record of the hearing.

Senator NELSON. It will be printed in full, in the record, at the appropriate place.

Mr. SEIDMAN. Thank you, Mr. Chairman.

The AFL-CIO strongly supports the goal of making the private pension plan system more responsive to the needs of the beneficiaries. Those covered by pension plans should have a greater assurance than they now have that they will, in fact, ultimately receive a pension when they retire.

Through collective-bargaining unions have, over the years, greatly improved the vesting and funding provisions of union negotiated plans. However, unions have no leverage over unorganized employers and collective bargaining cannot protect the interest of beneficiaries when their employer goes out of business. Only a Federal program of termination insurance can provide protection against this risk.

Neither S. 1179 nor S. 1631, the bills under consideration by the Pension Subcommittee of the Senate Finance Committee, nor S. 4 whose principles your subcommittee is considering adequately differentiate between single-employer and multi-employer plans. They are both pension plans, but we think there are the built-in advantages to the beneficiary of multi-employer plans which clearly indicate that less rigorous standards of vesting and funding would provide as much protection to beneficiaries as a more rigorous standard for single-employer plans. After all the bankruptcy of one single employer or even two or three in a multi-employer plan causes no hardship to either the plan or the plan's beneficiaries. Moreover, the value of a Federal termination insurance program is minimal for multi-employer plans and participants and, for this reason, such plans should not be required to pay the same termination insurance premium rate as single-employer plans.

The AFL-CIO favors the coverage provisions of S. 4 except that we think the coverage under the law should be broadened to include State and local government pension plans. In this regard we do not object to the Williams-Javits bill's exclusion of plans with 25 or fewer participants and we indicate in our testimony our reason for this. We also think it is appropriate to exclude union plans financed exclusively from members' dues. S. 1179 and S. 1631 exclude pay-as-you-go, unfunded plans. We think this is a major omission since such plans provide little protection to beneficiaries.

We think the vesting standard in all these bills should be improved for single-employer plans. The AFL-CIO recommends a standard of 100-percent vesting after 10 years of service for single-employer plans. Multi-employer plans should be given 5 years from enactment to provide relevant data after which the Secretary of Labor should be specifically authorized to grant variances from this standard for such plans. In granting such variances, the Secretary should be required to take into consideration such relevant facts such as the proportion of the industry or geographic area covered by the plan, the number and extent of reciprocity arrangements between plans, the special problems of fixed benefit plans and the economic hardship to employers and/or participants that would result from imposing the 10-year standard and such other factors that are appropriate to establishing a variance.

Portability of vested benefits is meaningless and amounts to no more than the privilege of receiving one check instead of two.

And, as has been indicated, we think there would be real problems in trying to establish portability of nonvested benefits in private pension plans.

The AFL-CIO favors a funding standard of 30 years for single-employer plans and 40 years for multiemployer plans. The Secretary should be given the authority to grant a variance from the 40 year standard for multiemployer plans based on the same relevant facts as are required for granting a variance from the vesting standard.

Few multiemployer plans terminate. Therefore, the AFL-CIO endorses the concept of S. 1179 which establishes two termination insurance pools: one for single-employer plans and the other for multiemployer plans. Termination insurance premiums for the two pools should reflect the degree of risk of termination for the two classes of plans. The AFL-CIO does not favor experience rating of plans within each of the two classes.

The AFL-CIO strongly opposes the granting of tax credits to individuals for money set aside to establish individual pension accounts. You will find in our detailed testimony the figures which clearly indicate that only well-to-do individuals could take advantage of such a program. To our minds, S. 1631 and to a lesser extent S. 1179 simply create another tax loophole for the wealthy which, if enacted, would probably expand in the future. Likewise the AFL-CIO opposes expanding the tax-deductible limit on pension contributions made by the self-employed. The Keogh Act has primarily benefited high paid doctors and lawyers. Most small businessmen have not been able to take advantage of the program.

Mr. Chairman, it has been claimed that the Keogh plan is necessary and should be strengthened in order to cut down on the establishment of professional corporations by doctors and lawyers. Well, I have the current issue of *Medical World News*, which is a magazine that goes to all of the doctors, and it says "the key then will be whether the new appeal of Keogh will make it a more viable alternative to professional incorporation than it is now." And they say the answer is "no." In other words, even that objective would not be achieved by raising the limits for tax deductible contributions to pension plans under the Keogh Act, which is proposed.

With respect to the question of where this legislation should be administered, we think that the appropriate agency for administering any pension reform legislation enacted by Congress is the Department of Labor. This is because pension plans are an integral part of the collective bargaining process and relate to labor relations generally. Regulation by the Internal Revenue Service relies on the employer's self-interest in maintaining tax deductions. Now, this is a very weak enforcement mechanism from the point of view of the beneficiaries. And it is this point that should be of paramount consideration to this committee. Ordering a plan to discontinue would not protect the interest of the participants.

In summary, while S. 4, of the three bills being considered by the subcommittee, comes closest to the kind of legislation the AFL-CIO would like to see enacted, we think it needs improvement. The bill should be improved along the lines suggested by this testimony in order that the private pension plan system be made more responsive to the needs of its beneficaries. And it is the beneficiaries, we repeat, who deserve the most careful consideration from this committee and the Congress.

Senator NELSON. Thank you very much. Senator Bennett?

Senator BENNETT. You're asking for more liberal vesting and funding requirements for multiemployer plans because of their special circumstances.

So you object to the application of the same principle to other areas indicating less need for proposed funding and vesting rules, for example, regulated utilities for companies that maintain a network several times the unfunded liability?

Mr. SEIDMAN. We are suggesting that from the point of view of the worker, that he will get more protection in a multiemployer plan than he will under any ordinary circumstances in a single-employer plan, including such things as public utilities. After all, if a worker leaves the employment of that public utility and goes somewhere else, he is not covered. If he is a carpenter and he goes from one plan covering him to another plan, which plan has reciprocity or a national reciprocity agreement, he will continue to be covered by that plan, and, therefore, it seems to us that multiemployer plans should have different treatment from the single-employer plans.

Senator BENNETT. No other questions, Mr. Chairman.

Senator NELSON. Senator Byrd?

Senator BYRD. No questions.

Senator NELSON. Senator Bentsen?

Senator BENTSEN. Just one comment concerning my provision for a person contributing to their own retirement where they don't have a plan in their company, for an individual contributing to it, I put a limit on it of $1,500 or 25 percent, which would means a tax credit of $375. I know that means a substantial savings. I used to own a savings and loan and I was always pleased and impressed with the fellow who came in with callouses on his hands, work boots, and got out of his old Chevy, as I watched him come in. Then I would see someone come in in a rented Cadillac and the fellow in the rented Cadillac often went over to borrow some money, yet the other fellow went over to make a deposit to his savings account. And so I would like to encourage that, and that is what I am trying to do with my bill.

Mr. SEIDMAN. I understand your objectives, Senator, but we do think by and large it would be the higher income people who would be able to take advantage of this and they would get the most advantage of it because they would be in the higher tax brackets as well.

Senator BENTSEN. Of course I made mine a tax credit, as you know.

Mr. SEIDMAN. I understand.

Senator BENTSEN. Rather than a deduction to meet that problem.

Senator NELSON. As to the credit approach, I assume you would agree that it is more equitable than the present system of tax deduction?

Mr. SEIDMAN. Yes, I would agree that if you have to make a choice, that the tax credit would be more equitable, but we still think that this would have greatest effects to the higher income people.

Senator NELSON. You stated in your testimony that you had previously favored the exemption of multiemployer plans but now you favor the coverage of multiemployer plans under a little bit different basis from a single employer plan.

Does this reflect a change in the position of your major union members who have ultimately employer plans?

Mr. SEIDMAN. Yes it does, Mr. Chairman. The AFL-CIO had taken a position in favor of the complete exemption of the multiemployer plans from vesting and funding standards. We have taken a good look at that and at a meeting in which we had wide representation of representatives of unions which have primarily multi-employer plans, there was a consensus which was later ratified by the Executive Council of the AFL-CIO that rather than seeking a complete exemption of the multiemployer plans, that instead we would do everything we could to get a realistic recognition of the differences between multiemployer and single employer plans reflecting in the provisions of the legislation. And so this is currently the position of the AFL-CIO and seems, as I said, from meetings with unions where these plans were widely represented that was a consensus.

Senator NELSON. Thank you very much. We appreciate your time in coming here today.

[The prepared statement of Mr. Seidman with attachments follow:]

STATEMENT OF BERT SEIDMAN, DIRECTOR, DEPARTMENT OF SOCIAL SECURITY AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. Chairman, we appreciate this opportunity to present our views with regard to S. 1179 introduced by Senator Bentsen, S. 1631 introduced on behalf of the Administration by Senators Curtis, Hansen, Bennett, Dominick and Fannin and on the principles and policies embodied in S. 4, introduced by Senators Williams and Javits along with 51 other sponsors, which has been reported to the Senate unanimously by the Labor and Public Welfare Committee.

All of these bills have for their basic purpose to improve the probability that workers now covered by private pension plans will, in fact, receive a pension when they retire.

The AFL-CIO supports this goal. In fact, our affiliates have, through collective bargaining, greatly improved the vesting and funding provisions of pension plans over the years. Unions have actually gone on strike over the issue of adequate financing of pension plans. Much has been accomplished. The vesting provisions of most negotiated pension plans are more liberal than the minimum standards proposed in any of the bills before this Committee.

Nevertheless, we believe the time has come to establish minimum Federal standards of vesting and funding in order that too many years will not pass before all employees covered by pension plans will have reasonable assurance that they will receive a pension on retirement.

This is essential because private pension plans are an important part of the retirement expectations of 30 million workers and their families.

Our unions can and they have improved the vesting and funding provisions of private pension plans through collective bargaining. However, we have no leverage on unorganized employers. Also, collective bargaining cannot provide a solution for employees who lose their pensions because their employer goes out of business. Only a Federal program of pension plan termination insurance can protect employees against this risk. We, therefore, strongly support such a program along the lines of S. 1179 and S. 3 and deplore the failure of S. 1631 to include any termination insurance provision in the bill.

With your permission, Mr. Chairman, we would prefer to discuss the bills before you together under the major subject headings of coverage, vesting and portability, funding and termination insurance, tax credits for individual pension accounts and administration.

Before discussing these issues, we believe that a clear distinction between two classes of pension plans needs to be drawn. The major difference between pension plans is between those that cover employees of only a single employer and those that cover employees in a plan that embraces many employers. Some of these multi-employer plans are national in scope and provide continuity of coverage under the pension plan even though the worker may change employers many times during the course of his working career.

The umbrella of coverage for participants in a multi-employer plan is broader than in a single employer plan. Therefore, our recommendations with respect to various aspects of the legislation reflect the fundamental differences between these two types of plans.

COVERAGE

Both S. 1179 and S. 1631 would apply to all private pension plans which desire favorable tax treatment under Sec. 401(a) of the Internal Revenue Code. Thus, the bills would apply to small employers with less than 25 employees. One of the major gaps in pension plan coverage today is small employers. We are concerned that placing them under the law with the associated burden of reporting would further discourage small employers from providing a pension plan for their employees. We, therefore, believe small employers should be exempted from coverage unless subsequent events should indicate to the contrary.

S. 1179 would also cover pension plans unilaterally administered by employee organizations and financed exclusively by employee contributions. S. 4 excludes such plans from coverage. We strongly favor S. 4 in this respect. It is unwise, in our opinion, to impose standards on plans where the participants themselves have the means through the democratic processes of their union to install these improvements themselves. To insist on the application of the standards to such plans would result in union members having to tax themselves at a higher rate for benefit improvements which they have been unwilling to institute.

Neither S. 1179 nor S. 1631 cover pay-as-you-go, unfunded plans established by the employer. Employees must, in such plans, rely entirely on the good faith of the employer and the indefinite prosperity of the company if their pension expectations are to be fulfilled. S. 4 would apply to unfunded plans.

All of the bills under consideration exempt local government plans. Unfortunately, many pension plans established by states, counties and municipalities are not adequately funded. For this reason, we favor covering state and local government plans in any legislation that is enacted.

In summary, we favor the coverage provisions of S. 4 except that we do not believe state and local government plans should be excluded as they are in all three of these bills.

VESTING AND PORTABILITY

The purpose of vesting is to increase the probability that any given participant will actually receive a benefit when he retires. Given any level of vesting—whether 10 years, 30 percent after 8 years plus 10 percent thereafter, 25 percent after 5 years plus 5 percent per year thereafter, or the "rule of 50"—

more participants will vest in a multi-employer plan than in a single-employer plan.

While we know of no study that proves this point, it is relevant to cite the following facts.

The International Ladies Garment Workers Union has a national pension plan. Thus, and ILGWU member can move from New York to California or to most places in between and continue his coverage in the national plan.

The Amalgamated Clothing Workers of America participates in six pension funds covering various subdivisions of the industry. Two of these plans are national in scope and the other four cover regional areas. The regional plans all have reciprocal agreements with the other plans so that service accrued under one plan counts toward the vesting requirement of the other plans. These reciprocal agreements even extend to plans in Canada.

In the building trades, multi-employer plans are generally confined to geographic areas (but a number of crafts have national plans). In the crafts not covered by a national plan, there is an extensive network of reciprocal agreements between plans in the same trade. A recent nationwide survey conducted by Professor Maurice E. McDonald of Georgia State University estimated 4.5 million, or about 65 percent of all workers covered under multi-employer plans, had some form of reciprocity.

It is our contention, therefore, that a vesting standard that would be appropriate for single-employer plans would not be appropriate for multi-employer plans.

Both the Williams-Javits and Bentsen bills would allow for a 5-year deferment of the vesting standard upon a showing that meeting the standard would cause "substantial economic injury" to employers or beneficiaries. However, there is no recognition of the difference between single and multi-employer plans as a class. The Administration bill makes no provision for any variance from the "rule of fifty."

The vesting standard proposed in all three bills is not strict enough for single-employer plans. At the same time, these same vesting standards might cause substantial economic injury to many multi-employer plans whose vesting standard, while apparently not as liberal, still results in a high percentage of participants becoming eligible for a benefit.

The Administration bill's "rule of 50" would credit an employee's past service only for the purpose of meeting the vesting standards and not for the purpose of computing his benefit. Thus, S. 1631 is meaningless to employees now covered by a pension plan until many years into the future. We urge that any bill enacted by Congress credit past service for the purpose of meeting both the vesting standard and the computation of the benefit.

The graded vesting provisions of the Bentsen and Williams-Javits bills yield minimal benefits after 5 or 8 years of service which do not appear to warrant the additional administrative costs that would result from keeping track of participants with vested rights to an almost meaningless pension. For example, a pension plan with a liberal benefit formula of $8.00 per month per year of service would vest a pension of only $10.00 per month upon retirement with 5 years of service under the Bentsen bill. Under the Williams-Javits bill the pension would amount to only $19.20 with 8 years of service. Inflation would further erode these dollar amounts.

Fixed benefit plans have a special problem that has not been dealt with in any of the bills before this committee. A fixed benefit plan plays a stipulated amount, $100 for example, after a stipulated number of years of service, say, of 20 years. Thus, there is no accrued benefit in the usual sense. There is no accrued or vested benefit until the full service benefit is met. Any bill enacted by the Congress should provide langauge to define what proportion of the fixed benefit would be vested where the mandated standard is less than provided by the plan. Our suggestion would be that the fixed benefits should be pro-rated from the age of entry into the plan to age 65.

Thus a worker who entered the plan at age 35 would be vested for 15/30 or ½ of the fixed benefit of $100 assuming full vesting after 15 years of service, this is of critical importance to some plans in the garment and maritime industries.

The AFL-CIO proposes for single employer plans a minimum standard of 100 percent of the accrued benefit to be vested after 10 years of service. Pension plans should have five years from the date of enactment of the pension legislation to meet the standard.

Multi-employer plans should be required to submit within five years appropriate data to the Secretary of Labor. The Secretary would then determine for each multi-employer plan, based on the facts submitted, an appropriate variance from the vesting standard, taking into consideration relevant criteria including, but not limited to, the proportion of the industry or geographic area covered by the plan, the number and extent of reciprocity arrangements between plans in the industry or area, the special problems of fixed benefit plans and the economic hardship to employers and/or plan participants that would result from imposing a stricter standard on the plan.

With regard to the portability of vested benefits, the concept is meaningless and amounts to no more than the dubious privilege of receiving one check in the place of two or, at the most, three. Portability of non-vested pension credits is another question and is equivalent, insofar as cost is concerned, to the cost of immediate vesting. None of the bills before us attempts to bite into this bullet. The only portable pension plan for non-vested pension credits is Social Security.

FUNDING AND TERMINATION INSURANCE

These two issues are closely related. Clearly, the more adequately a pension plan is funded, the less likely is it to present a claim under a pension plan termination insurance program. However, as long as past service is recognized for the purpose of paying benefits, a pension fund will seldom have sufficient assets to pay at a given time for all accrued benefits. A pension plan termination insurance program is therefore essential if beneficiaries are to have the assurance that they will receive a pension.

But with regard to both funding and termination insurance, it is essential that a distinction be made between single and multiemployer plans.

In single employer plans, both the employees' employment and his pension depend upon the viability of his employer's business. In fact, the employee is placed in double jeopardy. If his employer folds, he loses both his job and his pension.

In multiemployer plans, the union can generally place an employee in another job and his pension coverage continues regardless of the fate of the employer. In fact, we have been advised that about 300 employers go out of business each year in the ladies garment industry. Many contractors in the building industry likewise go bankrupt each year. But the pension plan goes on independent of the fate of any single employer.

The instances that have been cited in which employees have lost their pension benefit, including the Studebaker tragedy and others, have involved single employer plans.

Last year, the President directed the Departments of Labor and Treasury to undertake a 1-year study to determine the extent of benefit losses arising from pension plan terminations. In February of this year, a preliminary report on this study was released. This report stated that only 79 multiemployer plans terminated during the period 1965 through 1971. Almost all of these terminations came about because of merger which protected the accrued benefits of the beneficiaries.

With regard to benefit losses of beneficiaries in multi-employer plans during the 6 year period, the report stated:

"On the basis of information submitted by respondents, there were benefit losses for 540 participants in 3 plans (out of 64 who responded to the survey)".

Multi-employer plans are generally funded on the basis of paying only the interest on any past service liability that may exist. Apparently, this degree of funding is quite adequate for multi-employer plans. It is also apparent that multi-employer plans would have virtually no claim against a termination insurance fund.

The AFL-CIO therefore proposes that single-employer plans should be required to pay normal or current costs and fund all past service costs over a period of 30 years. This is the standard of S. 4 and S. 1179. While we believe "interest only" funding is adequate for multi-employer plans, we propose that such plans should meet a standard requiring that their unfunded liabilities be amortized over a period of 40 years. Multi-employer plans should, however, be allowed to petition for a variance from this standard. They should be required to demonstrate to the satisfaction of the Secretary that the plan's benefit commitments could be met under an alternative funding program. In considering applications for a variance from the 40 year standard, the Secretary should be required to take into consideration relevant criteria including, but not limited to, the proportion of the industry or geographic area covered by the plan, the number and extent of reciprocity arrangements between plans and the economic hardship to employers and/or plan participants that would result from imposing the standard on the plan. Any experience deficiency should, in our opinion, be amortized over the average remaining life of the employees covered by the plan as provided in the Bentsen bill rather than over 5 years as in the Williams-Javits bill.

With regard to termination insurance, we endorse the provisions of S. 1179 calling for two separate insurance pools—one for all single-employer plans and another for multi-employer plans. Separate premium rates related to the degree of risk should be established for each pool. We oppose, however, experience rating of the plans within each class as Sec. 407 of the Bentsen bill appears to allow.

A most important issue is a termination insurance program to protect the rights of plan participants to the benefits they have earned through their toil. Nothing can be more tragic than for an older man to lose both his job and his pension simultaneously when his employer shuts down his business.

Critics of termination insurance can correctly show that the number of persons who lose their pension because their employer goes out of business is quite low. These critics state this proves a termination insurance program is not necessary. On the contrary, we say that this proves that the cost of preventing this needless tragedy is very low. The ideal insurable risk is one in which the insured risk is financially unacceptable to the insured but that risk is of such infrequent occurrence, that the premium can be set very low. In short, termination insurance is just about as close to an ideal insurable risk as is possible to attain.

Has anybody proposed that because few banks go out of business, the Federal Deposit Insurance Corporation (FDIC) program should be abolished? The Securities Investor Protection Corporation (SIPC) was established to protect investors when brokers went out of business. Surely, if such protection can be provided to banks depositors and investors, it is unconscienable to deny workers protection against the loss of their pension. The suggested and very conservative estimate of the rate needed for such a termination insurance program is but 0.2 percent of the unfunded liabilities for vested benefits. This is the rate proposed in both the Bentsen and Williams-Javits bills. This comes to an average of only .02 percent of payroll. Where else can we achieve such a socially useful program at such low cost?

TAX CREDITS FOR INDIVIDUAL PENSON ACCOUNTS

The Administration proposal in S. 1631 to provide income tax deductions for individual savings that are placed in special retirement accounts would add still another tax loophole which will only benefit the wealthy.

There has been a remarkable consistency about the Administration's economic and tax policies which are making the rich richer and the poor poorer. Let us cite just a few of the new loopholes that have been initiated by this Administration:

(1) A new depreciation system, officially called the Asset Depreciation Range (ADR) system—speeds up by 20 percent of the tax-write-off allowance for business machinery and equipment.

(2) The 7% investment tax credit.

(3) A new provision which empowers U.S. companies to funnel their exports through subsidiaries—known as Domestic International Sales Corporations—wherein the tax on one-half of their export profits is deferred, perhaps indefinitely.

(4) This year the Administration has presented to Congress a package of tax propsals which refuses to address itself, except in a very limited way, to the major loopholes for the wealthy and for corporations. Instead, new loopholes are proposed including a $50 million-a-year tax giveway to the oil and gas industries, a property tax relief scheme and a private school tuition tax giveway. In total, the Adminstration tax package would result in a net loss in revenue of $600 million. (The AFL-CIO Executive Council Statement of May 6, 1973 on the Administration's tax bill is attached as Appendix A.)

The above measures afford tax relief primarily to wealthy corporations. The "Retirement Benefits Tax Act," the Administration's pension proposal, would, as stated by AFL-CIO President George Meany, provide "another tax break for the wealthy, the banks, the insurance companies and the mutual funds."

The bill provides that individuals may take an income deduction amounting to 20 percent of earned income up to a maximum of $1,500 per year for sums set aside for an individual retirement plan. But as a practical matter the plan has little value to those with low incomes.

To determine who will benefit from this proposal, the Committee might consider these questions

How many families with an earned income of $5,000 per year can save $1,000?

How many with a $6,000 income can save $1,200?

How many families with a $7,500 income can save $1,500?

How many families with an annual income of even $10,000 can save $1,500 in this day of sky-high living costs?

Now, ask the same question for those with annual earnings of $15,000, $20,000, $50,000 and up. Clearly, the percentage of families which will be able to take full advantage of this deduction will rise with income. Thus, the effect of this provision will be extremely regressive, benefiting all the rich who wish to take advantage of it and none of the poor.

Even if a family of four could save $1,000 out of a $5,000 income, their income tax would be reduced by $98. Thus, the Federal government would be subsidizing the retirement savings at the rate of 9.8%. The same family of four earning $10,000 would save $285 in taxes and the Federal government would be subsidizing their retirement plan at the rate of 19%. The $50,000 family of four would recoup 48 percent of their retirement contribution or $720 in taxes.

But that is not all. A worker with a $5,000 income even if he could take full advantage of this legislation could save only $98 in taxes. In contrast a wealthy investor who made $200,000 from clipping coupons and who also received a $5,000 consulting fee could save $700.

Thus, the proposed legislation is class legislation. The rhetoric from the Administration does not deceive us nor do we believe it will deceive this Committee nor the public. In this connection, we wish to present certain facts that relate to the ability of low and middle income families to save.

In 1971, according to the latest survey of the U.S. Bureau of the Census, median family income in the U.S. was $10,290. Half of all families were below this amount, half were above. Nevertheless, for that year:

(1) The U.S. Bureau of Labor Statistics reported than an income of $10,971 was considered the standard for a moderate budget for an urban family of four—and no savings were included in such a budget.

(2) Some 25.6 million persons, or 12.5% of the nation's families, were below the poverty income threshold which, according to official government estimates, required an income of $4,137 for a family of four in 1971.

(3) Among families with only one wage earner, only one out of every four (27%) families had incomes of $12,000 or above.

(4) Less than one out of 5 black families achieved the $12,000-and-above mark, and for families headed by a woman only one in ten attained that level.

Who, therefore, would benefit from the enctment of S. 1631?

We have stated that the Administration is making the rich richer and the poor poorer. We recognize that this is a serious charge but the facts amply support our contention.

Between 1960 and 1968, for example, the Census Bureau data shows that there was a modest but nevertheless real and continuing trend of improvement in the way in which the shares of the nation's income were flowing. Over that period, the bottom 20% of the nation's families increased their share from 4.9% of income to 5.7% while the share of the top 20% declined from 42% to 40.6%. This trend came to an abrupt halt in 1968. Between 1968 and 1971, the proportion of the nation's income received by the lowest 20% dropped to 5.5% while the top 20% increased its share of the nation's income from 40.6% to 41.6%.

The detailed data are shown in Appendix B which we have attached to our statement.

And, of course, these figures do not tell anywhere near the whole story, for huge chunks of the income of the very wealthy are not counted. The Census figures for example, do not consider capital gains as income—and on top of that, the IRS only taxes such income at half the rate which applies to the income of a wage earner.

The new proposed loophole would accelerate the trend toward distributing more of the nation's income, its wealth and its tax resources to the well-to-do.

S. 1631 would also raise the deductible limit on pension contributions made on behalf of the self-employed from 10 percent of earned income up to $2,500 per year to 15 percent of income up to $7,500. The AFL–CIO opposed the original Keogh bill as a tax avoidance program and we oppose the expansion of this tax loophole now. The main beneficiaries of this program have been doctors and lawyers and not proprietors of "mom and pop" groceries or small businessmen.

If a doctor goes into practice at age 35 and save $7,500 for 30 years he will have not only a tax shelter for his savings over this period but also a tax savings on the interest earnings on his account so that by age 65 he will have accumulated the tidy sum of $592,950 assuming a modest 6 percent interest return on his savings. While this is somewhat short of making every doctor a millionaire upon retirement, the estimate ignores any capital gains that might accrue under a Keogh retirement plan.

Even more than the individual tax deduction, the three-fold increase in the present maximum deduction for the self-employed would benefit only high income individuals.

S. 1179 is, of course, a substantial improvement over the Administration bill since the individual tax credit is limited to $375 or 25 percent of the contribution an individual makes toward his pension. The Bentsen bill also does not expand the tax loophole for the self-employed. However, tax loopholes are difficult to close and once enacted, usually expand. The present drive to increase the tax deductible contributions allowable under the Keogh law is an example. The AFL–CIO is therefore opposed to any tax credit for individual contributions to individual pension plans.

ADMINISTRATION

Both S. 1179 and S. 1631 provide for administration by the Treasury Department. Under S. 4 the law would be adminstered by the Labor Department. We strongly favor S. 4 in this respect for the following reasons:

(1) Pension plans are an integral part of the collective bargaining process. An improvement in a negotiated pension plan invariably means that workers will have to give up dollars that they could have received in wages. Even in unorganized firms, pension plans are considered a deferred form of compensation. Pension and other fringe benefits are invariably handled by the company's employee relations department and not by the company's tax counsel.

(2) If the enforcement of this legislation is entrusted to an agency whose primary interest is the collection of taxes, we suggest this places the agency in a conflict-of-interest situation in relation to policing any funding standard because the more rapidly a pension plan funds, the less it pays in taxes.

(3) Regulatory supervision under the Internal Revenue Code hinges on an employer's self-interest in maintaining tax deductions. This is a very weak enforcement mechanism from the point of view of the beneficiaries. What if the employer refuses to meet the funding standard even though he is financially able to do so? What would IRS do? One possibility would be to remove the plan's tax qualification in which case the employer may convert the plan into a pay-as-you-go, unfunded plan. Such a solution would not protect the interests of the beneficiaries. Or, IRS might order the plan discontinued in which case the employees would presumably be paid the contributions made on their behalf by the employer. The employees would have some cash but no pension. Does this help the beneficiaries?

(4) Under both S. 1179 and S. 1631, enforcement is separated from reporting under the Welfare and Pension Plans Disclosure Act. The annual reports are important for effective enforcement. While liaison arrangements could be worked out between Labor and Treasury, such arrangements would not be as satisfactory as having both functions under a single administration.

In contrast, the Williams-Javits bill would establish minimum safeguards to which virtually all plans would have to adhere independent of their taxable status. The bill is drafted as a minimum labor standards bill, like the minimum wage, and based in the constitutional authority to regulate interstate commerce. S. 4 provides for administrative and judicial remedies and penalties to enforce the standards and protections under the bill.

For these reasons we favor administration by the Labor Department.

In conclusion, of the three bills before the subcommittee, S. 4 comes closest to the kind of legislation we would like to have enacted. If S. 4 is improved by liberalizing the vesting provision for single employer plans, by providing more flexibility with regard to multi-employer plans and by eliminating the meaningless portability provisions, a major forward step will have been taken to make the private pension system more responsive to the needs of the beneficiaries. As we have indicated, we think the appropriate administrative agency for enforcement of the Act would be the Departemnt of Labor.

While we recognize and appreciate the interest of this Committee in pension reform legislation, we hope this important legislation will not be held up because of a difference of opinion between Senate Committees as to where the primary responsibility for pension legislation lies.

APPENDIX A—STATEMENT BY THE AFL–CIO EXECUTIVE COUNCIL ON TAXES, MAY 8, 1973

The Administration has presented a package of tax proposals to the House Committee on Ways and Means which, at best, can be characterized as an exercise in tokenism. Indeed, the most significant aspect of the Administration's proposals is what is omitted.

Through its refusal to address itself to the major loopholes of special privileges to wealthy individuals and corporations, the Administration made a calculated attempt to preserve inequities and thwart any efforts towards the goal of tax justice.

The Administration's package contains little in the way of reform. The "minimum tax" proposal would still let wealthy individuals use certain loopholes in order to cut their tax burdens in half. The proposals to tax the profits of foreign subsidiary operations of U.S. based multinational corporations go little beyond begrudging recognition that a problem exists.

At the same time, under veils such as "simplification" and "energy crisis", the Administration has put forward a series of proposals which are directly counter to the need for tax justice, increased federal revenue and public confidence.

The "simplification" proposals, for example, increase the tax burdens of many Americans who have suffered prolonged illnesses, high medical costs, severe casualty losses, as well as workers who are covered by health, accident and disability insurance programs to which their employer contributes.

Also contained in the package is a $50-million-a-year tax giveaway to the oil and gas industries—despite the fact that the loopholes presently enjoyed by these industries amount to a national scandal.

In addition, the Administration has proposed a property tax relief scheme which would potentially aggravate the current inequities in local government real estate taxation. And, there is a private school tuition tax giveaway that is clearly a new tax loophole which sets the dangerous precedent of subsidizing a particular group of individuals which chooses not to use a particular public service.

Last February 23, the AFL–CIO Executive Council called upon Congress and the Administration to respond to the need for justice in taxation and adequate federal funds by enactment of a program of loophole closing that would raise at least $20 billion in badly needed revenue.

The Administration has offered a program which will "reform" the tax structure to the tune of $800 million; "simplify" it at a cost of $400 million and, at the same time, add new loopholes costing $1 billion.

The result—a net loss of $600 million.

It is a tax package we cannot and will not support and we call upon the Congress to provide Americans with tax justice.

APPENDIX B

Percentage of Aggregate Income Going to Families

1960-1971

	1971	1968	1966	1964	1962	1960
Lowest 5th	5.5%	5.7%	5.5%	5.2%	5.1%	4.9%
Second 5th	11.9%	12.4%	12.4%	12.0%	12.0%	12.0%
Middle 5th	17.4%	17.7%	17.7%	17.7%	17.5%	17.6%
4th 5th	23.7%	23.7%	23.7%	24.0%	23.7%	23.6%
Highest 5th	41.6%	40.6%	40.7%	41.1%	41.7%	42.0%
Top 5%	N.A.	14.0%	14.8%	15.7%	16.3%	16.8%

Source: U.S. Bureau of the Census; Current Population Reports, Series P-60, No. 85: "Income in 1971 of Families and Persons in the United States."

N.A. - Not Available

BEST AVAILABLE COPY

The Physician's Finances: Keogh Plans Versus Professional Corporations

Long awaited changes in rules for establishing Keogh-type retirement plans for self-employed professionals are still under wraps, but it appears likely that liberalization is not far off. The question then will be whether the new appeal of Keogh will make it a more viable alternative to professional incorporation than it is now. The answer is no.

THE ADMINISTRATION PROPOSES

Plans now being weighed call for increasing the annual contribution allowable from 10% of income up to a maximum of $2,500, to 15% of income up to a maximum of $7,500. Voluntary contributions would be boosted from the current maximum of another $2,500 a year to $5,000. So the physician making at least $50,000 a year could deduct an annual Keogh contribution of $7,500 tax free and sock away another $5,000 on which he would pay income tax. The accumulation of the fund would not be taxed until retirement, at which time he would draw it out at ordinary income tax rates; but by then, presumably, he would be in a much lower tax bracket. This is the essence of the Administration's Keogh revision as currently being considered.

But regardless of his income level, the physician today is almost always better off in a professional corporation, and according to specialists in the field, Keogh liberalization will do nothing to change things. "I'm totally against Keogh," says practice management consultant and attorney Michael H. Rotman of Chicago. "If the doctor can afford to make a Keogh contribution, he's better off putting it into a corporate profit-sharing plan. The only people who shouldn't incorporate are those who can't afford any kind of savings plan."

Rotman objects to the restrictions on the types of investments available under Keogh and being locked into them. Another oft-recited objection to Keogh, the requirement that employees be vested, is no longer valid in his view. "In almost every jurisdiction for small corporate plans with less than five people, you have to vest everybody immediately, so the vesting issue is gone—and I think rightly so."

As currently provided, Keogh plans allow the physician to set aside up to $2,500 of his yearly income in an approved retirement fund. Employees of three or more years full-time service must then be provided with their own retirement funds. The money set aside for these funds is not taxed as current income. An additional $2,500 can be set aside by doctors who have employees included in the plan, but these voluntary contributions are not tax deductible. All appreciation of principal contributed to a Keogh fund is not taxed until withdrawn, at which time it is treated as ordinary income. The funds may not be withdrawn until the doctor reaches age 59½. Benefits must start before he is 70½, but tax-free contributions can continue as long as he keeps working.

Lack of flexibility is characteristic of Keogh plans, and will no doubt continue to be so after they have been liberalized. Withdrawing the fund prematurely elicits severe tax penalties. A second Keogh plan cannot be started within five years of the first one, with certain exceptions. Plans must be approved by the Internal Revenue Service. Master plans are set up by sponsoring organizations—mutual fund, insurance company, bank, brokerage firm, or whatever—and administered by them. Prototype plans are also available from sponsoring organizations, which in this case also includes medical societies and consultants. These latter are simply standard plans, accepted by the IRS but not administered by the sponsor. In either case, the physician's ability to control the investments in his fund is severely limited.

Professional corporations allow far wider latitude, and their most widely expressed drawback—that the IRS will eventually disallow them—appears at this point to be wholly unfounded. It has been estimated that nearly 40% of physicians are associated with professional corporations, and the tide is not likely to turn at this late date. "The new director of Internal Revenue is Don Alexander," says Rotman, "and some people may not remember that he was one of the pioneers of doctors' professional corporations. It's hard to imagine him going after them."

Merely increasing the amount of money that can be put aside in an approved Keogh plan, which is what current liberalization proposals amount to, does nothing to make Keogh more appealing than incorporation. It is the doctors who have more money to put away that incorporation helps most. And, according to practice management consultants in all areas, the physician in private practice with too little income to justify incorporation is rare indeed. Under a corporate structure, even solo doctors may incorporate, pay themselves a salary, or retain the rest of their earnings in the corporation, where it will not be reported as income on the doctor's yearly tax returns. There are restrictions as to use of funds, but nothing like the ABC's of Keogh plans.

Corporations require annual meetings, reports, selection of officers, strict accountability, and some limitations on the amount of funds that can be applied to salaries, but they also allow the physician greater control over the accumulation of his nest egg than under Keogh. Of nearly equal importance is the fact that the corporate accumulation will eventually be taxed at capital gains rates, while Keogh is taxed at payout as ordinary income. It is true that some curtailment of capital gains tax advantages may be passed into law before many of today's incorporated physicians will begin to draw out their retirement incomes. But sharp cutbacks in capital gains are less than certain.

A liberalized Keogh plan could become less liberal if IRS decided to tighten up rulings in some areas. This has happened before. In 1969, for example, IRS decided that physicians who shifted funds from one Keogh plan to another would pay a penalty tax unless the transfer was made directly from one fund trustee to the other. More recently, IRS ruled that withdrawals of the voluntary contributions in Keogh plans are fully taxable to owner-employees. (Although this part of the fund was taxed as income before contributed, the withdrawal is considered to have been made from the deductible part of the contribution.) Since corporate plans have fewer restrictions as to contributions, vesting, types of profit-sharing and retirement plans allowed, and management of funds, there is less likelihood that professional corporations will be hampered by new IRS rulings or tax legislation.

The professional corporation has clearly arrived, and because of it, Keogh, liberalized, is of no practical application for most physicians.

SEMIRETIRE AND STILL LIVE IT UP?

(By James A. Brussel, M.D.)

"When I'm ready to take life easy in 1990, I'll have the income from half a million dollars."

"You're sure that'll be enough to get by on?"

This exchange recently occurred after dinner at the home of a 45-year-old internist who was boasting about how he'd guaranteed his late-in-life security by starting a professional corporation. The younger doctor who challenged him was, of course, being facetious. But I didn't join in the round of chuckles that greeted his question. After a couple of years of semiretirement, I know how hard it is to calculate in advance how much you'll need to live in style when you're ready to take things easy.

Nevertheless my experience shows that it's possible to semiretire and still live it up. The lessons I've learned should be helpful to colleagues looking ahead to the time when they, too, can work less and enjoy life more. I realize that my situation and my life-style may seem untypical to many physicians. However, I believe that my two main guiding principles might serve any doctor, no matter what his circumstances are:

Plan ahead—the earlier, the better. It's in your productive years that you can use your earnings as a base for determining what you'll be able to afford later when you want to cut back. You can use the intervening years to gear your savings and investments to whatever goals you've set for yourself.

Stay flexible—and be prepared to adjust your plan to unpredictable factors, such as possible shrinkage in the worth of your investments or increases in the cost of living. You may have to choose between altering your way of life to cut down on expenses or working more than you'd anticipated in order to maintain your preferred life-style.

I've taken the second of those alternatives. The way I managed it may seem at first glance to be of limited applicability to the majority of doctors in fee-for-service private practice. For one thing, I've been on salary for most of my professional life and thus was able to center my semi-retirement program on a fixed pension. But more and more doctors will have a comparable retirement-income base from Keogh or corporate-benefits plans as these methods of providing for the future continue to grow in popularity. I've also been lucky in gaining additional income through freelance writing and other work that's only indirectly tied to doctoring. But the continuation of the doctor shortage should provide opportunities for any physician to supplement his income by consultations and other activities—no matter how much he cuts down on direct patient care, or even if he stops it altogether.

Though I'd been working for many years to build a nest egg to supplement my pension, it wasn't until 1965 that I sat down and drew up a formal prospectus on what I could expect in my first full year of semiretirement in 1969. That was when I was intending to leave (and subsequently did leave) my post with the New York State Department of Mental Hygiene after nearly 40 years as a medical civil servant.

According to my 1965 projections, my wife and I would need about $25,000 to live as we'd been accustomed: I figured that my pension plus what I expected to have as supplementary income should bring my annual income to nearly $53,000. But when 1969 came around and I reckoned up the actual figures, I found I'd been a bit pessimistic about earnings and far too optimistic about expenses. The main reason for this was that I'd underestimated both my tax obligations and the pace of runaway inflation. A closer look at how this pessimism and optimism balanced, and how I managed and expect to manage from now on, may prove helpful to other doctors—no matter what variations there may be in their income potential, standard of living, or obligations to heirs.

WHEN SEMIRETIREMENT LIVING COSTS MORE

	1965 projection for 1969	Actual, 1969
Income:		
Net income from practice	$10,000	$16,000
Other income (freelance writing, witness fees)	3,000	17,000
Retirement pension	22,000	22,000
Dividends (stocks, bonds, Federal short-term notes)	12,000	12,000
Insurance annuity	5,000	5,000
Real estate	700	700
Total net income	52,700	72,700
Adjustments:		
Taxes (Federal, state, city income taxes; sales, amusement, and miscellaneous taxes)	11,000	26,000
Insurance premiums	1,750	1,500
Savings and investments	15,000	8,000
Total spendable income	24,950	37,200

YOU EARN MORE, SAVE LESS

	1965 projection for 1969	Actual, 1969
Expenditures:		
Housing (rent and utilities)	$4,650	$5,450
Furniture and furnishings	1,000	1,100
Household help	800	1,000
Clothing	900	1,300
Food (44 weeks)	1,100	1,500
Medical and dental	600	600
Entertainment, recreation, and hobbies	1,700	3,000
Travel (8 weeks)	7,000	10,000
Local transportation	400	700
Gifts	2,000	6,750
Contributions	2,400	2,400
Miscellaneous (club dues, fees, newspapers and magazines, tobacco, personal grooming, etc.)	2,400	3,400
Total expenditures	24,950	37,200

Let's take an item-by-item look at what I anticipated and what actually happened, starting with costs. You'll see that inflation accounts for most of the discrepancies. I'd expected a rent hike, for example, but got an even bigger one than anticipated. The additional $200 a year for our cleaning woman is mainly due to a new minimum wage law and to the increase in the Social Security tax. But *everything* costs more than I'd thought it would four years before—prices in the supermarket and in restaurants, clothes, laundry and dry cleaning, barber and beauty shop treatments, theater tickets, taxi and subway fares, long-distance transportation and resort living, even my accountant's fees.

However, unforeseeables apart from galloping inflation also had a big effect in putting my calculations out of whack. I didn't know in 1965 that by 1969 we'd have four new granddaughters. The big jump in gifts reflects my having bought stock for all four. The increase in my utility bills isn't solely attributable to increased telephone and power company rates either. Ever since the additions to our family, my spouse's role as a doting grandmother has featured marathon long-distance phone calls. It all adds up.

How did I more than make up for this added spending by upping my earnings? I'd seen some private patients even during my years of full-time salaried employment, and I've continued to do so. At $50 an hour, it took only a little more than eight hours a week for 40-some weeks to net me the $16,000 I made in the private practice of psychiatry during 1969. I could easily double that with little strain if I so wished. As for the money I've made from writing, I hardly count that as work since it's a labor of love.

The 1965 computations that stood up in 1969 had to do with my investments. That was because I kept a close eye on the market and was able to shift many of my holdings from common stocks to Federal notes in time to avoid losses in the market slide. But since going into semiretirement, I don't force myself to save or invest. Making more money than anticipated but spending a lot more, I wasn't able to put aside the $15,000 I'd projected, but I was still $8,000 ahead for my first semiretirement year. And I stil don't intend to put more money away if there should be something my wife and I want to do or want to buy.

That, to me, is the beauty of the freedom that semiretirement can give you. My wife and I go out more. Our food budget would be even higher than it is if we stayed home more than the 44 weeks we now spend in New York. Most of our vacation time is spent in the Caribbean, where we rent cottages for ourselves and sometimes for our children and grandchildren. We also go to Europe and other places abroad. Much of our "getting away from it all" is unplanned: When the mood strikes us, we simply hop a plane for a weekend in the West Indies, a week in London, or a drop-in visit to our college-professor son and his family in Virginia.

Our cleaning woman comes to our apartment for half-days even when we're away. There's no problem about scheduling my few private-patient appointments around our absences; not many of the people I see are on long-term courses of treatment, and I've habituated all my patients to deferring visits when I plan to be unavailable. Even on days when I have professional duties, my wife and I manage to walk at least a mile. And I invariably sleep eight to 10 hours a night without sedatives.

But what if the pace of inflation should zoom even more in the years ahead? What if my freelance writing income should dry up? Right now I could, as I've said, increase my part-time practice earnings with little strain—but what if I found myself unable to do that, too? We could stint if we had to. spending less on travel and recreation and on being bountiful to our grandchildren. But the flexibility of my planning allows us to have other alternatives.

Drawing against capital is, of course, the main alternative. As I explanned to my wife during a recent discussion of our future: "Look, you're 63, and I'm 65. Even if we needed as much as $20,000 a year for additional expenses, we could sell that much in securities every year without exhausting our holdings until we're in our 80s. Meanwhile, the loss of dividend income from what we sold would amount to only about $800 a year."

Even if we ended up liquidating all our securities, there'd be other assets for our son and daughter to inherit. But they're both in their mid-30s and in good circumstances, so their financial future doesn't depend on what we may leave to them.

If I should leave my wife a widow, her living expenses would be proportionately less than our joint expenses, and she'd still have the capital to draw on if need be. Though my pension would stop, there still remain nine years before I wipe out my contributions to it, and she'd inherit the residue. There's also the life insurance.

Even if worst came to worst, we'd have to live to be 90 before there'd be a chance of going broke. All in all, the elasticity of my financial arrangements and the pleasure of doing what I want when I want give me only one regret—that I didn't take the plunge seven years earlier, when I first became eligible to retire. I'd advise any physician who's approaching his 60th birthday to do what I did—sit down and make a balance sheet to get an idea of what you can and can't do when you decide to move into semiretirement. Just be sure to allow enough time for planning and preparations that will accentuate the "can" and minimize the "can't."

Managing Your Money After You Incorporate

(By Sheldon H. Gorlick, J.D.)

Creating an over-all design that will mesh your corporate retirement funds with your other assets sounds like a tall order. It needn't be. The guidelines in this article will show how you and your advisers can devise such a plan with a minimum of effort. You'll be well rewarded for that minimal effort, too, because once you've worked out your plan, it can show you how to:

Reach your financial goals faster by shifting your personal investments in the ways that are made possible by the corporate retirement plan.

Balance your retirement plan and personal investments.

Side-step estate taxes on your retirement fund so that your family gets the maximum benefit possible.

Let's take those up in order.

Corporate pension and profit-sharing plans can help you reach financial goals faster if you remember that the savviest tax move you can make is to put as much as possible into such plans. The tax deductions will let you save up to twice as much in your retirement fund as you could outside it. And exemption of the income and gains from current tax puts even more zing into retirement-plan savings.

What goals can you save for through the retirement plan? More than retirement, certainly: maybe a new house, a college education for your children, or whatever you choose. When you want to tap the fund before retirement, you can, provided the wording of your plan permits you to. You may even be able to borrow up to 100 per cent of the money in your account, or you may have to put up outside collateral. In any case, you'll have to pay interest on what you borrow, but that can only help your fund grow.

If you're already putting away the tax-deductible maximum you're allowed—as much as 25 or 30 ;percent of your annual compensation under a typical corporate setup—then your only way of fattening up the plan faster is to put away the voluntary 10 per cent contribution in addition. That wouldn't be tax-deductible, but income from that money would be exempt from current tax.

If you're like most doctors, however, you're not putting away the tax-deductible maximum. In that case, you should consider beefing up the contributions to help you save more.

Here's a plan I recently worked out for one incorporated physician. Because his receipts rose faster than he'd anticipated, he estimated that he'd have $4,000 to spare at the end of the year. That amount couldn't be stuffed into the pension plan he had, so it went into a new profit-sharing plan, set up to supplement the pension plan. That allowed him to put away the entire $4,000 as a tax-deductible expense. If the corporation had paid out the money to him, he'd have paid $2,000 income tax on it, leaving only $2,000 to put away.

Assuming that he'll continue to put the extra $4,000 into his profit-sharing plan and that it will earn 7 per cent annually, his retirement fund will have an additional $23,000 in five years. If the doctor had put away the money after taxes, he'd have less than $11,000.

Just such a corporate retirement fund can help you build up money fast for your children's education. Say you have a child starting college five years from now. Putting $4,000 a year in the fund, you'd have $23,000 available to borrow. On your own, you'd have to earmark $8,000 a year in pre-tax earnings to have that much in hand.

It can pay you to increase your retirement-plan contributions, even if you have to eat into savings to do it. Take the case of a New York doctor who has decided to make the maximum contribution to his retirement plan even though that leaves him with a gap between his salary and personal expenses. He plans to bridge that gap by drawing on savings he accumulated before incorporating. Here's what he hopes to accomplish:

Estimating that his income will fall $4,000 short of his expenses, the doctor has set out on an ingenious withdrawal program. He's taking $4,000 a year out of the bank and his personal stock account. Allowing for after-tax interest, his $50,000 savings-and-investment account will last him 15 years. In effect, he'll be taking the money out of one pocket and putting it into another—with this important gain: The tax he saves on the additional contributions to the retirement plan will go into the second pocket, too.

Thus, at the end of the 15 years, when that $50,000 account will be all used up, the doctor will have put an extra $140,000 in his retirement plan. If he'd put away money outside the pension plan at the same rate of return (cut in half by the tax payments) his $50,000 savings account would have grown to only $78,000. So making use of the withdrawal idea will put him $62,000 ahead.

As those examples show, you can use corporate pension and profit-sharing plans to do more than just save up for your retirement. You may tap the funds whenever and for whatever you wish—provided that any loans are repaid. You must also pay a going rate of interest, warns Donald C. Alexander, an attorney with the Cincinnati, Ohio, firm of Dinsmore, Schohl, Coates & Dupree. The specific requirements are spelled out in rulings by the Internal Revenue Service, points out Mel Maisel of Stabilization Plans for Business, Inc., a pension planning firm in White Plains, N.Y. In most cases, you'll have to repay any loans in two years, although you may be able to renew them for additional periods. If there's any doubt in an I.R.S. agent's mind of your intention to repay a loan, it will be treated instead as a distribution, and you'll have to pay tax on the amount you borrowed. Also, all employes must have the same right to borrow from the funds that you have.

Tax considerations aside, you should be careful not to borrow too heavily from your retirement plan or you may end up without enough for your old age. One way to keep control over what you put in and take out is to earmark the deposits and gains to be used for retirement and the ones that can be tapped for other goals.

With your retirement fund on the track, you must still plan how to manage and use your other assets. Unless they're eaten up to finance contributions to your retirement plan, they'll remain as part of your nest egg. You may even find you keep adding to your personal assets if your colleagues won't go along with increased contributions. Or you may decide not to fatten your pension plan if the amounts you would have to put in for other employes would make the cost prohibitive, points out Berrien Eaton, a Phoenix, Ariz., attorney. In any event, consider this approach to personal investments kept in tandem with a pension plan:

Make an important place in your own portfolio for stocks, especially growth stocks. The bias in favor of equities should be especially pronounced if your retirement funds are in fixed-income investments. By weighting your personal portfolio with stocks, you'll maintain the balance that professionals consider essential in an investment program. Besides, with your personal assets in stocks, most of your yield can come through capital gains taxed at no more than half the usual rate.

Another reason for puting your private funds into stocks is that, with your retirement and possibly other goals taken care of through the corporation, you can afford to take risks that may bring the reward of large capital gains. And if you should want a little speculative spice in your investments, the place for it is outside the retirement fund, which should be exposed to as little risk as possible.

Invest in tax-exempt municipal bonds and other tax shelters. Since they have no place in your corporate retirement plan, which is itself tax-sheltered, you'll want them in your personal portfolio. That's especially important if you're a high-earning doctor who might be liable for tax in brackets as high as 70 per cent on rents, dividends, interest, and all other so-called passive income.

Cut cash savings to the bone. As your corporate retirement plan builds up, you really have less need for money in the bank. Because the bank interest will be taxed in your highest bracket, the only reason to have money in the bank is as a quick source for an emergency. And because you can tap the retirement plan, which is probably cash-rich, there's certainly little need to have the money sitting in the bank where the after-tax yield is negligible.

Put money into real estate. With the extra liquidity you'll have in your retirement plan, you can well afford to tie up your money in property. Besides the economic benefits, the tax play continues to be valuable. Developed real estate can give you tax-free current income, and your gains can get favorable long-term capital gains treatment. If you're interested in a sophisticated tax parlay, consider this plan suggested by Chicago attorney Marvin Kamensky:

Buy developed real estate, with the building in your name and the land in the name of the retirement trust. You'll get personal tax deductions that may not only offset the rental income, but some of your other income as well. When the time comes to sell the real estate, most or all of the gain can be assigned to the land and the building can be sold at a depreciated value. So the gains go largely untaxed while you don't have to pay back any of the depreciation deductions that you've taken as you would if you owned all of the real estate. The important thing, according to Edward Pesin, a Newark, N.J., attorney, is to make sure the trust isn't shortchanged.

Important as it is to work out a plan for your investments and goals in the light of your corporate retirement plan, it may be even more rewarding in the case of your estate plan. With the proper moves, tens of thousands of dollars that would otherwise go for needless estate tax payments can be saved.

Remember that any money in your retirement fund at your death is exempt from estate tax as long as it's left directly—to your wife, your children, or any other person you name—not through your will. Chicago attorney Jerry M. Reinsdorf points out how to carry the advantages even farther by leaving the money in trust. The savings he comes up with by doing this are so startling that they may send you back to your own lawyer to review the figures you got on incorporation.

If you leave your retirement benefits in trust, they'll be insulated from estate tax as long as the trust remains in effect. If the circumstances are right, you could set up the trust to last for your children's lifetimes as well as your wife's. Here's a comparison of the savings for a doctor whose retirement fund reaches $250,000 (after payment of the income tax that will be levied on any distribution from the retirement trust) and whose other assets total $200,000.

Assuming the doctor already has a will dividing his $200,000 estate in two, half the money can be left to his wife outright and the other half left in a trust paying her income but restricting her right to the principal. That will cut the Federal estate tax on the $200,000 to less than $10,000.

But the real tax saving, Reinsdorf points out, comes by leaving the retirement benefits in trust. That insulates the retirement benefits from estate tax as long as the trust remains intact. Thus the doctor's children and even his grandchildren can have the $450,000 with an estate tax bite of under $10,000. If the money were paid out to the wife, the tax on both the husband's and wife's estates would balloon to more than $80,000.

The advantages of holding the retirement benefits in a trust are available *after* retirement as well as before. In that case, you'd have to take your retirement payments in installments and leave the balance with the retirement trust.

Don't get the idea, though, that you can bring off the savings simply by changing the beneficiary of your retirement plan to a trust. That requires an expert. In some states, if you leave the death benefit of a retirement plan to a trust set up in your will, you'll lose the estate tax exemption at your death. Even if you don't live in one of those states, the safest way to avoid estate tax is to leave the money to a trust you set up during your lifetime, advises New York attorney Leonard Bailin. In any case, special safeguards are needed to make sure the funds are properly insulated from estate tax.

Because of the likelihood that your corporate retirement fund will become one of your largest assets, many financial advisers believe that estate planning should be done at the time you incorporate rather than later. That's the way it's handled at Reinsdorf's firm of Altman, Kurlander & Weiss. Explains Reinsdorf: "Delaying needed changes in an estate plan frequently results in not making them at all. If a doctor has not yet worked his retirement benefits into his estate plan, he should make that a top-priority item."

Coming: A Better Keogh Deal for Doctors

(By William A. Levinson)

There's a bill in Congress now, drawn up by the Treasury and submitted by President Nixon last December, that may enable nearly all doctors to save more money for their old age. Those with Keogh plans would get the biggest break—ceilings on their tax-deferred contributions would go up to $7,500 a year. But corporate pension plans would become even more flexible than they are today. And doctors with no tax-deferred retirement plans at all would be able to start modest ones without having to include their staffs.

If you're hung up on which type of plan will come out best for you, you can decide without waiting for Congress. The one that's best today will still be best tomorrow.

That's the consensus of tax and legislative experts in Washington and elsewhere around the country. It was obtained in a series of confidential interviews during which many of these insiders talked quite candidly about the Individual Retirement Benefits' Act of 1971, its chances for passage this year, and what it might mean for doctors in private practice. They declined, however, to be quoted by name because of their sensitive roles in drafting the legislation or coping with it once it becomes law.

To understand why they feel the way they do, it's important to examine the act itself. Its purpose is simple—better old-age security for more people, professional and nonprofessional, employed and self-employed alike. The key provisions by which it aims to accomplish this are simple, too:

It raises the ceilings on annual tax-deferred Keogh contributions, now $2,500 or 10 per cent of net earnings, whichever is less, to $7,500 a year or 15 per cent. The strategy is that Keogn plans must include qualified employes, so making Keogh more attractive to employers will result in more such plans and more employes covered by them.

It creates a new, personal-type, mini-pension plan into which any worker, employed or self-employed, can put up to $1,500 a year, tax deferred until retirement. Since this plan is aimed at helping people who aren't covered, who are insufficiently covered, or who aren't currently receiving tax-deferral benefits from Keogh or corporate plans, its benefits don't have to be extended to any staff members.

It proposes minimum vesting standards for all pension plans, based on the "Rule of 50." That means every employe becomes at least 50 percent vested by the time his age plus his years in the plan equal 50.

When the President submitted the bill, which is now in the hands of the Senate Finance and the House Ways and Means Committees, he expressed the hope it would remove "an artificial incentive for the self-employed to incorporate." Significantly, however, it does not take away or even reduce any of the present benefits enjoyed by professional corporations. In fact, if it becomes law as it is now written, the bill will reopen the door for a once-popular tax-saving tactic that has been out of favor among professional corporation boosters for several years.

More about that intriguing prospect later. First, according to most of our insiders, the President's proposals have a long way to go before they can become law, and there's almost no chance at all that they'll escape the Congressional scalpel along the way. Only one, a former Treasury employe, sees any chance of passage this year. "I know some of the thinking that went into this bill," he told me, "and I know the trouble we went through to check out our ideas in advance with the key committees and those members of Congress who have been especially interested in this kind of legislation. It gives something to everybody and takes nothing from anybody. If the President really puts some muscle behind such a sure vote-getter, what politician would risk opposing him?"

I repeated that comment to the legislative aide of a Congressman on the House Labor Subcommittee, and he laughed. "He sounds like a proud parent. Look at it this way: You've got two strong Democrats, Senator Russell B. Long of Louisiana and Congressman Wilbur D. Mills of Arkansas, running Finance and Ways and Means, respectively. How much priority do you think they'll give a Republican bill during a Presidental campaign? Hell, right on the title page of the House version, it says 'Introduced by Chairman Mills at the request of the Administration. Not to be construed as the statement or position of the Committee . . . or any member thereof.' How lukewarm can you get?"

"If I remember correctly," said a Southern attorney who specializes in incorporating professionals and was in the thick of the original Keogh battle, "it took more than 10 years to get H.R. 10—Keogh—passed with a $1,250 annual ceiling, and another six years to get it up to $2,500. Why should this bigger can of worms move any faster?"

The other observers take a middle ground. Most of them feel the bill has a 50–50 chance of coming out of committee sometime this year—the later the likelier. They say neither Senator Long nor Congressman Mills, both veteran politicians, would risk being tagged an obstructionist during a campaign year by a President who's currently a heavy favorite for re-election. A Treasury attorney expressed the majority sentiment best when he said: "Such big-ticket bills as the President's family welfare and national health programs and Congressman Mills' own version of revenue sharing will occupy the committee first. Even if those go through smoothly, and there are no dramatic Phase 2 complications to pre-empt the priorities, the best we can expect for the pension package is to get it out of committee sometime late this year—and that's just the beginning. We expect the real fight during floor debate."

Most of the other insiders also see a fight coming. That's why they see no chance for the pension proposals—amended or not—to become law until next year at the earliest and maybe not for two or three years after that. They tend to peg the bill's timetable through Congress on the President's own political fortunes. If he loses in November, he'll be a lame duck and so will the bill. If he wins, there'll probably be a tough one- or two-year floor fight, but something resembling his proposals wil probably be enacted into law.

The legislative aide to a member of the House Labor Subcommittee was even more hard-nosed. "Until now," he said, "pension reform was Big Labor's turf; all proopsals went through the House and Senate labor committees. Tax reform, on the other hand, belonged to the Treasury, acting through Finance and Ways and Means. Maybe the President did a smart thing by bringing both parts of the same problem into one package, but he's created conflicts, too.

"The labor committee people can't get at his bill while Long and Mills have it, but wait till it comes down to the floor for a vote. There are at least five other pension-reform bills in Congress right now. Senator Javits, who's already screamed publicly that the Rule of 50 isn't adequate protection for a lot of workers, has one he's been working on for years. It's important to him to keep his name on it during an election year. And I can hardly wait to hear what Senators like Ribicoff and Kennedy will say about bigger and better pensions for doctors after the way they cheered the fee freeze. The President may be able to beat them in a floor fight, but he may not want one during an election year, and he'll have to accept some changes they'll demand."

Which provisions in the bill would most likely be changed during a floor fight? Here, surprisingly, in view of our experts' wide range of occupations and loyalties, there is remarkable unanimity: The $7,500 ceiling on contributions will probably be lowered.

"It's unrealistic," says a Midwestern practice management man. "In order to put away $7,500 in a Keogh plan, an M.D. would have to be netting $50,000 a year. A professional corporation would let the same man salt away $10,000 a year—more under special circumstances—in a pension plan that would be free of estate tax, more flexibly tailored to his personal requirements, and able to be integrated into Social Security. His corporation could buy disability insurance for him and a group medical policy for him and his staff. Keogh, even at $7,500, isn't attractive to him.

"The doctor who needs to be encouraged to start a Keogh plan or expand his present one is the doctor who may not be making enough to incorporate but who can afford to save more than $2,500 a year. An M.D. netting $34,000 a year, for example. Fifteen per cent of that is $5,100 a year—twice what Keogh allows him now—and you don't have to go any higher to interest him."

A prominent New York City tax lawyer expects a different line of attack on the proposed $7,500 ceiling for Keogh. "Congress isn't going to let all that new tax-deferred money fly out the window without looking for a place to make it up. First thing they'll try is to lower the ceilings on corporate retirement plans and recapture some revenue."

"We thought of that," the Treasury attorney told me. "But frankly, we've tried twice to get corporate ceilings down. The corporate lobby is just too tough. Maybe, this time, by leaving corporate ceilings out of the bill, we'll wake up a few Congressmen to do the job for us."

A West Coast labor-union lobbyist chips in with another reason why the $7,500 Keogh ceiling, and the $1,500 personal pension plan, too, might come under fire. "The bill's supposed to help workers and small-business men," he told me. "But those two provisions are strictly for professional men and white-collar workers. A doctor can net $50,000 a year or more on a gross of around $90,000. Most small-business men work on a much lower profit margin; that same $90,000 gross for a small business might mean $15,000 profit, or even less—and 15 per cent of that is $2,250, tops. Can anybody making $15,000 or less afford that big a cut in take-home pay? And what blue-collar worker can afford to put away $1,500 a year? Besides, it doesn't save either of them enough in their tax brackets."

We expected, when we started our confidential survey, to find some practice management experts who'd decry fuller and faster vesting proposals as likely to cost a lot of doctors more money in the funding and operation of their employes' pension funds. But we put the question to four different men, and got the same answer from each: Whatever plan you now offer your employes, the proposed changes won't cost you a dime. That's because of the strict attitude taken by the Internal Revenue Service before qualifying a pension plan. Most professional corporation plans already offer the employe a better deal than the President's Rule of 50. And Keogh, which insists on immediate vesting, is even stricter.

So if the Individual Retirement Benefits Act of 1971 goes completely down the drain—which isn't likely—doctors will be no worse off than they are now. If it's amended—which is likely—the same old pecking order will hold true:

Incorporation will still be the best deal for doctors who can afford the initial cost and the cutback in take-home pay; a Keogh plan will be the next-best alternative for doctors who want to put away more than $2,500 a year and include their employees; and doctors who now have no tax-deferred retirement plan at all will be able to set aside $1,500 a year. Don't sneer at the latter. If you're in the 50 per cent bracket, that's a $750 annual tax saving, and in 25 years, the Treasury figures a doctor in his 40's can fund a withdrawal plan that'll pay him at least $7,500 a year after retirement.

And should the bill go through exactly as submitted, there'll be a tax break and a potentially bigger pension in the future of every doctor. Every doctor? You don't recall a previous mention of a better tax break for incorporated M.D.s? That's right, because we've been saving it for last. First, because it won't work for every incorporated doctor, and second, because it shows how the whole problem often boils down to a battle of wits between the Government and your tax advisers.

Remember Subchapter S? Under it an incorporated M.D. could enjoy all fringe benefits but could save money—and trouble with the I.R.S.—by electing to have the corporation's profits or losses taxed to him as an individual. Congress tightened the screws on that in 1969. Since then, in order to elect Subchapter S, the doctor has to accept a ceiling on his corporation's annual contribution to his pension plan—same as Keogh, $2,500 or 10 per cent, whichever is less. So it's no longer such a good deal. But if Keogh limits go up to $7,500, or even $5,000, a lot of incorporated physicians who don't want to put away more than that will go into Subchapter S.

"The best thing that could happen to an incorporated doctor," explains a veteran East Coast attorney, "would be for the limits on Keogh contributions to go as high as possible. They can't go any higher than the corporate ceilings, nor buy the other corporate advantages."

In other words, the winds of change are blowing in a favorable direction for self-employed M.D.s, but the more things change, the more they'll remain the same. The important thing is to act now. A Texas attorney, whose firm has some 80 professional incorporations to its credit, explains why:

"When Keogh was first passed, we had to push doctors into it. When the ceiling was raised to $2,500, a lot of them continued to put it off. And now that incorporation is legal, some of them still need a shove. Those who did take our advice are happy today, while the ones who waited for a better deal have lost years of substantial tax savings. Many are now too old to take the best advantage of any plan."

So, if you're planning to incorporate, go ahead. If you can't afford to or don't want to be bothered, a brighter Keogh is on the way. And if you're still trying to make up your mind, don't wait for Congress to make it up for you.

Senator NELSON. Our next witness will be Robert Albright, vice chairman, employee benefits committee, National Association of Manufacturers, and chairman, vice president, administration, United States Steel and Carnegie pension fund.

BEST AVAILABLE COPY

STATEMENT OF ROBERT A. ALBRIGHT, VICE CHAIRMAN, EMPLOYEE BENEFITS COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS; VICE PRESIDENT, ADMINISTRATION, UNITED STATES STEEL AND CARNEGIE PENSION FUND, ACCOMPANIED BY KENNETH SCHWEIGER, DIRECTOR, EMPLOYEE RELATIONS, INDUSTRIAL RELATIONS DEPARTMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. ALBRIGHT. Thank you, Mr. Chairman. Appearing with me today is Kenneth Schweiger, director, employee relations, industrial relations department of NAM.

I am pleased to submit our views with respect to the general area of private pension legislation, which is now pending before the Congress. I have submitted to you our complete statement. I would like to summarize it in a few minutes here.

Senator NELSON. Your full statement will be printed in full in the appropriate place in the record.

Mr. ALBRIGHT. Thank you. The NAM seeks to encourage the expansion and improvement of private pension plans which now have tremendous flexibility to adapt to the varied requirements of employers and employees. Private pension plans are making and will continue to make a significant contribution to the retirement security of more than 30 million Americans. In addition, pension funds are a vital source of capital accumulation so necessary to sustain the continued growth of our economy.

Currently there are more than $160,000,000,000 in private plan assets which help to supply the capital needed for the creation of more jobs, expanded business, increased homebuilding, and many other facets of our economic life. While some of today's critics of private pension plans imply that few actually receive benefits, the fact is that benefits of about $8 billion are paid annually to approximately 6 million retirees.

While we believe in general that the private pension system has served the Nation and a substantial number of the labor force well, there are some areas where constructive legislation would be helpful. We believe it is time to enact legislation now covering those areas in which there is substantial agreement.

Disclosure. NAM believes that adequate disclosure of pension plan operations is desirable. The existing statute and current reporting forms under the Disclosure Act now calls for much greater detailed information than is generally realized.

While the disclosure of some additional information may be useful, we believe that it is not desirable or helpful to further burden plant administrators, beneficiaries, and Government agencies by requiring disclosure of information of a more marginal and generally less meaningful nature. In this connection, we can support the provisions of S. 4 dealing with the disclosure of individual investment transactions.

There is currently pending before the House H.R. 2, the Employee Benefits Securities Act, introduced by Representative Dent on January 3 of this year on which NAM testified on March 1 of this year. We made specific comments at that time with respect to certain provisions of H.R. 2 dealing with disclosure and we would like to include a copy of that testimony as a part of our formal statement.

Senator NELSON. It will be printed in full and placed in the record.

Mr. ALBRIGHT. Fiduciary responsibility. NAM is firmly convinced that administrators of pension funds should absorb the highest standards of fiduciary responsibility and we support the desirability of legislation which would concurrently define the nature of fiduciary responsibility. We do, however, believe that because of the nature of the duties of a fiduciary, there could be some unintentional and innocent violations. Since a fiduciary could face personal and financial ruin through the inadvertence of others, even while acting himself in good faith and with prudence, and since it is not the purpose of this legislation to discourage reasonable and honest persons from acting as trustees, we believe that fiduciaries should be held personally responsible for willful misconduct or gross negligence on their part only. In addition, we believe that the substance of section 111 of H.R. 2 should be incorporated in any final legislation. This section permits the allocation of specific responsibilities among fiduciaries, in which event a fiduciary would not be liable for responsibilities not allocated to him provided he did not participate in or have knowledge of activities constituting a breach.

Effect of other laws. NAM strongly urges that the provisions of any new Federal pension bill supersede any and all laws of the States as they relate to the specific provisions of that bill in order to preclude the confusion and jurisdictional problems that could result from conflicting State and Federal laws since many plans operate in several States.

Vesting. NAM supports the concept of vesting and has long espoused its inclusion in private pension plans. The vast majority of such plans do provide varying degrees of vesting. We recommend that this committee consider alternative vesting standards since many plans now have vesting provisions in different forms. Permitting substantially equivalent vesting forms would avoid the complexities and confusion which would come about by having dual vesting formulas in a single plan.

In addition, we believe that any legislation in the area of vesting should have a reasonable transitional rule and properly indicate that payment of mandatory vesting requirement benefits would be at the normal retirement age specified in the plan, but in no event greater than age 65 and would encompass only a life annuity and not any early or ancillary benefits, such as death, disability, or other benefits that may be available under the plan.

Funding. NAM endorses adequate funding and we believe that the vast majority of private pension plans are being adequately funded. This is confirmed by the study made by the Pension Research Council of the Wharton School of Finance and Commerce of the University of Pennsylvania which is a definitive study of the matter. This study and others showed that the vast majority of plans are being adequately funded and diversity and flexibility rather than uniformity should be the watchword. Present IRS funding requirements together with Accounting Principles Board Opinion No. 8 give additional assurance that adequate funding will continue in the future. However, NAM can support additional IRS requirements for the funding of unfunded vested liabilities provided the rules are reasonable and flexible.

For example, NAM would support additional funding requirements along the lines presently required for costing purposes under APB Opinion No. 8.

Portability. NAM believes that the adoption of mandatory vesting would make the justification or reason for portability largely academic. Additionally, there are many reasons why portability would be undesirable, which we have discussed in the full statement submitted for the record.

Plan termination insurance. NAM believes that the concept of plan termination insurance is unworkable, inequitable and undesirable. Among the reasons for these conclusions are the following:

One, a pension plan may terminate as a result of an employer's seriously declining operations, bankruptcy or for many other reasons. These situations are not insurable risks since the risks would to a considerable degree be within the control of the insured.

Second, pension plan termination insurance would encourage the making of unsound pension promises and would discourage adequate funding of private plans.

Three, a plan termination insurance program could lead to a huge bureaucracy with regulations to control in detail all aspects of pension plan funding, financing, and investing, all of this to deal with a relatively small problem.

Four, it is inequitable to force soundly funded, well managed plans to pay for the broken promises of others.

NAM believes that the tremendous problems and inequities inherent in the establishment of a plan termination insurance program far outweigh any benefits that may be derived from such a program.

Tax incentives for retirement savings. We believe that a concept that would liberalize the tax treatment of savings for retirement purposes by allowing new deduction from adjusted gross income for employers not covered by retirement plans or where the employer contributions are not significant and by raising the limit on deductible plan contributions by the self employed or shareholder employees of small business corporations, is most desirable. The effect of this kind of legislation would be to encourage additional private capital formation and personal savings for retirement purposes particularly among those who are not now covered or only marginally covered by employer financed pension plans.

Taxability of lump sum distributions. In view of the fact that the tax rates on substantial capital gains have been increased as a result of the Tax Reform Act of 1969, NAM recommends that Congress take a new look at the action taken in 1969 and seriously consider restoring capital gains treatment to the total distribution from qualified pension and profit sharing plans in the interest of simplifying the complicated area that presently is a source of great confusion to both employers and employees. If Congress insists on continuing the present approach, NAM strongly urges enactment of revised legislative language which will simplify the approach and clarify its intent.

Administrative jurisdiction. S. 4, would create an Office of Pension and Welfare Plan Administration within the Department of Labor to be responsible for the establishment, administration, operation, and enforcement of pension. profit-sharing retirement and other employee benefit plans.

NAM seriously questions the need for this provision. Under present law, several Federal departments and agencies have jurisdiction over matters affecting private pension plans. For example, the Treasury Department, the Department of Labor, the Senate Banking and Insurance Departments, among others, now have clear and definite responsibility in this area. In view of the extent of existing regulations, NAM believes that care should be taken not to impose an additional level of supervision which would create confusion by duplication and conflict with current laws and agencies.

Conclusion. In conclusion, while NAM is definitely opposed to mandatory portability and plan termination insurance features, we also believe that there is an urgent need for speedy enactment of legislation incorporating fiduciary standards, meaningful disclosure, early vesting, individual retirement tax deductions, and some additional IRS requirements for the funding of unfunded vested liabilities.

Mr. ALBRIGHT. NAM supports S. 1557, relating to fiduciary responsibility and reporting. We also support S. 1631 as modified by recommendations contained in the statement. NAM is, however, strongly opposed to S. 4 as it contains among other things provisions establishing portability and plan termination insurance.

If Congress would act in accordance with the foregoing suggestions, we believe that they will have accomplished their desired objectives relating to the protection of private pension participants, without unduly interfering with the flexibility necessary for the system to operate effectively and efficiently.

Thank you.

Senator NELSON. Senator Byrd, any questions?

Senator BYRD. No questions.

Senator NELSON. Senator Bentsen?

Senator BENTSEN. Isn't it true that when people emphasize vesting at younger ages and portability, they would be taking away funds from the pension plan which would otherwise be available for older workers.

Mr. ALBRIGHT. Very definitely. That is one of the dangers of enacting very strong vesting. Companies would be unable to afford better benefits for those retiring at the normal retirement age and who have worked for a long time.

Senator NELSON. Well, thank you very much.

[The prepared statement of Mr. Albright follows:]

PREPARED TESTIMONY OF ROBERT A. ALBRIGHT, VICE PRESIDENT-ADMINISTRATION, U.S. STEEL AND CARNEGIE PENSION FUND, ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

My name is Robert A. Albright, and I am Vice President-Administration of the U.S. Steel and Carnegie Pension Fund. I appear today on behalf of the National Association of Manufacturers with whom I currently serve as the Vice Chairman of the Employee Benefits Committee. Appearing with me is Kenneth E. Schweiger, Director of Employee Relations for the National Association of Manufacturers.

NAM member companies, large, medium and small in size, account for a substantial portion of the nation's manufactured goods as well as for the employment of millions of people in manufacturing industries. A significant majority of these people are covered by a private pension or profit-sharing retirement plan which for the most part is paid for by the employer.

I am pleased to submit our views with respect to the general area of private pension plan legislation which is now pending before the Congress.

INTRODUCTION

The National Association of Manfacturers seeks to encourage the expansion and improvement of private pension plans which now have tremendous flexibility to adapt to the varied requirements of employers and employees. Private pension plans are making and will continue to make a significant contribution to the retirement security of more than 30 million Americans, and it is expected that by 1980 more than 42 million workers will be covered.

In addition, pension funds are a vital source of capital accumulation so necessary to sustain the continued growth of our economy. Currently there are more than $160 billion in private plan assets. With an anticipated rate of growth of more than $10 billion a year, it is projected that by 1980 private pension plans will have assets in excess of $250 billion—all of which will help to supply the capital needed for the creation of more jobs, expanded business, increased home building and many other facets of our economic life. While some of today's critics of private pension plans imply that few actually receive benefits, the fact is that benefits of about $8 billion are paid annually to approximately six million retirees.

It is quite apparent, therefore, that voluntary private pension plans—both those unilaterally established by companies and those established as a result of the collective bargaining process—have made, and are continuing to make, a vital contribution to the retirement security of more than 50 percent of the private non-farm labor force. Here again, it is estimated that by 1980 almost 60 percent of the private labor force will be covered by such pension plans.

While we believe, in general, that the private pension system has served the nation and a substantial number of the labor force well, there are some areas where constructive legislation would be helpful; and we believe it is timely to enact legislation now covering those areas in which there is substantial agreement.

MEANINGFUL DISCLOSURE

NAM believes that adequate disclosure of pension plan operations is desirable. The existing statute and current reporting forms under the Disclosure Act now call for much greater detailed information than is generally realized. The D–2 report form, which is required under the Act, demands 16 pages of detailed information concerning the operation of private pension plans. The new D–1 Supplement will require several more pages.

While the disclosure of some additional information may be useful, we believe that it is not desirable nor helpful to further burden plan administrators, beneficiaries and government agencies by requiring disclosure of information of a more marginal and generally less meaningful nature. Disclosure for voluminous individual investments and investment transactions other than those involving parties-in-interest is not necessary and indeed could be harmful to many pension plans. In this connection, we can support the disclosure provisions of S. 4.

We enthusiastically support the provision which would require an annual audit by independent accountants except where such plans are regularly examined by banking or insurance regulatory agencies. We suggest, however, that the accountant's responsibliity should by limited to that of an auditor and he should not be required to deal with actuarial considerations.

There is currently pending before the House H.R. 2, The Employee Benefits Security Act, introduced by Representative Dent on January 3, 1973, and on which NAM testified on March 1 of this year. We made specific comments at that time with respect to certain provisions of H.R. 2 dealing with disclosure, and we would like to include a copy of that testimony as a part of this statement.

FIDUCIARY RESPONSIBIITY

NAM is firmly convinced that administrators of pension funds should observe the highest standards of fiduciary responsibility and we support the desirability of legislation which would concretely define the nature of fiduciary responsibility. We do, however, believe that because of the nature of the duties of a fiduciary there could be some unintentional and innocent violations. Since a fiduciary could face personal and financial ruin through inadvertence of others even while acting himself in good faith and with prudence, and since it is not the purpose of legislation to discourage reasonable and honest persons from acting as trustees, we believe that fiduciaries should be held personally responsible only for willful misconduct or gross negligence on their part. In addition, we believe the substance of Section 111(f) of H.R. 2 should be incorporated in any final legislation. This section permits the allocation of specific responsibilities among fiduciaries in which event a fiduciary would not be liable for responsibilities not allocated to him, provided he did not participate in nor have knowledge of acitvities constituting a breach.

EFFECT OF OTHER LAWS

NAM strongly urges that the provisions of any new federal pension bill supersede any and all laws of the states as they relate to the specific provisions of that bill in order to preclude the confusion and jurisdictional problems that could result from conflicting state and federal laws. Many pension plans operate in several states. Federal law must predominate in the pension field in order to avoid the expense, inefficiency, and confusion of conflicting state laws, particularly where multi-state collective bargaining agreements on pensions are in effect.

ELIGIBILITY REQUIREMENTS FOR PARTICIPATION

NAM endorses the principle of requiring reasonable limits on the time an employee may be excluded from participation in a qualified pension or profit-sharing plan. Whatever periods are legislated should take into account existing collective bargaining agreements so that they would not have to be amended during their present term.

VESTING

NAM supports the concept of vesting and has long espoused its inclusion in private pension plans. The vast majority of such plans do provide varying degrees of vesting. We recommend that this Committee consider alternative vesting standards since many plans now having vesting provisions have them in different forms. NAM, for example, has endorsed the Rule of Fifty. Additionally, it should also be possible for a plan to qualify with a vesting provision under which a participant is 100 percent vested after ten year of covered service at any age. Permitting substantially equivalent vesting forms would avoid the complexities and confusion which could come about by having dual vesting formulas in a single plan.

Many plans now having vesting provisions which would not meet new requirements of law have deliberately decided to allocate available funds for employees at or near retirement age and will need an appropriate transition. Accordingly, to help avoid the obvious inequities which would come about if a legislated minimum vesting standard were to be immediately applied across the board to plans with little or no current vesting provisions and plans with liberal vesting provisions, we suggest that the minimum vesting requirement in general not become applicable until plan improvements are made. This would also serve to minimize problems where pension plan provisions are a part of a collective bargaining agreement.

In addition, we believe that any legislation in the area of vesting should properly indicate that payment of mandatory vested retirement benefits would be at the normal retirement age specified in the plan but in no event later than age 65 and would encompass only a life annuity and not any early or ancillary benefits, such as death, disability or other benefits that may be available under the plan. Further, we recommend that a transition rule be established such as a provision that any specified period of service for acuiring mandatory vested rights apply only to service accrued subsequent to the effective date of the legislation or some equivalent alternate. For obvious reasons mandatory vesting provisions should not apply to the class-year type of profit-sharing saving plans.

FUNDING

NAM endorses adeuate funding and we believe that the vast majority of private pension plans are being adequately funded. This is confirmed by the study made by the Pension Research Council of the Wharton School of Finance and Commerce of the University of Pennsylvania which is a definitive study of the matter. The study showed that the ratio of fund assets to all accrued benefits was 94 percent and that the ratio for vested accrued benefits was 99 percent.

The study left little doubt that the vast majority of plans are being adeuately funded and that diversity and flexibility rather than uniformity should be the watchword. This finding has also been confirmed by a more recent compilation by the Office of the Commissioner of Insurance of the State of Wisconsin entitled "Comparison of Fund Assets to Vested Liability," dated May 1, 1972, and covering plans audited by that department. The results of these studies are evidence that the vast majority of plans are being adeuately funded. Present IRS funding requirements, together with Accounting Principles Board Opinion No. 8, give additional assurance that such adequate funding will continue in the future.

However, NAM can support additional IRS requirements for the funding of unfunded vested liabilities provided the rules are reasonable and flexible. For example, NAM would support an additional funding requirement along the lines presently required for costing purposes under APB Opinion No. 8.

PORTABILITY

There is considerable confusion with respect to portability and vesting. Many who argue for portability are in reality arguing for vesting. In our opinion, the adoption of mandatory vesting will make the justification or reason for portability largely academic. Additionally, there are many reasons why compulsory portability would be undesirable.

Portability would create many problems. If an employer had to be prepared at any time to transfer funds, it would be necessary to restrict a greater portion of investments to securities which are readily convertible to cash—thereby foregoing the consideration of long-term yield which helps to reduce the cost of benefits or make higher benefits possible. Thus, portability would have an undesirable effect on sound investment policies. Many technical difficulties also appear unsolvable. For example, we have been unable to ascertain how the present value of a vested pension with its ancillary features would be determined for transfer to another plan. In the absence of uniform plans, it would be equally difficult to purchase credits having an equivalent actuarial value under the new plan.

Portability would require a participating employer to allocate or set aside funds to meet current and immediately pending portability obligations for short service employees who might leave. In the net result, this could adversely affect or discriminate against long service employees who stay with the employer to retirement, not only by reducing their retirement security and the funds available for them, but also by reducing the earnings of the funds which help pay their benefits.

With portability there would be a necessity to duplicate recordkeeping and add greatly to administrative costs, all without any benefit to the employees. For these reasons we seriously question the need for or desirability of portability.

PLAN TERMINATION INSURANCE

NAM believes that the concept of plan termination insurance is unworkable, inequitable, and undesirable. Among the reasons for these conclusions are the following:

1. A pension plan may terminate as a result of an employer's seriously declining operations, bankruptcy or for many other seasons. These situations are not insurable risks. An essential element in insurance is that the risk insured against be beyond the control of the insured. In the case of pension plan termination insurance, the risk would be within the control of the insured in three important areas:

(a) The pension obligation (which determines the amount of the insured risk) is determined by the insured (an employer either unilaterally or by agreement with a union). At the outset, this is based on nothing more than a statement of intent. Even such an important matter as crediting service rendered prior to the establishment of the plan would be determined by the insured.

(b) The insured is generally in a position to determine whether the business operation will continue or whether the plan will terminate. Thus the insured controls not only the establishment of the amount of insured liability but also the occurrence of the event which results in the payment of the insured liability.

(c) The insured determines investment policy which has an important bearing on the amount of the liability insured.

2. Pension plan termination insurance would encourage the making of unsound pension promises and would discourage adequate funding of private plans. A lack of adequate funding would lead to a greater number of problems in cases of plan terminations, each with a larger amount of exposed risk. As a result of the high cost of subsidizing terminated plans, the soundness of the remaining plans would be reduced.

3. A plan termination insurance program could lead to a huge bureaucracy with rigid regulations to control in detail all aspects of pension plan funding, financing and investing—all of this to deal with a relatively small problem.

4. It is inequitable to force soundly-funded, well-managed plans to pay for the broken promises of others.

NAM believes that the tremendous problems and inequities inherent in the establishment of a plan termination insurance program far outweigh any benefits that may be derived from such a program.

TAX INCENTATIVES FOR RETIREMENT SAVINGS

While approximately 50 percent of the private non-farm work force, numbering close to 30 million people are covered by retirement plans and enjoy the prospect of retirement security, it is axiomatic that the other 50 percent do not have this kind of protection. NAM believes that the private pension plan system should be expanded to cover as many of the work force as possible and that additional federal legislation that encourages such expansion should be considered. We believe that a concept which would liberalize the tax treatment of savings for retirement purposes by allowing a new deduction from adjusted gross income for employees not covered by employer plans, or where the employer contributions are not significant, and by raising the limits on deductible plan contributions by the self-employed or shareholder-employees of small business corporations is most desirable.

The effect of this kind of legislation would be to encourage additional private capital formation and personal savings for retirement purposes, particularly among those who are not now covered or only marginally covered by employer-financed pension plans. The additional private savings generated would contribute to productive investment in the economy. Legislation of this kind would properly recognize that our labor market is mobile and diverse and that regular corporate pension plans cannot account for all conditions of employment. The revenue loss of any new tax legislation of this nature must be assessed very carefully in view of our overall fiscal problems but the cost of this program, we believe, would be quite minimal compared to the mass of direct government spending programs for income maintenance and otherwise.

TAXABILITY OF LUMP SUM DISTRITUTIONS

The Tax Reform Act of 1969 amended Section 402(a) of the Internal Revenue Code to deny capital gains treatment to post-1969 employer contributions distributed as a part of a lump sum distribution from a qualified pension or profit-sharing plan. Such amounts are to be treated as ordinary income but since a significant amount may be involved in the distribution paid out in one taxable year, the Act also amended Section 72(n) of the Code to provide for a seven-year averaging device in lieu of capital gains treatment to avoid as unfair tax on deferred compensation earned and accuculated over many years. Unfortunately, due to the problems and complexities inherent in the subject matter, IRS attempts to write implementing regulations which are equitable and consistent with the Act have been unsuccessful to date. It has been over three years since enactment and final regulations have not yet been issued. In view of the fact that the tax rates on substantial capital gains have been increased as a result of the Tax Reform Act of 1969, NAM recommends that the Congress take a new look at the action taken in 1969 and seriously consider restoring capital gains treatment to the total distribution in the interest of simplifying a complicated area that presently is a source of great confusion to both employers and employees. If Congress insists on continuing the present approach, NAM strongly urges enactment of revised legislative language which would simplify the approach and clarify its intent.

ADMINISTRATIVE JURISDICTION

S. 4 would create an Office of Pension and Welfare Plan Administration within the Department of Labor to be responsible for the establishment, administration, operation and enforcement of pension, profit-sharing retirement and other employee benefit plans.

The NAM seriously questions the need for this action. Under present law several federal departments and agencies have jurisdiction over matters affecting private pension plans. For example, the Treasury Department, the Department of Labor, the State Banking and Insurance Departments, among others, now have clear and definite responsibilities in this area. In view of the extent of existing regulations, NAM believes that care should be taken not to impose an additional level of supervision which would create confusion by duplication and conflict with current laws and agencies.

CONCLUSION

While NAM is definitely opposed to portability and plan termination insurance features, we also believe that there is an urgent need for speedy enactment of legislation incorporating fiduciary standards, meanintul disclosure, early vesting, individual retirement tax deductions, and some additional IRS requirements for the funding of unfunded vested liabilities. Accordingly, NAM supports S. 1557, relating to fiduciary responsibility and reporting. We also support S. 1631 as modified by recommendations contained in this statement. NAM is, however, strongly opposed to S. 4 as it contains, among other things, provisions establishing portability and plan termination insurance.

If Congress would act in accordance with the foregoing suggestions, we believe that they will have accomplished their desired objectives relating to the protection of private pension plan participants without unduly interfering with the flexibility necessary for the system to operate effectively and efficiently.

Testimony of the National Association of Manufacturers on H.R. 2, Employee Benefits Security Act and H.R. 462, Employee Retirement Benefits Security Act Before the General Subcommittee on Labor of the House Committee on Education and Labor, March 1, 1973

My name is Robert A. Albright and I am Vice President-Administration of the U.S. Steel Co. and Carnegie Pension Fund. I appear today on behalf of the National Association of Manufacturers. I currently serve as the Vice Chairman of the NAM Employee Benefits Committee. Appearing with me is Kenneth E. Schweiger, Director of Employee Relations for the NAM.

I am pleased to submit our views on H.R. 2 and H.A. 462. NAM member companies—large, medium and small in size—account for a substantial portion of the nation's production of manufactured goods, as well as for the employment of approximately 15 million persons. A vast preponderance of these people are covered by a private pension or profit sharing retirement plan which, for the most part, is paid for by the employer.

INTRODUCTION

The National Association of Manufacturers seeks to encourage the expansion and improvement of private pension plans which now have tremendous flexibility to adapt to the varied requirements of employers and employees. Private pension plans are making and will continue to make a significant contribution to the retirement security of more than 30 million Americans at present. It is expected that by 1980, more than 42 million workers will be covered.

In addition, pension funds are a vital source of capital accumulation so necessary to sustain the continued growth of our economy. Currently there are more than $160 billion in private plan assets. With an anticipated rate of growth of more than $10 billion a year, it is projected that by 1980 private pension plans will have assets in excess of $250 billion all of which will help to supply the capital needed for the creation of more jobs, expanded business, increased home building and many other facets of our economic life. While some of today's critics of private pension plans imply that few actually receive benefits. the facts are that benefits of about $8 billion are paid annually to approximately 6 million retirees.

It is quite apparent, therefore, that voluntary private pension plans—both those unilaterally established by companies as well as those established as a result of the collective bargaining process—have made, and are continuing to make, a vital contribution to the retirement security of more than 50 percent of the private non-farm labor force. Here again, it is estimated that by 1980 almost 60 percent of the private labor force will be covered by private pension plans.

While we believe, in general, that the private pension system has served the nation and a substantial number of the labor force well, there are some areas where constructive legislation would be helpful. The chairman of this committee has sponsored legislation in this area for several years and we believe it is timely to enact legislation now covering those areas in which there is substantial agreement. NAM believes that H.R. 2 generally represents a positive and a constructive approach, although we have reservations concerning the desirability of Title III of the bill which deals with Funding.

NAM supports legislation in the area of meaningful disclosure, fiduciary responsibility and reasonable vesting. We do, however, have some specific comments with respect to the provisions of the bill as follows:

1. Meaningful disclosure

NAM believes that adequate disclosure of pension plan operations is desirable. The existing statute and current reporting forms under the Disclosure Act now call for much greater detailed information than is generally realized. The D-2 report form, which is required under the Act, calls for 16 pages of detailed information concerning the operation of private pension plans.

While the disclosure of some additional information may be useful, we believe that it is not desirable or helpful to further burden plan administrators, beneficiaries and government agencies by requiring disclosure of information of a more marginal and generally less meaningful nature. Disclosure for voluminous individual investments and investment transactions other than those involving parties-in-interest is not necessary and indeed could be harmful to many pension plans.

We enthusiastically support the provision which would require an annual audit by independent accountants except where such plans are regularly examined by banking or insurance regulatory agencies.

Section 104(b)(1).—This section requests a listing of names and addresses of each fiduciary which in a multi plant company could involve a listing of several hundred people. Such fiduciaries are covered by a group bond, there is nothing gained by the government or a plan participant knowing who is considered a fiduciary except as a breach occurs. Basically the responsibiilty for control of the fiduciaries under the plan rests with administrators and such administrators are identified. We therefore urge that this requirement be eliminated.

Section 104(b) (3 and 4).—As we interpret these paragraphs, there would have to be disclosure of all assets held for investment purposes, aggregated and identified by issuer, borrower or lessor, with maturity date, rate of interest, collateral, cost and current value. In addition, paragraph (4) calls for disclosure in chronological order for each separate receipt and disbursement from the fund during the year covered by the report. Further, it requires identification of "each transaction by transaction date, description of the asset involved, specifying issuer, borrower or lessor or similar party to the transaction, rate of interest, maturity date, collateral, par or maturity value and shall enumerate any expense occasioned by the transaction and the proceeds or cost to the fund. In the case of regular and recurring transactions such as receipt of contributions or benefits payments these may be aggregated on a periodic basis, at least monthly, etc." Such exhaustive and detailed requirements in our opinion, is tremendously burdensome and counterproductive. We believe, as a minimum that both of these paragraphs should be modified and limited in the kind of detail required to those assets and transactions involving amounts in excess of 3% of the size of the fund. Of course, the Secretary would have sufficient investigatory power to examine the complete detail where appropirate.

Section 104(b)(6).—This provision would require the disclosure of all loans made from the fund during the reporting year or outstanding at the end of the year. The language, however, beginning at line 20, states an exclusion "unless such loan was a loan to a participant in a profit sharing plan . . ." We believe that the words "in a profit sharing plan" should be changed to "in accordance with the provisions of the plan . . ." Such a modification would relieve an employer of having to report individual loans made to plan participants—in accordance with the provisions of a collective bargaining agreement, the plan or both—and not just a profit sharing plan.

Section 104(e)(6).—In the interest of reducing the size of the filings required, we urge that a plan furnish either a copy of the most recent actuarial report or the information on actuarial assumptions as found in Paragraph 104(e)(6) A and B—not both.

Section 104(e)(7).—In view of the mandatory vesting requirements of Title II, we urge the deletion of this paragraph, which calls for statistics on terminations of employment, as being unduly burdensome and no longer necessary.

Section 105(b)(1) and (3).—We believe that these paragraphs, which deal with disclosures directly to participants, need clarification. They are too broad as presently constituted. The intent of adequate disclosure to participants by these paragraphs could be reasonably met by requiring that (a) a copy of the plan or a description thereof as it applies to the participant along the lines of the new D-1 Supplement recently promulgated by the Labor Department and (b) an adequate summary of the latest annual report be furnished each participant upon request.

Section 105(c).—In order to relieve the Administrators of undue burden and without detracting from meaningful communications with plan participants, we suggest the following alternative:

"The administrator of an employee benefit plan shall furnish to any plan participant at least once every three years, a statement indicating whether or not he has a non-forfetiable right to receive a benefit and, if he does, the benefits he has accrued. In the event that he does not have a non-forfeitable right to receive a benefit, the statement should indicate the earliest date on which benefits will become non-forfeitable."

The suggested change would substitute three years for one year and would clarify what we believe to be the intent of the language.

Section 106(e).—This section should be changed to limit the right of a participant or beneficiary "to recover benefits due him under the terms of his plan or to clarify his rights to future benefits under the terms of the plan;" since there appears to be adequate protection for such participants under the powers given to the Federal Government for enforcement. Private class actions are unnecessary and could lead to nuisance suits.

In addition, it is suggested that employees be required to exhaust any collectively bargained remedies (e.g., grievance and arbitration procedures) before initiating civil actions involving his rights to benefits under the plan.

2. Fiduciary Responsibility

NAM is firmly convinced that administrators of pension funds should observe the highest standards of fiduciary responsibility. We therefore support Section 111 which concretely defines fiduciary responsibility and establishes a prudent man rule.

3. Effect on Other Laws

Section 114.—We support this section which states that the provisions of this Act shall supersede any and all laws of the states as they relate to certain specified provisions of the bill. We believe, however, that the provisions of this section should be broadened to encompass all Titles of the bill as enacted.

4. Title II—Vesting

NAM supports the concept of vesting and has long espoused its inclusion in private pension plans. The vast majority of such plans do provide varying degrees of vesting. We therefore concur with the principle of vesting as set forth in this bill. Further, we believe that in this connection, the bill should appropriately indicate that payment of mandatory vested retirement benefits would be at the normal retirement age specified in the plan but in no event later than age 65, and would encompass only a life annuity and not any early or ancillary benefits, such as death, disability or other benefits that may be available under the plan.

Section 203(a)(1).—We recommend a clarification of this paragraph to conform with the Committee's summary of H.R. 2 so as to make it clear that under this alternate the specified period of service for acquiring mandatory vested rights applies only to service accrued after the effective date of this Title.

5. Title III—Funding

The National Association of Manufacturers endorses adequate funding and we believe that the vast majority of private pension plans are adequately funded. This is confirmed by the study made by the Pension Research Council of the Wharton School of Finance and Commerce of the University of Pennsylvania which is a definitive study of the matter and with which this Committee is familiar. As you remember, the study showed that the ratio of fund assets to all accrued benefits was 94 percent and that the ratio for vested accrued benefits was 99 percent.

The study left little doubt that the vast majority of plans are being adequately funded and that diversity and flexibility rather than uniformity should be the watchword. This finding has also been confirmed by a more recent compilation by the Office of the Commissioner of Insurance of the State of Wisconsin entitled "Comparison of Fund Assets to Vested Liability" dated May 1, 1972 and covering plans audited by that department. The results of these studies are evidence that the vast majority of plans are being adequately funded. Present IRS funding requirements, together with Accounting Principles Board Opinion No. 8, give additional assurance that such adequate funding will continue in the future. For these reasons, we do not believe that there is real need for Title III and any possible advantages would be more than offset by the disadvantages and harm that could result to the future growth and development of private pension plans.

SUMMARY

We believe that this bill, H.R. 2, subject to the foregoing comments, represents a forward step. We therefore urge its speedy enactment.

H.R. 462—Employee Retirement Benefit Security Act

1. Title I—Portability

Sections 101 through 105 of the bill would provide for a compulsory portability program to be administered by and under the direction of the Secretary of Labor. It is our understanding that portability would require, upon termination of employment by an individual with vested benefits, the transfer of assets equal to the value of the vested pension to a "portability program fund." In addition, the Secretary of Labor would be designated as the Trustee of the "Fund." He would have responsibility for administering it and reporting to Congress concerning its operation and status as well as reviewing general policies in the management of the fund.

There is considerable confusion with respect to portability and vesting. Many who argue for portability are in reality arguing for vesting. In our opinion, the adoption of vesting makes the justification or reason for portability largely academic. Additionally, there are many reasons why compulsory portability would be undesirable.

Portability would create many problems. If an employer had to be prepared at any time to transfer funds, it would be necessary to restrict a greater portion of investments to securities which are readily convertible to cash—thereby foregoing the consideration of long-term yield which helps to reduce the cost of benefits or make higher benefits possible. Thus portability would have an undesirable effect on sound investment policies. Many technical difficulties also appear unsolvable. For example, we have been unable to ascertain how the present value of a vested pension with its ancillary features transferred would be determined for transfer to another plan. In the absence of uniform plans, it would be equally difficult, under the language of the bill, to "purchase credits having at least an equivalent actuarial value under the new plan" (Section 105(1)).

Portability would require a participating employer to allocate or set aside funds to meet current and immediately pending portability obligations for short service employees who might leave. In the net results, this could adversely affect or discriminate against long service employees who stay with the employer to retirement, not only by reducing their retirement security and the funds available for them, but also by reducing the earnings of the fund which help pay their benefits.

With portability there would be a necessity to duplicate record-keeping and add greatly to administrative costs, all without any benefit to the employee. For these reasons, we question the desirability or need for Title I.

2. Title II—plan termination insurance

Sections 201 through 206 provide for the establishment of a "private pension plan termination insurance program." NAM believes that the concept of plan termination insurance is unworkable, inequitable and undesirable. Among the reasons for these conclusions are the following:

1. A pension plan may terminate as a result of an employer's seriously declining operations, bankruptcy or for many other reasons. These situations are not insurable risks. An essential element in inurance is that the risk inured agaiut be beyond the control of the insured. In the case of pension plan termination insurance, the risk would be within the control of the insured in three important areas:

(a) The pension obligation (which determines the amount of the insured risk) is determined by the insured (an employer either unilaterally or by agreement with a union). At the outset, this is based on nothing more than a statement of intent. Even such an important matter as crediting service rendered prior to the establishment of the plan would be determined by the insured.

(b) The insured is in a position to determine whether the business operation will continue or whether the plan will terminate. Thus the insured controls not only the establishment of the amount of insured liability but also the occurrence of the event which results in the payment of the insured liability.

(c) The insured determines investment policy which has an important bearing on the amount of the liability insured.

2. Pension plan termination insurance would discourage adequate funding of private plans. A lack of adequate funding would lead to a greater number of problems in cases of plan terminations, each with a larger amount of exposed risk. As a result of the high cost of subsidizing terminated plans, the soundness of the remaining plan would be reduced.

3. A plan termination insurance program could lead to pressure for rigid requirements controlling in detail all aspects of pension plan funding, financing and investing.

4. Employers who have established and maintained sound pension plans for their employees may for a period of time have a large unfunded vested liability because of recent pension improvements. It is inequitable to impose on such employers the additional burden of contributing to the insurance fund for the purpose of supporting employers and unions who may make unwarranted pension promises.

5. Some proponents of pension plan termination insurance compare this proposal to Federal Bank Deposit Insurance (FDIC). Such a comparison is invalid. FDIC insures assets in being while pension plan termination insurance proposes to insure pension plan promises and not necessarily actual assets in being.

Our conclusion is that a sufficient case has not been made for pension plan termination insurance.

CONCLUSION

While we are definitely opposed to mandatory portability and plan termination insurance, we do not want to conclude our testimony without reiterating our support and endorsement of the need for speedy enactment of H.R. 2, subject to our recommendations. This is necessary and desirable to clarify the uncertainty on the matter of federal/state jurisdiction and to remedy areas of weakness in present law in order to support the beneficiaries of the private pension system.

If Congress would act in accordance with the foregoing suggestions, we believe they will have accomplished their desired objetives related to the protection of plan participants without unduly interfering with the flexibility necessary for the private pension system to operate effectively and efficiently. It would also create the atmosphere necessary to promote the growth and development of existing plans and expansion of coverage through the creation of new plans.

Senator NELSON. Our next witness is Mr. John R. Lindquist on behalf of the Profit Sharing Council of America.

STATEMENT OF JOHN R. LINDQUIST OF CHICAGO LAW FIRM OF McDERMOTT, WILL & EMERY, IN BEHALF OF PROFIT SHARING COUNCIL OF AMERICA

Mr. LINDQUIST. My name is John Lindquist. I am a member of the law firm of McDermott, Will & Emery which is located in Chicago, Ill. I appear before you today on behalf of the Profit Sharing Council of America (formerly known as the Council of Profit Sharing Industries). My firm has been a member of the Profit Sharing Council of America for more than 25 years, and I am a member of the council's legal and legislative committee. The council is grateful to the subcommittee for this opportunity to comment with respect to certain topics which are included in the scope of these hearings.

We have submitted a longer, formal statement and I would ask at this time it be incorporated in full in the record.

Senator Nelson. It will be printed in full in the record in the appropriate place.

Mr. Lindquist. A brief word about the council. The council is a non-profit association of approximately 1,400 companies which have profit sharing plans covering approximately 2 million employees. The council believes that profit sharing has made a significant contribution to the growth, productivity and stability of our economy and to the economic security and well-being of millions of employees and their families. The council also believes that the goals of profit sharing are completely in accord with our current national efforts to increase our ability to compete in world markets and to stabilize our economy at home.

Many of the proposals which are now being considered by Congress which would affect the private retirement system are directed primarily toward pension plans. However, many of those proposals also would apply to profit sharing plans.

It is toward some of these proposals that the council would direct its comments.

First, *Vesting*

Practically all pending proposals would adopt a minimum Federal standard of vesting applicable to all qualified plans. The council is not convinced that a statutory vesting standard applicable to profit sharing plans is necessary or desirable. The council's belief on this point is grounded on the fact that, in general, profit sharing plans have historically commenced vesting of employee benefits and have attained full vesting of benefits more rapidly than is true, for instance, in pension plans. Generally, profit sharing plans also commence to vest earlier and reach full vesting more rapidly than many of the proposals that have been included in the bills now before Congress.

Senator Nelson. That doesn't cause you to oppose these minimum provisions in the bill, though?

Mr. Lindquist. No, sir. Some of the reasons why this has been so are set forth in the council's formal statement.

However, if Congress deems it to be in the public interest to adopt some form of statutory vesting for all plans, then the council would not object if certain considerations were taken into account. Some of those considerations are:

1. There should be no *single* vesting which is standard applicable to *all* plans.

2. We believe an alternative vesting requirement, based on length of participation, and without regard to age and length of service, should be included in any legislation and should be specifically applicable to profit sharing plans.

3. Any legislation should take into account certain types of profit sharing plans which are called "class year" plans. Under those plans (which usually vest at a relatively rapid rate) all of the funds attributable to a particular class year become vested separately at the rate specified in the plan. The council is pleased to note that both S. 4 and S. 1179 recognize the special nature of this type of plan.

On the question of Taxation of Lump-Sum Distributions: While not in any specific proposal presently before Congress, one of the announced topics of these hearings was the question of tax treatment of lump-sum distributions under qualified pensions and profit-sharing plans. For reasons set forth the council's formal statement, if Congress is going to consider any change in the method of taxation of such distributions as contained in present law, then the council would urge that Congress restore the method of treatment which prevailed prior to the Tax Reform Act of 1969. The council feels that the treatment which applied prior to the Tax Reform Act of 1969 was the proper treatment of lump sum distributions made under qualified profit-sharing plans. Moreover, the council feels that any allegedly favorable tax treatment granted to high bracket taxpayers under the treatment which prevailed prior to the Tax Reform Act of 1969 was eliminated by Congress' final decision in 1969 to tax long-term capital gains in excess of $50,000 at a 35-percent rate, rather than a 25-percent rate, and to treat one-half of any long-term capital gains as an item of tax preference income.

The council also recommends that the deferral of taxation of unrealized appreciation in securities of the employer which are included as a part in a lump-sum distribution should be continued. The council believes that elimination of this deferral of taxation would not only be unfair but would violate well-established principles of income tax. Income should not be taxed until the exact amount of the income is ascertained and it has been realized by the taxpayer. Deferral of taxation of unrealized appreciation of securities of the employer which are included in the lump-sum is consistent with those principles.

Next, Federal Fiduciary Standards: The council endorses the concept of a Federal fiduciary standard applicable to all trustees and others who occupy a fiduciary position with respect to the beneficiaries of any qualified plan. However, because many qualified profit-sharing plans have been established under diverse conditions and with diverse objectives, the council believes that any legislation should take into account those facts. For example, many qualified profit-sharing plans are designed to invest in, and explicitly provide for the investment in, securities of the employer. Any Federal fiduciary standard which limits investments by a qualified plan in securities of the employer or which imposes a "prudent man" rule (which might carry with it an obligation to diversify investments) should not be applicable to such plans. The council is pleased to note that S. 4 and S. 1631 recognize this problem and urges that any final legislation adopted by Congress retain this justified exception to any diversification requirement or percentage limitation.

In the subject of "Administration of New Regulatory Legislation": In order to avoid duplication and the necessity for securing approval of, and for perhaps being audited by, two separate agencies of the executive department, the council believes that any new major regulatory legislation adopted by Congress should continue to be administered by the U.S. Treasury Department. The administrative expertise required to administer any new law already exists in that Department. The council does not believe that any legislation which, in large part, would require employers to perform certain acts or to include certain provisions in their plans should be vested in a department of the executive branch whose basic mandate might be to advance the interests of another important segment of our economy.

On the question of overlapping State regulation: Whatever new regulatory legislation is adopted, the council would urge Congress to make clear that, having acted, Congress has preempted the field at a Federal level insofar as the several States are concerned. If this is not made clear, and the several States continue to be free to impose additional requirements, whether they deal with vesting, fiduciary obligations, reporting requirements, and so forth, the results could be chaos, confusion, and conflict. The council commends S. 4, for directing attention to this in section 609(a) and would recommend that any legislation adopted should specifically cover this troublesome point.

Senator NELSON. Is the language in S. 4 adequate in your judgment?

Mr. LINDQUIST. I have a difficulty in that it does not preempt, as it were, other existing Federal legislation, but there it has a clause in it that says "Except to the extent otherwise provided in this bill." That leads me to see some possible conflict, for instance, between S. 4 and the Treasury Department. For example, nothing is going to be taken away from the Treasury Department by S. 4, or nothing is intended to, but, for instance, vesting has been mentioned in S. 4. Would there be a conflict there? I don't know. I think the basic problem is being grappled with in 609(a) and I think any legislation should grapple with it. I note that this legislation does specifically.

Senator NELSON. Have you completed your statement?

Mr. LINDQUIST. Yes.

Senator NELSON. Senator Bennett?

Senator BENNETT. No questions.

Senator NELSON. Thank you very much Mr. Lindquist. We appreciate your taking the time to testify.

[That prepared statement of Mr. Lindquist and a letter of Mr. Lindquist to Senator Nelson follows:]

PREPARED STATEMENT OF JOHN R. LINDQUIST OF THE LAW FIRM OF MCDERMOTT, WILL AND EMERY, ON BEHALF OF THE PROFIT SHARING COUNCIL OF AMERICA

WHY THE COUNCIL APPEARS

The Profit Sharing Council of America (which was formerly known as the Council of Profit Sharing Industries and which celebrated its 25th anniversary in 1972) is a non-profit association of approximately 1,400 employers who have profit sharing plans. Those plans cover approximately 2,000,000 employees. Council members are located throughout the United States and are engaged in practically all areas of economic activity. The Council's offices are located at 20 North Wacker, Drive, Chicago, Illinois 60606.

The Council believes that profit sharing has made a significant contribution to the growth, productivity and stability of our economy and to the economic security and well-being of millions of employees and their families. The Council also believes that the goals of profit sharing are completely in accord with our current national objective of increasing our ability to compete in the economic world while, at the same time, restoring stability and real growth at home.

The Council naturally is concerned about any proposals which would discourage or inhibit the growth of profit sharing.

The breadth and scope of these hearings is evidence of the numerous proposals which have been advanced with the aim of improving the strength and security of the private retirement system. The thrust of many of the proposals is directed primarily towards pension plans. However, because profit sharing plans provide retirement benefits (in addition to other benefits which often are not found in pension plans), many of the proposals advanced also would apply to profit sharing plans. It is toward those proposals that the Council would direct its comments.

I. VESTING

Practically all of the major pieces of legislation under consideration would introduce vesting at a compulsory rate in all plans, including profit sharing plans. This is true of S. 4, S. 1179 and S. 1631. This principle is also embodied in H.R. 2 introduced in the House of Representatives.

Profit sharing plans have historically provided for more rapid vesting than has been the case in pension plans. In fact, it is fair to say that benefits under profit sharing plans generally commence to vest at an earlier date and reach full vesting more rapidly than would be required under most of the major bills which are now pending in either the House or the Senate. For example, in a recent Council survey of vesting provisions in the plans of its members, it was found that approximately 80% of the plans of its members responding to the survey provide for full vesting after a period of participation in the plan of ten years or less. Where an employee separates with less than ten years, while he may not be fully vested, generally he is vested in some ratable portion of his accumulated benefits based on the length of time he has participated. This is to be contrasted with the absence of a requirement of any vesting during (i) the first eight years of service under S. 4; (ii) the first five years of service under S. 1179; (iii) varying lengths of service, dependent on age, in the case of S. 1631; and (iv) ten years in the case of H.R. 2.

There are a number of reasons why early commencement of vesting and more rapid attainment of full vesting are found in profit sharing plans. Among them are:

1. Profit sharing plans are designed to provide a sense of "partnership" and an incentive to employees who participate in them. Requiring long periods of employment and participation before an employee attains any vested rights under a profit sharing plan does little to promote either of those goals.

2. While it is not universally true, generally amounts which are contributed by an employer to a profit sharing plan and which are forfeited by employees who terminate before they become fully vested are simply reallocated among the other participants in the plan. Therefore, except in those relatively few cases where forfeited amounts serve to reduce the employer's contribution obligation for the year in which the forfeited amounts are ascertained, the employer has no particular interest in the size or amount of the forfeitures which will arise during a plan's operations. This is one of the significant differences between pension plans and profit sharing plans. In the case of a pension plan, the Internal Revenue Code requires that contributions made for the purpose of providing benefits for an employee which are forfeited by him, in whole or in part, because he separates before he becomes fully vested, must be applied to reduce the costs of providing benefits for those who remain with the employer. In a pension plan forfeited amounts may not be used to increase the benefits of employees who remain with the employer.

3. Because forfeitures usually are reallocated among other participants in a profit sharing plan, the Internal Revenue Service, in discharging its responsibility to see that qualified plans are not operated in a fashion which produces discrimination in favor of certain categories (i.e., officers, shareholders, or highly compensated or supervisory employees), generally insists upon more rapid vesting than it would require in the case of a pension plan.

Since most profit sharing plans vest more rapidly than pension plans and also generally vest as fast as, or faster than, the proposals presently under consideration, the Council is not convinced that any minimum vesting standard is required in connection with profit sharing plans. The Council would prefer to leave the subject of vesting in profit sharing plans for settlement by the parties involved with each profit sharing plan. However, if Congress deems it to be in the public interest to provide a reasonable minimum standard of vesting, the Council would not object if certain considerations, some of which are peculiarly applicable to profit sharing plans, were taken into account.

Accordingly, the Council would caution against the adoption of any *single* standard which *all* qualified plans must meet. The hundreds of thousands of qualified plans already in existence have been established under diverse conditions and with diverse objectives. In recognition of this, the Council believes that any legislation recommended by this Subcommittee or the Senate Finance Committee for adoption by Congress should take into account the following:

(a) An alternative statutory vesting requirement, based upon length of *participation* and applicable specifically to profit sharing plans, should be included in any legislation adopted. The Council questions whether a single minimum vesting standard, whether based solely on length of service or based on length of service and age, is appropriate for profit sharing plans. The Council further questions whether age, in any event, is an appropriate factor to be taken into account in a vesting standard which would apply to all profit sharing plans. In the above-mentioned survey on vesting conducted by the Council among its members, only 1% of the companies reporting indicated that age was a factor in determination of vesting in a profit sharing plan. Many profit sharing plans are contributory and if an employee does not elect to join the plan when he is first eligible to do so, he may join at some later date.

Vesting based solely on *service* in such a situation, as compared with vesting based on participation, would not be appropriate. Not only are age and length of service (as contrasted with participation) generally ignored in determining the vesting rate under a profit sharing plan, but both factors also generally are ignored or given little weight in allocating annual employer contributions under a profit sharing plan. While length of service is sometimes taken into account for this purpose, existing Internal Revenue Service practices require that the amount allocated to all employees in each year must have a relatively uniform relationship to their compensation within the year. In this sense profit sharing plans differ substantially from pension plans. Under a typical pension plan the annual cost for an older employee's benefits is substantially greater than the cost for a younger employee, even though their compensation and benefits may be identical. Therefore, while age and length of service may be appropriate factors for pension plans, they generally have no significant relationship to profit sharing plans.

(b) Special consideration should be given to certain types of profit sharing plans which are referred to as "class year" plans. Typically, under these plans a relatively rapid rate of vesting applies, but it applies separately with respect to the funds accumulated under the plan attributable to each class year. Frequently, these plans are designed to enable employees to invest in stock of the employer if they so desire. In most of such plans with which the Council is familiar, vesting of each class year occurs within a period of ten years or less (usually five years) after the close of the particular class year. The Council is pleased to note that Sec. 202(a)(3) of S. 4 recognizes the special nature of this type of profit sharing plan. The Council strongly recommends to Congress that any final legislation on the subject of vesting should include recognition of the special nature of these plans.

II. TAXATION OF LUMP SUM DISTRIBUTIONS

In considering the Tax Reform Act of 1969, both the Senate Finance Committee and the House Ways and Means Committee extensively studied the question of the tax treatment of lump sum payments under qualified pension and profit sharing plans. As a part of the Tax Reform Act of 1969, Congress adopted a change in the tax treatment of lump sum distributions which had been in existence since the Revenue Act of 1942.

In brief, under the Tax Reform Act of 1969 Congress continued long term capital gain treatment with respect to lump sum distributions, except with respect to that part of any such distribution which consists of employer contributions made for plan years beginning after December 31, 1969. The Tax Reform Act of 1969 provided for a special seven-year averaging of such post-1969 employer contributions which are included as a part of a lump sum distribution. In 1969 Congress also continued the deferral of taxation of net unrealized appreciation in the value of securities of an employer which are distributed as a part of a lump sum distribution.

In its consideration of any proposals to change the method of taxation of lump sum payments made under qualified plans, the Council earnestly urges Congress to return to the treatment of lump sum distributions made under qualified profit sharing plans as long term capital gains and to continue the deferral of any tax on unrealized appreciation in securities of the employer which are included as a part of a lump sum distribution. The Council urges this for the following reasons:

1. Because an employee's interest in a qualified profit sharing plan represents funds "at risk", often for long periods of time, treatment of such distribution as long term capital gains is the appropriate tax treatment. Once an employer has made a contribution on behalf of an employee under a profit sharing plan, the employee bears all of the risks (and enjoys all of the benefits) of the investment results. As contrasted with a pension plan, the employer no longer has any interest in the fruits of the contribution once it has been made. On the other hand, in a typical pension plan the fruits of investment are taken into account in determining the amount of the employer's contribution and, to the extent those fruits exceed the expected return, employer contributions are reduced.

2. Clearly in a contributory profit sharing plan the fruits of an employee's contributions produced by the investment thereof under the plan is no different from any investment which the employee could make in his own right and independent of the plan.

3. Deferral of tax on net unrealized appreciation in securities of an employer which are included in a lump sum distribution is consistent with fundamental principles of tax law, as well as principles of equity. As pointed out above, in the case of such securities purchased by an employee's own contributions under a contributory plan, the employee should be placed in no different position than he would be had he purchased the stock independent of the plan. Insofar as any such securities attributable to an employer's contributions are concerned, the lump sum distribution represents funds which have been "at risk" and with respect to which, by the mere act of distribution, there has been no realization of income. A fundamental concept of our federal income tax law is that income is taxed when it is "realized". When a share of employer stock is distributed as a part of a lump sum distribution, no "income" is realized at that time. Imposition of a tax at that time based on the value of the share would be unfair if that value has not been realized by the employee. The employee might actually sell the share at a later date for a lesser amount than the amount on which he had paid taxes. Taxation of any unrealized appreciation should continue to be deferred until the share is actually sold and income is realized by the employee.

4. Taxation of a lump sum distribution as a long term capital gain produces an equitable result. The changed method which was adopted in 1969 was not intended to produce significant amounts of revenue. In fact, the Council speculated at that time before the Senate Finance Committee that the hoped-for revenues contemplated by the House version would be outweighed by the increased administrative burdens imposed upon the tax-paying public and the Internal Revenue Service. One of the stated objectives of the changed method of taxation of lump sum distributions as proposed in the House in 1969 was to eliminate what was felt to be an unwarranted tax advantage enjoyed by high bracket taxpayers who might receive substantial lump sum distributions. This objective was achieved and any allegedly unwarranted tax benefits for high bracket taxpayers were eliminated by Congress' decision in 1969 to tax long term capital gains in excess of $50,000 at a 35% rate rather than a 25% rate and to treat one-half of any long term capital gains as an item of preference income.

In the event Congress does not see fit to return to taxation of lump sum distributions under qualified plans as long term capital gains, then the Council would urge that Congress not adopt some other method of taxing such distributions. Lump sum distributions often represent amounts accumulated over a long period of time and represent the retirement security of employees who receive them. An important factor in the retirement planning of employees is the element of certainty regarding how their benefits will be taxed to them if they receive them in the form of a lump sum distribution. This element of certainty is lost if the method of taxing such distributions is changed frequently. While the Council believes that the changes made in 1969 brought about needless complexity without any compensating revenues and would prefer to see long term capital gain treatment restored, if Congress does not see fit to do this, then the Council would urge Congress to retain the method of taxation adopted in 1969. Adoption of another new method of taxing lump sum distributions would only serve to confuse employees who receive such distributions and would impair the confidence of employees in planning for their retirement.

III. FEDERAL FIDUCIARY STANDARDS

Most of the major pension reform bills under consideration in the House and in the Senate would impose federal fiduciary standards governing the conduct of trustees and plan administrators. This is true of S. 4, S. 1557 and H.R. 2.

The Council endorses the concept of a federal standard for the conduct of trustees and others who occupy a fiduciary relationship to the beneficiaries of qualified profit sharing and pension plans. The Council believes that profit sharing trusts should be managed and administered for the exclusive benefit of employees and their beneficiaries, and that fiduciaries should be held to standards of conduct in accordance with the time-tested principles of trust law. Further, the Council believes that the vast majority of profit sharing trusts are so operated and would not condone the actions of those who do not observe those time-tested standards of fiduciary conduct.

In adopting any federal fiduciary standard, the Council again would recommend that Congress take into account the fact that many qualified plans have been established under diverse conditions and with diverse objectives. For example, many qualified profit sharing plans contemplate that the funds held under those plans will be invested in securities of the employer corporation. This provides a "double-barreled" incentive for employees who are covered by the plan. Those employees share not only in the annual profits of the employer who maintains the plan, but also in the long term growth and prosperity of the employer as reflected in the value of the securities of the employer which are acquired under the plan. This type of plan provides employees with a long term and continuing incentive to increase the value of their own investment in stock of their employer. This incentive aspect of many qualified profit sharing plans should not be overlooked, especially at a time when our national efforts are directed toward becoming more productive and competitive in world markets.

The Council is pleased to note that S. 4, in prescribing limits on investments by pension and profit sharing plans in the securities of the employer who maintains the plan, makes special allowance for the fact that many qualified profit sharing plans are designed to be invested in securities of the employer. As reported, S. 4 would exempt such profit sharing plans from any percentage limitation applicable to investments in employer securities and also would exempt such plans from any diversification requirement which otherwise might apply under a federal "prudent man" rule. The Council would strongly urge Congress to include in any final legislation which it sees fit to adopt the concept embodied in S. 4 with respect to profit sharing plans which are designed and intended to invest in securities of the employer.

IV. ADMINISTRATION OF NEW REGULATORY LEGISLATION

In addition to setting federal standards in areas such as vesting, fiduciary conduct and funding of pension benefits, some of the proposed legislation now before Congress would place responsibility for administration of the new legislation under the jurisdiction of the Secretary of Labor. This is the case in S. 4 and H.R. 2. Other legislative proposals, such as S. 1179 and S. 1631, would leave primary responsibility for administration where it has been for the past thirty years under existing law (i.e., with the Treasury Department and the Internal Revenue Service). Earlier versions of some of the legislation now proposed or pending would have created an entirely new administrative agency to administer new federal laws regulating the private retirement system.

Of all of the approaches suggested in various past and current bills, the Council recommends continuing to vest responsibility for administration of any new federal regulatory statutes in the Treasury Department. The Council's reasons for this recommendation are:

1. The major federal laws which presently regulate the private retirement system (i.e., Sec. 401, et seq. and Sec. 501, et seq. of the Internal Revenue Code) have been administered by the Treasury Department for the past thirty years. Over that period of time, a substantial body of expertise in this highly technical field has been built up within the Treasury Department. Such expertise should not be wasted or ignored, nor is the expense of duplicating it in another administrative agency warranted.

2. Transferring new regulatory functions to a different branch of the Executive Department can only lead to unnecessary duplication and possible confusion. To illustrate, none of the proposals which envision that new regulatory laws will be

administered by the Secretary of Labor take away any responsibilities now conferred on the Treasury Department by the Internal Revenue Code. (See, for example, Sec. 609(a)(3) of S. 4.) In effect, employers would have to have their plans initially approved by *two* separate branches of the Executive Department. Moreover, qualified plans presumably would have to be audited periodically for compliance by *two* separate branches of the Executive Department. It is entirely possible that in the normal course of events a qualified plan might be caught between the requirements of two different branches of the Executive Department. This possibility should be avoided.

3. Enforcement of legislation regulating the conduct of employers should not be vested in a department of the Executive Branch whose basic mandate is to advance the interests of another important segment of our economy. The Council feels that this would be applicable whether enforcement were vested in the Department of Commerce or the Department of Labor. The Council believes that there would be greater public confidence in the "even-handedness" of the administration of any new law if it were not vested in a department representing any particular segment of our economy.

V. OVERLAPPING STATE REGULATION

The Council recommends that it be made explicit in any legislation that Congress, having acted, has preempted the area of regulation of the private retirement system. Unless it is made completely clear that this is so, it is respectfully submitted that literally thousands of qualified pension and profit sharing plans could be subject to future laws passed by states which would require the performance of, or abstinence from, certain additional acts and which would impose additional penalties for failure to comply with those state laws.

Some of the proposed legislation, notably Sec. 609(a) of S. 4, directs attention to this problem. Some of the other proposed legislation does not attempt to clarify this troublesome question.

The Council recommends to Congress that the concepts embodied in Sec. 609(a) of S. 4 be included in any legislation which is adopted by Congress.

McDermott, Will & Emery,
Chicago, Ill., May 25, 1973.

Hon. Gaylord Nelson,
Chairman, Subcommittee on Private Pension Plans, Committee on Finance, U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

Sir: In reviewing the transcript of my testimony before your Subcommittee on May 22 on behalf of the Profit Sharing Council of America, I noticed that my response to one of your questions toward the end of my testimony perhaps did not make clear the problem I envisioned.

Specifically, you asked me whether or not the federal "preemption" provisions of S. 4, as set forth in Section 609(a) of that Bill were adequate. I replied that I envisioned some difficulty with it and touched on the kind of difficulty I could foresee. Perhaps the following will set forth more clearly what I had in mind:

Assume that an employer has a qualified profit sharing plan which purports to vest employees on the basis of length of *participation* in the plan. The Internal Revenue Service usually insists that vesting in a profit sharing plan be based upon *participation*, rather than length of service, on the grounds that more highly compensated, supervisory, etc. employees will tend to have longer periods of service than other employees, and, for this reason, a disproportionate share of any amounts forfeited by terminating employees eventually will be reallocated to highly paid, supervisory, etc. employees.

Assume now that S. 4 were enacted into law. The employer would have to amend his plan to specifically provide for vesting based upon length of *service* in order to comply with S. 4. The Internal Revenue Service, on the other hand, might well take the position that engrafting of such a provision upon the profit sharing plan could result in prohibited discrimination and therefore, would disqualify the profit sharing plan for tax purposes. Which law would prevail? Section 401(a) of the Internal Revenue Code or S. 4? I am not sure that the preemption language of S. 4 would answer the question since it says, in effect, that no other federal legislation is "preempted" (i.e., superseded), "except as specifically provided in this Act". (See Section 600(a)(3).) Section 202(a) of S. 4, which sets forth the statutory vesting standard, says that all profit sharing plans "shall provide under the terms of the plan * * *", and then proceeds to set forth the vesting standards. Does this mean that, having expressly provided or required a vesting standard based upon *service*, any Internal Revenue Service claim that vesting must be based upon participation (in order to preclude discrimination) is no longer valid?

Admittedly, the matter is a technical one, but it is the kind of problem with which we lawyers must constantly concern ourselves. Any final legislation, in preempting, either should take care of this dilemma, or, as suggested in the testimony of the Profit Sharing Council of America, should have an alternate vesting standard based upon participation, rather than service, in the case of profit sharing plans.

Once again, let me express my own personal gratitude, as well as that of the Profit Sharing Council, for allowing us to make our views known to your Subcommittee.

Very truly yours,

JOHN R. LINDQUIST.

Senator NELSON. Our final witness is Mr. Robert G. Skinner, chairman, Division of Federal Taxation, American Institute of Certified Public Accountants.

Would you identify for the reporter your associates?

STATEMENT OF ROBERT G. SKINNER, CHAIRMAN, DIVISION OF FEDERAL TAXATION, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOMPANIED BY JOEL M. FORSTER, DIRECTOR OF THE INSTITUTE'S DIVISION OF FEDERAL TAXATION, AND THOMAS R. HANLEY, DIRECTOR OF THE INSTITUTE'S FEDERAL TECHNICAL LIAISON DIVISION

Mr. SKINNER. Thank you, Mr. Chairman, and Senator Bennett. My name is Robert G. Skinner, and I am chairman of the Division of Federal Taxation, of the American Institute of Certified Public Accountants. I am accompanied by Mr. Joel M. Forster, director of the institute's division of Federal taxation, and Mr. Thomas R. Hanley, director of the institute's Federal technical liaison division.

The American Institute of Certified Public Accountants is the sole national organization of professional CPA's. It was established in 1887 and currently has more than 91,000 members.

Our comments at this hearing on the Federal income tax aspects of private pension plan legislation are limited generally to those provisions of the administration bill (S. 1631) which may directly affect the members of the Institute and their employees. Accordingly, our comments in this respect will cover the proposed changes relating to funding, eligibility, vesting and contribution limitations in the case of plans which cover one or more self-employed individuals; the proposal for deductions for individual retirement savings; and the proposal to impose an excise tax on the parties to prohibited transactions. Our comments on disclosure and reporting requirements are limited generally to proposals contained in the retirement income security for employees bill (S. 4).

Our comments regarding the income tax aspects of the proposed pension legislation have been developed by our Tax Division, and our comments with respect to the reporting and disclosure requirements have been developed by our Committee on Health, Welfare and Pension Funds.

In the interest of conserving time, I would like to emphasize four aspects of our testimony: eligibility, vesting, contributions on behalf of self-employed individuals, and disclosure and reporting requirements.

It is our general view that special restrictions or limitations on qualified retirement plans covering self-employed individuals should be imposed only where there is a clear and present need to establish rules which would not otherwise be satisfied by the general nondiscrimination and other qualification provisions of the code as they relate to employee retirement plans. We therefore urge that the goal of equal treatment in this respect be a key element in your consideration of this important area of tax legislation.

With regard to eligibility, the administration bill would not permit a plan to qualify if it requires that an employee have completed continuous service with the employer in excess of 3 years, have obtained an age in excess of 30 years, or where, as of the time he is first eligible to participate, he has not obtained an age greater than 5 years preceding normal retirement age under the plan.

In the case of plans covering self-employed individuals who are "owner employees," the eligibility conditions could not require that an employee have completed more than 3 years of continuous service if the employee's age is less than 30 years, more than 2 years of such service if his age is 30 years or more but less than 35 years, or more than 1 year of such service if his age is 35 years or more.

The Institute agrees with the underlying philosophy that qualification of private retirement plans should be permitted only where the eligibility conditions are not unduly restrictive as to age and service. It is a matter of judgment whether an appropriate age qualification requirement should be established at a specific point within the 30- to 35-year range, or whether the service qualification requirement should be based on a 3-year formula. However, we do not believe that the age qualification requirement should be less than age 30.

Moreover, the Institute does not believe that there is any basic justification for imposing additional restrictions on the qualifying conditions for a plan which also benefits self-employed individuals who are "owner-employees." We, therefore, oppose the "three-two-one" service and age eligibility tests proposed for such plans. The eligibility requirements for plans benefiting "owner-employees" should be no different than for plans established by corporate employers.

As to vesting, the Internal Revenue Code——

Senator NELSON. What was that last sentence again?

Mr. SKINNER. We feel that the eligibility requirements for plans that benefit "owner-employees" should be no different than for plans established by corporate employers. In other words, we feel that there should be an equality of benefits and availability of these plans for the self-employed and their corporate counterparts. As to vesting, the Internal Revenue Code does not presently specify vesting standards for qualification of employee retirement plans, and various standards have been applied administratively. Generally, the administrative standards applied for profit-sharing plans have been more restrictive than those for pension plans. In the case of profit-sharing plans vesting usually has been required to begin within the first 5 years of participation, whereas in the case of pension plans vesting may be deferred until retirement.

The administration bill would provide the same standard for both penison and profit-sharing plans through the general application of a "Rule of 50," or in the case of plans which cover "owner-employees," a "Rule of 35." Under the "Rule of 50" and employee's rights to at least 50 percent of his accrued benefits derived from employer contributions would have to be nonforfeitable (vested) when the sum of his age and years of plan participation equals 50; and this percentage must increase annually thereafter at a rate of at least 10 percent per year.

The "Rule of 35" requires 50 percent vesting when the sum of an employee's age and participation years equals 35; and thereafter his vested interest percentage must increase at a rate of at least 10 percent per year.

The Institute agrees with the basic philosophy that qualified retirement benefits should become fully vested after a substantial period of service——

Senator NELSON. What do you mean by substantial?

Mr. SKINNER. Well, that is a matter of judgment. I would say personally, after the employee has established that he is suited for the job, is acceptable to the employer and is well situated from his own personal employment goals. Someone who has passed a test period, so to speak, would fit into that definition.

Senator BENNETT. That could be 3 months.

Mr. SKINNER. It could be any number. There may not be any black or white answer. It seems at the minimum there ought to be a trial period of time and consideration of other important factors after which the vesting of retirement benefits would become justified.

We believe that vesting standards should now be legislatively prescribed——

Senator NELSON. Should what?

Mr. SKINNER. We believe that they should be provided by legislation.

There is a wide variation in the many proposals for standards of minimum vesting. The "Rule of 50" is distinguishable in principle from other proposals in that age and years of service are effectively considered to have equal importance for this purpose. We believe that years of service should be the most important element in any vesting formula. If it is indeed desirable to recognize age in addition to service as an appropriate factor in establishing vesting standards, we urge that the recognition be on a basis other than the "one-to-one" approach of the "Rule of 50."

In proposing its legislative changes, the administration has stressed the importance of eliminating artificial distinctions in the tax treatment of similar plans because such plans are sponsored by different types of business entities. Yet the administration's earlier proposal (H.R. 12272) had three levels of vesting standards. Although the current proposal eliminates the third standard, which was specifically directed toward certain closely controlled partnerships and corporations, it does include a two-tiered formula which provides an artificial distinction between similar plans depending upon whether an "owner-employee" is a participant in the plan. We look forward to the time when all such artificial distinctions are eliminated from the code, but if at this time such a distinction is considered necessary, we urge that Congress promote greater uniformity between and among qualified retirement plans by providing for a two-tiered formula for vesting—with a rational basis for the more stringent second tier. An appropriate test would be where the accrued benefits are primarily for a limited group of participants who also have controlling ownership interests in the business entity. We suggest that this more restrictive vesting provision should apply irrespective of the form of business entity.

We propose, therefore, that the second standard for vesting (which should be no more restrictive than the "Rule of 35") should apply in any case where the controlling ownership interests of those who participate in the plan aggregate more than 50 percent of the value (or vote) of the business entity (partnership or corporation), and the present value of their aggregate interests in accrued benefits exceeds 50 percent of the total present value of accrued benefits under the plan. Although we urge that any second vesting standard be prescribed by legislation, the administrative aspects of this provision, such as the future treatment in instances where the ownership interests change, could properly be the subject of Treasury Department regulations.

Regarding contributions on behalf of self-employed individuals, present law provides a distinction between plans covering only employees and those which also cover self-employed persons. In the case of plans covering self-employed persons, the lesser of $2500 or ten per cent of earner income in the maximum allowable annual deduction for contributions on behalf of a self employed person. The Administration bill proposes a revision of the limitations on deductible employer contributions to qualified plans covering self-employed individuals by raising the allowable deduction to the maximum of the lesser of $7500 or 15 percent of earned income. In our view, with respect to deductible contributions to qualified retirement plans, there is no rational justification for distinguishing between plans covering self-employed persons and employees and those which cover only employees.

Although such a double standard may have been considered appropriate in 1962 when the H.R. 10 provisions were first enacted, it does not appear reasonable to continue that distinction now since professional activities in most States may be carried on in corporate form as partnerships or as sole proprietorships. Nevertheless, we commend the Administration proposal for attempting to achieve greater equity than currently exists.

The present $2500 limitation is generally inadequate to provide meaningful retirement benefits for self-employed individuals at all levels of earnings.

We not that certain bills before the Congress which include disclosure and reporting requirements stipulate that audits are to be conducted annually by independent qualified public accountants. We strongly support legislation requiring such audits.

As you may know, the Comptroller General in a letter dated September 15, 1970 to the heads of federal departments and agencies outlined the qualifications of independent public accountants deemed necessary for financial audits of governmental organizations and programs. For your convenience we have incorporated these qualifications as Appendix I to our written testimony.

We endorse the standard audit language advocated by the Comptroller General and recommend that such language be incorporated in any legislation relating to annual audits of employee benefit funds.

We would like now to comment on the financial disclosure and reporting requirements which are incorporated in the "Annual Report" section of certain of the proposed bills.

As drafted, these requirements would, in effect, necessitate incorporating into the annual report duplicate copies of substantial parts of the books and records maintained by an employee benefit fund. This would result in extremely cumbersome filings and, in our opinion, would interfere with the accomplishment of the legislative intent of achieving adequate financial supervision. We recognize that there is need for assurance that adequate books and records will be maintained by these funds. We believe, however, that alternatives exist and should be explored.

We have included as appendix II of our written testimony, suggested alternatives to sections 506 (c) and (d) and 507(c)(2) of S. 4. We believe that our suggestions will meet the legislative intent of Congress concerning disclosure and reporting requirements, while at the same time provide a more effective supervision of employee benefit funds and be less costly both to the funds and to supervisory agencies.

The form of our suggestions undoubtedly will require review and revision by your legislative draftsmen; however, we would be happy to discuss with you or your staff any refinements to our proposals on financial disclosure and reporting requirements which you believe would be appropriate.

The institute has for some time shared with committees like yours the keen interest in reforming the existing requirements relating to employee benefit funds. In connection with the financial statements of these funds and related disclosures, the Institute has prepared and we respectfully submit for inclusion in the record of these proceedings a draft of a proposed publication entitled "Audits of Pension Funds".

Senator NELSON. That will be printed in the record.*

Mr. SKINNER. That draft was recently circulated to interested parties for comment. We think it will be helpful because it bears directly on your studies.

We also have a publication entitled "Audits of Employee Health and Welfare Benefit Funds" which we would like to submit at this time. These audit guides are intended to provide direction to CPA's engaged to examine and report upon financial statements of employee health, welfare, and pension benefit funds; they incorporate the principles of accounting to be followed in preparing financial statements for these funds and the auditing procedures to be followed in examining them.

Senator NELSON. That will be accepted for the record.*

Mr. SKINNER. In addition, it is significant to note that any member of the AICPA who departs from recommendations set forth in these guides can be called upon to justify his departure.

*The draft referred to was made a part of the official files of the subcommittee.

*The publication referred to was made a part of the official files of the subcommittee.

We appreciate the opportunity to present these comments on behalf of our members and hope they are helpful to you. If the institute can assist you or your staff in further analysis of these proposals, we would be pleased to do so.

Senator NELSON. Thank you very much, gentlemen. We appreciate your taking the time to come here and testify.

[The prepared statement of Mr. Skinner follows:]

PREPARED TESTIMONY OF THE DIVISION OF FEDERAL TAXATION OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, SUBMITTED BY ROBERT G. SKINNER

My name is Robert G. Skinner. I am Chairman of the Division of Federal Taxation of the American Institute of Certified Public Accountants. I am accompanied by Joel M. Forster, Director of the Institute's Division of Federal Taxation, and Thomas R. Hanley, Director of the Institute's Federal Technical Liaison Division.

The American Institute of Certified Public Accountants is the sole national organization of professional CPAs. It was established in 1887 and currently has more than 91,000 members.

Our comments at this hearing on the Federal income tax aspects of private pension plan legislation will be limited generally to those provisions of the Administration bill (S. 1631) which may directly affect the members of the Institute and their employees. Accordingly, our comments in this respect will cover the proposed changes relating to funding, eligibility, vesting and contribution limitations in the case of plans which cover one or more self-employed individuals; the proposal for deductions for individual retirement savings; and the imposition of an excise tax with respect to prohibited transactions. Our comments on disclosure and reporting requirements are limited generally to proposals contained in the Retirement Income Security for Employees Bill (S. 4).

Our comments regarding the income tax aspects of the proposed pension legislation has been developed by our Tax Division and our comments with respect to the reporting and disclosure requirements have been developed by our Committee on Health, Welfare and Pension Funds.

FEDERAL INCOME TAX ASPECTS OF PROPOSED PENSION LEGISLATION

It is our general view that special restrictions or limitations on qualified retirement plans covering self-employed individuals should be imposed only where there is a clear and present need to establish rules which would not otherwise be satisfied by the general nondiscrimination and other qualification provisions of the Code as they relate to employee retirement plans. We therefore urge that the goal of equal treatment in this respect be a key element in your consideration of this important area of tax legislation.

Funding

Under present law, there is no specific requirement that the accrued liability for past service under a defined benefit plan ever be actually funded. However, in order to achieve the vesting objectives of the plan, the related trust must be funded in an amount at least equal to the sum of normal cost and interest on the unfunded liability.

Section 2(a)(1) of the Administration bill would, in general, require a defined benefit plan to be funded annually in an amount at least equal to the sum of normal cost, interest on the unfunded liability, and 5% of the principal of the unfunded vested liability. The White House Fact Sheet issued on April 11, 1973 relating to this proposal states that "The accounting profession now requires audited financial statements to show pension costs in a substantially similar manner."

The Institute generally supports the position that the minimum funding standard of present law should be modified to require systematic payments of the unfunded liability under the plan. Such a requirement would reduce the frequency and magnitude of benefit losses when pension plans are terminated.

It should be noted, however, that the accounting profession has not established any requirement that pension liability be funded. The relevant pronouncement of our profession in this connection is Accounting Principles Board Opinion (APBO) No. 8 which was issued in November of 1966. That Opinion provides that the cost of pension plans should be recognized annually, whether or not the plans are funded. To the extent that such plans are not funded, an appropriate liability should be recognized in the financial statements. It does not impose a requirement that the past service liability to participants, whether they have vested or nonvested benefits under the terms of the plan, be systematically funded. The thrust of APBO No. 8 is that fair presentation in financial statements requires a reflection of such past service liability over a period of not more than 40 years and not less than 10 years.

Eligibility

The Internal Revenue Code does not presently contain any specific requirements for a qualified plan concerning eligibility conditions based on age or length of service, except that in the case of an unincorporated business in which an "owner-employee" participates, the plan cannot exclude an employee who has been employed for three or more years. Apart from this exception, existing administrative practice permits a plan to limit participation to employees who have attained a specified age (e.g., 40 years), who have been employed for a specified period of time (e.g., 5 years) or who are too close to retirement age at the time they would otherwise first become eligible to participate in the plan.

Section 2(a)(2) of the Administration bill would not permit a plan to qualify if it requires that an employee have completed continuous service with the employer in excess of 3 years, have attained an age in excess of 30 years, or where, as of the time he is first eligible to participate, he has not attained an age greater than 5 years preceding normal retirement age under the plan. In the case of plans covering self-employed individuals who are "owner-employees," the eligibility conditions could not require that an employee have completed more than three years of continuous service if the employee's age is less than 30 years, more than 2 years of such service if his age is 30 years or more but less than 35 years, or more than one year of such service if his age is 35 years or more.

The Institute agrees with the underlying philosophy that qualification of private retirement plans should be permitted only where the eligibility conditions are not unduly restrictive as to age and service. It is a matter of judgment whether an appropriate age qualification requirement should be established at a specific point within the 30-to-35 range, or whether the service qualification requirement should be based on a 3-year formula. However, we do not believe that the age qualification requirement should be less than age 30. Moreover, the Institute does not believe that there is any basic justification for imposing additional restrictions on the qualifying conditions for a plan which also benefits self-employed individuals who are "owner-employees." We, therefore, oppose the "3–2–1" service and age eligibility tests proposed for such plans. The eligibility requirements for plans benefiting "owner-employees" should be no different than for plans established by corporate employers.

Vesting

The Internal Revenue Code does not presently specify vesting standards for qualification of employee retirement plans, and various standards have been applied administratively. Generally, the administrative standards applied for profit-sharing plans have been more restrictive than those for pension plans. In the former case, vesting usually has been required to begin within the first 5 years of participation, whereas in the latter case, vesting may be deferred until retirement.

Section 2 of the Administration bill would provide the same standard for both pension and profit-sharing plans through the general application of a "Rule of 50", or in the case of plans which cover "owner-employees", a "Rule of 35". Under the "Rule of 50" an employee's rights to at least 50% of his accrued benefits derived from employer contributions would have to be nonforfeitable (vested) when the sum of his age and years of plan participation equals 50; and this percentage must increase annually thereafter at a rate of at least 10% per year. The "Rule of 35" requires 50% vesting when the sum of an employee's age and participation years equals 35; and thereafter his percentage vested interest must increase at a rate of at least 10% per year.

The Institute agrees with the basic philosophy that qualified retirement benefits should become fully vested after a substantial period of service and at a point in time prior to retirement. Further, we believe that vesting standards should now be legislatively prescribed.

There is a wide variation in the many proposals for standards of minimum vesting. The "Rule of 50" is distinguishable in principle from other proposals in that age and years of service are considered of equal importance for this purpose. We believe that years of service should be the most important ingredient in any vesting formula. If it is indeed desirable to recognize age in addition to service as an appropriate factor in establishing vesting standards, we urge that the recognization be on a basis other than the "one-to-one" approach of the "Rule of 50".

In proposing its legislative changes, the Administration has stressed the importance of eliminating artificial distinctions in the tax treatment of similar plans because such plans are sponsored by different types of business entities. Yet the Administration's earlier proposal (HR 12272) had three levels of vesting standards. Although the current proposal eliminates the third standard, which was specifically directed toward certain closely-controlled partnerships and corporations, it does include a two-tiered formula which provides an artificial distinction between similar plans depending upon whether an "owner-employee" is a participant in the plan. We look forward to the time when all such artificial distinctions are eliminated from the Code, but if at this time such a distinction is considered necessary, we urge that Congress promote greater uniformity between and among qualified retirement plans by providing for a two-tiered formula for vesting—with a rational basis for the more stringent second tier. An appropriate test would be where the accrued benefits are primarily for a limited group of participants who also have controlling ownership interests in the business entity. We suggest that this more restrictive vesting provision should apply irrespective of the form of business entity.

We propose, therefore, that the second standard for vesting (which should be no more restrictive than the "Rule of 35") should apply in any case where the controlling ownership interests of those who participate in the plan aggregate more than 50% of the value (or vote) of the business entity (partnership or corporation), and the present value of their aggregate interests in accrued benefits exceeds 50% of the total present value of accrued benefits under the plan. Although we urge that any second vesting standard be prescribed by legislation, the administrative aspects of this provision, such as the future treatment in instances where the ownership interests change, could properly be the subject of Treasury Department regulations.

Deduction for Retirement Savings

The Internal Revenue Code does not presently permit a deduction for amounts which are set aside by an employee for a personal retirement plan. Section 3 of the Administration bill provides a method whereby an employee may establish and contribute to a personal retirement plan to provide for his own retirement benefits and secure a limited deduction for Federal income tax purposes. In general, the amount deductible would be limited for any year to the lesser of 20% of his earned income or $1,500, subject to further reduction for (1) amounts contributed on his behalf under another qualified plan of his employer, or (2) for the equivalent amount of tax that would be imposed on the employee under FICA in the case of an employee who is not covered by the social security system.

The Institute urges the adoption of this provision in the proposed bill because it believes that the individual retirement plan provisions will be beneficial to employees of many business entities which do not now have employer-sponsored retirement plans. In this respect, the proposal represents a step in the right direction. However, we also believe that there should be an early reappraisal of the deduction limitation with a view toward establishing complete equality with employer-sponsored plans.

In addition, appropriate provision should be made for a simple method of annual reporting by individuals. The benefits of individual retirement savings plans should not be eroded by placing onerous reporting burdens on relatively unsophisticated taxpayers who choose to adopt such plans. The desirability of a simplified reporting procedure could be described in accompanying committee reports.

Contributions on Behalf of Self-Employed Individuals

Present law provides a distinction between plans covering only employees and those which also cover self-employed persons. In the latter case, the lesser of $2,500 or 10% of earned income is the maximum allowable annual deduction for contributions on behalf of such a self-employed person. Section 4 of the Administration bill proposes a revision of the limitations on deductible employer contributions to qualified plans covering self-employed individuals by raising the allowable deduction to a maximum of the lesser of $7,500 or 15% of earned income.

In our view, with respect to deductible contributions to qualified retirement plans, there is no rational justification for distinguishing between plans covering self-employed persons and employees, and those which cover only employees. Although such a double standard may have been considered appropriate in 1962 when the HR 10 provisions were first enacted, it does not appear reasonable to continue that distinction now, since professional activities in most states may be carried on in corporate form, as partnerships or as sole proprietorships. Nevertheless, we commend the Administration proposal for attempting to achieve greater equity than currently exists. The present $2,500 limitation is generally inadequate to provide meaningful retirement benefits for self-employed individuals at all levels of earnings.

With respect to the proposed new limitation of $7,500 as a deductible contribution, we are pleased to note that the earlier Administration proposal (HR 12272) to apply the 15% rate to a $50,000 maximum earned income base has been eliminated. At that time, we suggested that a formula involving a maximum earned income base operates unfairly in many instances and further compounds the lack of equality between self-employed plans and corporate plans. We strongly support Section 4 of the current Administration proposal which corrects many of these inequities.

Prohibited Transactions

Under the present Code provisions, an otherwise qualified retirement trust is denied tax exemption if it engaged in a prohibited transaction. Under such circumstances, in addition to the taxation of the trust's earnings, the employer may be denied a current deduction for contributions in certain cases, and the employee participants will be denied the benefits of deferral of taxation of nonforfeitable amounts contributed on their behalf by employers, as well as the special averaging provisions available with respect to lump sum distributions. In effect, the consequences of denial of exemption may fall largely upon innocent covered employees.

The proposed legislation switches the burden occasioned by a prohibited transaction from the employees to the parties to such a transaction—usually the employer and the fiduciary—by the imposition of excise taxes on the amount involved in the transaction.

The Institute agrees with the philosophy that the detriment arising from prohibited transactions should be borne by the parties who engaged in such transactions.

DISCLOSURE AND REPORTING REQUIREMENTS

We note that certain bills before the Congress which relate to disclosure and reporting requirements stipulate that audits are to be conducted annually by an independent qualified public accountant. We believe that independent audits conducted by qualified persons are in the public interest and, therefore, strongly support legislation requiring them. However, legislation providing for such audits of financial information should be worded to produce the result which Congress deems necessary.

In a letter sent to the Senate Subcommittee on Labor, dated February 23, 1973, the American Institute in commenting on S. 4 recommended that the bill be modified to require that audits be conducted in accordance with "generally accepted auditing standards."

The objective of an audit made in accordance with generally accepted auditing standards is to enable the CPA to express an opinion, for which he assumes professional responsibility, as to whether the financial statements under examination present fairly the financial position and the results of operations of the reporting entity.

Generally accepted auditing standards are well recognized as the standards which establish the responsibilities assumed by a CPA, and have frequently been cited by the courts, the Securities and Exchange Commission and other governmental agencies. It is significant to note that CPAs are subject to disciplinary action if it is determined that they have not adhered to such standards.

Audit Guides for CPAs

Recognizing your keen interest in pension reform, we are pleased to report at this time that an Institute draft of a proposed publication *Audits of Pension*

Funds was recently circulated to interested persons for comment. This audit guide will complement one already published by the Institute regarding *Audits of Employee Health and Welfare Benefits Funds.*

These audit guides are intended to provide guidance to CPAs engaged to examine and report upon financial statements of employee health, welfare and pension benefit funds; they incorporate the principles of accounting to be followed in the financial statements for such funds and the auditing procedures to be followed in examining and reporting on them.

Audit guides such as the ones mentioned are authoritative references which contain the views of informed members of the accounting profession as to what constitute the best practices of accounting, auditing and reporting in a specific area. Any member of the AICPA who departs from recommendations set forth in a guide can be called upon to justify his departure.

We respectfully submit for your information and for inclusion in the record of your proceedings, our publication, *Audits of Employee Health and Welfare Benefit Funds* and the draft on *Audits of Pension Funds.*

Qualified Auditors

The Comptroller General, in a letter dated September 15, 1970 (B-148144) to the heads of Federal departments and agencies, outlined the qualifications deemed necessary for independent public accountants making financial audits of governmental organizations and programs. For your information, we have enumerated these qulifications in Appendix I attached hereto.

Specifying such qualifications would ensure that audits required under any legislation would be conducted by individuals with the highest qualifications and we believe the public interest would be better served if audits are conducted by those who meet these requirements. Therefore, we endorse the language as to the qualification of independent auditors advocated by the Comptroller General and recommend that such language be incorporated in any legislation requiring independent audits.

Annual Report

As previously mentioned, generally accepted auditing standards require that the report of an independent qualified public accountant, as a result of his examination, include the expression of an opinion as to whether the financial statements he has examined present information fairly in conformity with generally accepted accountnig principles, or to clearly set forth the reasons why such an opinion cannot be expressed.

In our comment letter on S.4 sent to the Senate Subcommittee on Labor we recommended a modification of the section on disclosure requirements to clarify the intent of the legislation as it relates to financial statements and related information specified in the bill. The purpose of the modification would be to simplify the reporting process and at the same time provide for the filing of financial statements and other information necessary to effectively supervise the financial activities of employee benefit funds. Financial reportig requirements can be developed which would permit adequate financial supervision but which, in comparison with the proposed requirements contained in bills such as S. 4, would be less costly both to the employee benefit funds and to supervisory agencies.

Certain provisions of proposed bills as drafted would, in effect, require incorporating into the annual report duplicate copies of substantial parts of the books and records maintained by the fund. This would result in extremely cumbersome filings and, in our opinion, would interfere with the accomplishment of the legislative intent of achieving adequate financial supervision. We recognize that there is a need for assurances that adequate books and records will be maintained by such funds. However, we believe that alternatives exist and should be explored.

Legislation and regulations applicable to commercial companies subject to federal regulation require that certain financial documents be preserved. Examples are:

Section 31(a) of the Investment Companies Act,

Rules 17a-2 through 4 of the General Rules and Regulations Under the Securities Exchange Act of 1934, and

The Holding Company Act of 1935 and the related Securities and Exchange Commission's "Accounting Series Release No. 84."

Incorporating provisions similar to those adopted by other agencies of the Federal Government, but tailored to employee benefit funds, efficient in supervising financial operations of funds and at the same time assure necessary record maintenance and preservation.

In Appendix II we have redrafted Sections 506(c) and (d) and 507(c)(2) of S. 4 in a manner which we believe would meet the legislative intent of Congress concerning disclosure and reporting requirements, but at the same time provide more effective supervision of employee benefitt funds and be less costly both to the employee benefit funds and to supervisory agencies.

We would be happy to discuss with you or your staff any refinements to our proposed draft of financial disclosure and reporting requirements which you believe would be appropriate.

We appreciate the opportunity to present these comments on behalf of our members. If the Institute can assist you or your staff in further analysis of these proposals, we would be pleased to do so.

Appendix I—Qualifications of Independent Auditors Engaged by Governmental Organizations

When outside auditors are employed for assignments requiring the expression of an opinion on financial reports of governmental organizations, only fully qualified public accountants should be employed. The type of qualifications, as stated by the Comptroller General, deemed necessary for financial audits of governmental organizations and programs is quoted below:

"Such audits shall be conducted * * * by independent certified public accountants or by independent licensed public accountants, licensed on or before December 31, 1970, who are certified or licensed by a regulatory authority of a State or other political subdivision of the United States: Except that independent public accountants licensed to practice by such regulatory authority after December 31, 1970, and persons who although not so certified or licensed, meet, in the opinion of the Secretary, standards of education and experience representative of the highest prescribed by the licensing authorities of the several States which provide for the continuing licensing of public accountants and which are prescribed by the Secretary in appropriate regulations may perform such audits until December 31, 1975: provided, that if the Secretary deems it necessary in the public interest, he may prescribe by regulation higher standards than those required for the practice of public accountancy by the regulatory authorities of the States."[1]

Appendix II—Proposed Modification of Sections 506(c) and (d) and 507 (c)(2) of S. 4: Annual Report Requirements

(Present bill in roman; *proposed revisions in italic*)

506 (c) Section 7(a) of Such Act is further amended by adding the following paragraphs:

"(2) If some or all of the benefits under the plan are provided by an insurance carrier or service or other organization, such carrier or oganization shall certify to; the administrator of such plan, within one hundred and twenty days after the end of each calendar, policy, or other fiscal year, as the case may be, such information as determined by the Secretary to be necessary to enable such administrator to comply with the requirements of this Act.

"(3) The administrator of an employee benefit plan shall cause an audit to be made annually of the employee benefit fund established in connection with or pursuant to the provisions of the plan. Such audit shall be conducted in accordance with generally accepted standards of auditing by an independent qualified public accountant *who shall conduct such an examination of the financial statements of the fund as he may deem necessary to enable him to form an opinion as to whether the financial statements required to be included in the annual report by Section 506 (d) are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards and shall involve such tests of the books and records of the fund as are considered necessary by the independent qualified public accountant. The independent qualified public accountant shall also submit a report as to whether the supplementary financial data specified in*

[1] Letter (B-148114, Sept. 15, 1970) from the Comptroller General to heads of Federal departments and agencies. The reference to "Secretary" means the head of the department executing tbe instrument in which the quotation appears.

506(d) presents fairly in all material respects the information contained therein when considered in conjunction with the financial statements taken as a whole. Nothing herein shall be construed to require such an audit of the books or records of any bank, insurance company, or other institution providing insurance, investment, or related function for the plan, if such books or records are subject to periodic examination by any agency of the Federal Government or the government of any State. The auditor's opinion and comments with respect to the financial information required to be furnished in the annual report by the plan administrator shall form a part of such report.

"*(4) For purposes of subparagraph (3) of this paragraph, the term "qualified public accountant" means—*

(i) a person who is a certified public accountant certified by a regulatory authority of a State,

(ii) a person who is a licensed public accountant, licensed on or before December 31, 1970, by a regulatory authority of a State, or

(iii) with respect to audits performed before January 1, 1976, any other person who meets, in the opinion of the Secretary, standards of education and experience which are representative of the highest prescribed by the licensing authorities of the several States which provide for the continuing licensing of public accountants and which are prescribed by the Secretary in appropriate regulations;

except that if the Secretary deems it necessary in the public interest, he may prescribe by regulation higher standards than those required for the practice of public accountant by the regulatory authorities of the States, and a person shall be considered a qualified public accountant for purposes of subparagraph (3) only if he meets such standards.

(d) Section 7(b) and (c) of such Act are amended to read as follows:

"(b) A report under this section shall include—

(1) (A) Financial statements for Employee Welfare benefit plans.—a statement of assets and liabilities; a statement of revenues and expenses for the period aggregated by general source and application; a statement of changes in fund balance; a statement of changes in financial position; in the notes to financial statements disclosures concerning the following items should be considered: a description of the plan including any significant changes in the plan made during the period and the impact of such changes on benefits; a description of material lease commitments, other commitments and contingent liabilities; a description of agreements and transactions with persons known to be parties in interest; a general description of priorities upon termination of the plan; information concerning whether or not a tax ruling or determination letter has been obtained; and any other matters necessary to fairly present the financial statements of a particular welfare benefit fund.

(B) Financial statements for Employee Pension benefit plans.—a statement of assets and liabilities including the estimated actuarially determined present value of accrued benefits to be paid under the plan as calculated by a qualified actuary and aggregated by type of participant (retired, nonretired, vested, nonvested, etc.); a statement of changes in net assets available for plan benefits which shall include details of revenues, expenses and other changes aggregated by general source and application; in the notes to financial statements disclosures concerning the following items should be considered: a description of the plan including any significant changes in the plan made during the period; the funding policy (including policy with respect to prior service cost), and any changes in such policies during the year; the most recent valuation date used to compute the present value of accrued benefits and the actuarial cost methods and assumptions; a description of any significant changes in plan benefits made during the period and the impact of such changes on the present value of accrued benefits; a description of material lease commitments, other commitments and contingent liabilities; agreements and transactions with persons known to be parties in interest; a general description of priorities upon termination of the plan; information concerning whether or not a tax ruling or determination letter has been obtained; and any other matters necessary to fairly present the financial statements of a particular pension benefit fund.

(2) Supplementary financial information for all employee benefit funds:

(A) a summary of investment transactions for the year by major classifications including the balance at the beginning of the period (at cost), purchases, sales and meturities, the balance at the end of the period (at cost and at market value) and investment income (dividends, interest, etc.).

(B) a schedule setting forth all assets held for investment purposes (including investments in securities, properties, etc.) during the period which (1) represent more than five percent of the total assets (at cost) held for investment, (2) involve a person known to be a party in interest, or (3) are not listed or traded on an exchange, or (4) are in default as to the payment of principal or interest at the end of the period. Such schedule shall also state separately all assets held for investment written off during the period as uncollectible. The assets so scheduled should be identified by issuer, borrower or lessor, a similar party to the transaction, maturity date, rate of interest (amount of rental income, etc.), collateral, par or maturity value, cost, and current market value.

(c) In addition, the administrator of the plan shall furnish the following information:

(1) the average number of employees covered (contributory and noncontributory) during the period;

(2) a detailed schedule of salaries, fees and commissions paid or accrued by the plan to any individual or organization which exceeds the lesser of 5% of total revenue or $20,000 for the year, to whom paid, in what amount and the purpose of such payments.

(3) the name and address of each fiduciary, his position with respect to the plan, his relationship to the employer of the employees covered by the plan or the employee organization, and any other office, position or employment he holds with any party in interest. In additin to the foregoing, such information shall include the names and addresses of all persons who were trustees of the plan during the year, showing the following: the year each such person became a trustee, his occupation(s) and position(s) held during the past five years, fees, compensation, etc. paid as a trustee, and expenses (travel, entertainment, etc.).

(4) a statement listing any changes in the appointment of trustees, the qualified public accountant, insurance carrier, actuary or administrator and the reason for the change.

(d) The Secretary, should he deem necessary, may request that the administrator of an individual plan(s) provide such other financial information as may be necessary in a particular circumstance.

(*e*) Subject to rules of the Secretary designed to preclude the filing of duplicate or unnecessary statements if some or all of the assets of a plan or plans are held in a common or collective trust maintained by a bank or similar institution or in a separate account maintained by an insurance carrier, the report shall include a statement of assets and liabilities and a statement of receipts and disbursements of such common or collective trust or separate account and such of the information required under paragraphs (*1*)(*A*), (*1*)(*B*), (*2*)(*A*) *and* (*2*)(*B*) of Section 7(b) with respect to such common or collective trust or separate account as the Secretary may determine appropriate by regulation. In such case the bank or similar institution or insurance carrier shall certify to the administrator of such plan or plans, within one hundred and twenty days after the end of each calendar, policy, or other fiscal year, as the case may be, the information determined by the Secretary to be necessary to enable the plan administrator to comply with the requirements of this Act.

(*f*) If the assets of the plan are held in more than one fund, then the schedule required under subparagraph (*2*)(*B*) may be prepared for each fund or at the option of the administrator, the required information may be prepared for all such funds in one schedule treating the assets as though they were held in a single fund.

"(g) If the only assets from which claims against an employee benefit plan may be paid are the general assets of the employer or the employee organization, the report shall include (for each of the past five years) the benefits paid and the average number of employees eligible for participation."

In addition Sec. 507(c)(2) (relating to publication requirements) should be modified as follows:

"(2) the administrator shall furnish *annually to each* plan participant or beneficiary *so requesting in writing a fair summary of the latest annual report; the statements and schedules described in Section 506(d);*"

Senator NELSON. We will conclude the hearings for today. The committee will meet tomorrow in the same room and hearings will begin at 10 o'clock.

[Whereupon, at 12:35 p.m. the subcommittee recessed to reconvene at 10 a.m. Wednesday, May 23, 1973.]

PRIVATE PENSION PLAN REFORM

WEDNESDAY, MAY 23, 1973

U.S. SENATE,
SUBCOMMITTEE ON PRIVATE PENSION PLANS
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:12 a.m., in room 2221, Dirksen Senate Office Building, Senator Gaylord Nelson (chairman of the subcommittee) presiding.

Present: Senators Long (chairman of the full committee), Nelson, Hartke, Bentsen, Curtis, Dole, and Roth.

Senator NELSON. Our first witness this morning is the Honorable Paul Fasser, Assistant Secretary of Labor for Labor-Management.

The committee welcomes you here, Mr. Fasser. If you would identify your associate for the reporter and the record.

We are operating under a 10-minute rule but that is not applicable to administration witnesses nor to authors of legislation we are considering.

We will print your prepared testimony in full in the record.

Go ahead, Mr. Fasser.

STATEMENT OF PAUL J. FASSER, ASSISTANT SECRETARY OF LABOR FOR LABOR-MANAGEMENT, ACCOMPANIED BY FRANK M. KLEILER, DEPUTY ASSISTANT SECRETARY FOR LABOR-MANAGEMENT RELATIONS, DEPARTMENT OF LABOR, AND HENRY ROSE, ASSOCIATE SOLICITOR FOR LEGISLATION, DEPARTMENT OF LABOR

Mr. FASSER. Thank you Mr. Chairman.

I have with me this morning Mr. Frank Kleiler, Deputy Assistant Secretary, Labor-Management Relations on my right and on my left, Mr. Henry Rose, Associate Solicitor for Legislation in the Department of Labor.

I have a written statement, Mr. Chairman, that would run about 10 minutes and I am cognizant of the 10-minute rule. If it is OK with you, I would like to proceed to read the statement and if you find that I am going too long, I will be happy to cut it short.

Senator NELSON. As I said, the administration witnesses are not limited to 10 minutes.

Mr. FASSER. I hope the statement will obviate more questions than it will stimulate and I think we can keep to the time fairly closely.

Mr. Chairman, members of the subcommittee: I wish to thank you for the invitation to appear here on the subject of pension reform legislation. Because Secretary Shultz testified yesterday on a major part of the administration's pension proposals, I will restrict my remarks to our proposed Employee Benefits Protection Act and to some observations on the subjects of portability and termination insurance.

The Employee Benefits Protection Act (EBPA), introduced as S. 1557 and commonly called the fiduciary bill, is one of two administration proposals for strengthening the rights and interests of participants in employee benefit plans. It provides improvements in the areas of fiduciary standards, reporting and disclosure, and enforcement procedures. Similar legislation was recommended by the administration during the 91st and 92d Congresses. The current proposal has some improvements over the prior bills, and I will address these items later on in my testimony. Before doing that, I would first like to describe the basic features of the legislation.

A key part of the bill establishes Federal standards of fiduciary responsibility applicable to persons who hold responsibile positions in funded employee benefit plans. These standards would require plan administrators and other fiduciaries to act solely in the interests of participants and beneficiaries and to perform their duties in accordance with the plan documents and consistent with the Federal prudent man rule embodied in the bill. In addition to these general principles, S. 1557 contains specific prohibitions against certain types of self-dealing and conflicts of interest. A fiduciary who breaches any of the standards would be personally liable to the plan for any financial loss resulting from the breach and would have to restore to the plan any personal profit made through use of plan assets. As a further safeguard against irresponsibility in plan management, the bill would prohibit persons convicted of certain listed criminal offenses from serving in responsible plan positions for a period of 5 years.

With regard to reporting and disclosure, the EBPA would provide participants and beneficiaries with more significant information about their benefit rights and plan operations, including management of plan assets. The plan description would be comprehensive and would have to be written in layman's language. Annual reports would provide more detailed information about plan investments, and pension plans would be required to furnish data on their funding status. The requirement of an annual independent audit will help to insure accuracy in annual reports, and will allow plan participants to reach informed judgments about their plans' financial condition.

Participants in pension plans would be entitled upon written request to receive a variety of statements and documents, including complete copies of the plan description, the annual report, and a statement of benefits (including vested benefits)) which have accrued to them. In addition, upon his termination of service under a plan, a participant would be automatically furnished with information about his rights and privileges under the plan.

Enforcement of the bill's provisions would be shared by the plan participants and the Secretary of Labor. Participants would be empowered to sue for redress of fiduciary breaches, to remove persons holding plan positions in violation of the criminal conviction bar, and to enforce their rights to disclosure by the plan administrator. The Secretary would have power to bring suit for the same purposes, as well as to enforce other provisions of the bill such as those on reporting.

There is a criminal penalty for violating any provision of the legislation except for the fiduciary standards.

Our proposal would provide for a uniform source of Federal law in the areas of fiduciary responsibility, reporting, and disclosure. However, State law would continue to apply to plans not subject to the bill and there would be no interference in State regulation of insurance, banking, or securities.

That completes my description of the bill's basic features. Admittedly it is a general description, and this subject can get very technical. I am therefore submitting for the record a more detailed explanatory statement of the bill.

Now I would like to point out the main improvements in this bill over our earlier versions.

One change involves an expansion of coverage to include plans administered by tax-exempt organizations established for charitable, religious, educational, or fraternal purposes. We are also covering any plan which has a trust fund subject to section 302(c) of the Taft-Hartley Act. This will include plans established for such purposes as vacation benefits, apprenticeship programs, scholarship funds, and child care centers. These expansions of coverage are logical, and avoid inconsistency of treatment.

In the bill introduced in the 92d Congress, information in the plan description about vesting was required to be stated in layman's language. S. 1557 requires all of the plan description to be stated in such plain terms. All of this information is vital to participants and the value of its disclosure would be seriously diminished if it is not easily understandable.

A new provision has also been added to give the Secretary authority to require that plan administrators furnish reasonable notice to participants and beneficiaries of their rights under the EBPA. This authority is necessary to insure that participants know about the new law, and the protections, rights and entitlements it bestows on them.

I think I can safely dispense with a time-consuming explanation of the need for this legislation. The need is urgent, has been well expressed in the past, and is fully documented in executive branch and congressional studies. Fiduciary legislation now has widespread support, as evidenced by the similarity between the administration bill and title V of S. 4. Clear communication of plan provisions and open, honest, and prudent management of plan funds are fundamental to the integrity of the Nation's private employee benefit plans.

Having alluded to title V of S. 4, I would like to direct a few comments to the differences between our fiduciary bill and the analogous provisions of S. 4. I would preface these remarks by pointing out that although these differences are not major if considered in the overall context of pension reform legislation, several of them are nevertheless substantial.

For example, the enforcement provisions of S. 4 would involve the Secretary directly as a collection agent for a participant who believes that he has not received the proper amount of benefits from his plan. Under our fiduciary bill, the Secretary is authorized to sue in the case of fiduciary breach (which, of course, would have ramifications affecting all plan parties), but in the absence of such a breach, the Secretary would not become involved in disputes between the administrator and a particular participant or beneficiary over the amount of benefits owing. Federal involvement, we believe, should be limited to cases in which an action or omission has ramifications affecting the plan itself rather than a particular, individual participant or beneficiary.

A second significant difference relates to the criminal conviction bar provisions. Under the administration bill, the decision as to whether a convicted individual is sufficiently rehabilitated so that he should be allowed to serve in a responsible plan position even though the 5-year period has not run is made by the Parole Board of the Justice Department. Not only is this treatment consistent with that under the similar provision of the Labor-Management Reporting and Disclosure Act: it is also appropriate because the Parole Board has the experience and expertise necessary to make this type of decision. Under S. 4, the decision about sufficient rehabilitation is to be made by the Secretary of Labor. By vesting in the Secretary the authority to lift the bar, S. 4 not only departs from a time-tested system, but also burdens the Secretary with a duty calling for judgments of a type for which he has no special expertise.

There is also a subtle, yet important difference in the disclosure schemes of the two bills. I have already outlined the disclosure mechanism of S. 1557. Among other things, it provides that a participant or beneficiary must, upon written request, be furnished with all pertinent reports and documents. In the normal course of events, we expect that participants will be aware that they have a right to inspect these papers and to receive copies if they so request. For those cases where they are not aware, the Secretary has authority to require the plan administrator to furnish each participant and surviving beneficiary with a statement of their rights under the act.

S. 4, on the other hand, has a long and complex provision which requires that pertinent plan reports and documents be "furnished or made available, whichever is most practicable." There is no provision giving the Secretary authority to require the furnishing of a statement of rights. It is entirely possible, therefore, that a plan might decide that it is "most practicable" merely to make plan documents available (in workplace offices, union halls, etc.) rather than furnish the documents directly to the participants. In this situation, a good many participants might never know of this "availability" and of their rights under the law.

Now I would like to take up the subject of portability. But first, I must admit that whenever I consider this subject, it calls to mind the old expression about the cowboy who hopped on his horse and rode off in all directions. That very corny statement, Mr. Chairman, I had scratched out of the other copy, but I trapped myself when I read it.

The term "portability" has been used with various implied meanings to such an extent that it distracts attention from the critical issues.

Many people who speak of portability really are concerned about the preservation of pension credits as a worker moves .rom one job to another. This certainly is an important issue, but it is the issue to which the administration's vesting proposal is directed. A reasonable vesting standard is the most direct and effective approach to achieving preservation of pension credits. Therefore, an affirmative conclusion on the vesting question will achieve resolution of the major concerns regarding portability.

Other portability concepts, such as a clearinghouse for pension credits or technical assistance to plan parties in their efforts to develop reciprocity arrangements, raise questions which we believe have not been satisfactorily answered in any pending legislation. The clearinghouse idea, for example, raises several issues, technical and substantive. To our knowledge, no one has yet devised a method to provide equitable treatment among participants whose benefits are transferred and those whose benefits remain with the plan. Moreover, one of the major obstacles which now prevents a pension plan from voluntarily distributing the monetary value of a vested benefit is the taxation that might occur. Removal of this obstacle is provided for in the administration's proposed Retirement Benefits Tax Act.

The technical assistance idea seems appealing and certainly reciprocity arrangements and plan mergers should be encouraged. However, these efforts often involve hard bargaining and compromise—matters which are best left to the parties themselves unless they need outside help. This type of assistance is easily obtained from consulting firms and other sources, and private assistance has the virtue of providing a flexibility and diversity that are most valuable in an area where the "best way" has not yet been identified.

Regarding the issue of pension plan termination insurance, the administration decided, after thorough consideration, not to recommend such a program at this time. This does not mean that we are unsympathetic to the problem of benefit losses resulting from plan terminations. The interim report on terminations issued jointly by the Departments of the Treasury and Labor shows that the number of people who lost benefits in terminated plans and the total dollar value of benefits lost are very small figures compared with the total number of pension plan participants and the amount of benefits currently being paid to retirees. On the other hand, the report also shows that serious hardships and frustrations are suffered by individuals who lose benefits when a plan terminates with insufficient assets.

Recognizing a problem and solving it are two different things. We have not come forward with a solution because we have not yet been able to develop a termination insurance system that does not have serious drawbacks. An interagency task group worked very hard examining the termination insurance question, and concluded that its complexity makes it extremely difficult to develop an approach that will not lead to undesirable changes in our pension system or undue Government interference. To do the job well, an insurance program should have wide coverage of plans, should guarantee benefits with a minimum of "ifs" and "buts," and should not be subject to manipulation by plan parties. At the same time, the program should not interject the Government into every major facet of pension planning or require the Government to regulate excessively collectively bargained pension benefits or a firm's business practices. What needs to be developed is a workable balance between these considerations.

I do not want to give the impression that we have thrown in the towel on termination insurance. Quite the opposite. We are continuing to study the problems and will acquire comments and advice from a broad range of pension experts and interest groups. We are hopeful that this effort will move us closer to a workable termination insurance program.

This concludes my comments on the fiduciary bill, portability proposals, and pension plan termination insurance. I will be happy to answer any questions that the members of this subcommittee may have.

Senator NELSON. Mr. Fasser, in your statement, you state that the total dollar value of benefits lost are very small figures compared to the total number of pension plan participants.

What is the nature of the difficulty of some kind of an insurance policy? If the losses are small and the numbers are small and the amount of money is small, why wouldn't some kind of fee levied on all plans create a pool of money that would cover any losses?

Mr. FASSER. The problem, Mr. Chairman, is that while there are small numbers of people that lose benefits as a result of plans terminating with insufficient assets, we would be imposing on the broad pension system over the country a burdensome, arduous solution to a very small but serious problem by those that suffer. That is the reason that we have not come forward with what on the surface would seem to be a simple solution, but the administrative cost that it would require to administer the kind of thing that you suggest might bear somewhat in regard to the benefits that are paid by the beneficiaries of the plan that are in good shape and would not be in jeopardy.

However, that, of course, Mr. Chairman, is something that we must investigate very closely and I really do not look upon this as a putoff in terms of termination insurance. We work very hard in the Labor Department with other departments attempting to develop a termination insurance procedure that would not cause all of these kinds of problems that I have related. We will continue to do that. We will continue to work, to look toward a solution of the problem where a man loses his benefits because there were insufficient assets.

Of course, we have proposed certain funding investing requirements and these go a long way toward helping that, but nevertheless there are programs that do terminate with insufficient assets to handle the people that thought that they were earning pension benefits during their work years, and this does need to be corrected.

Senator NELSON. Whether or not termination insurance is the most important aspect of a pension legislation depends upon your vantage point. I suppose for those who worked for Studebaker the most important thing for them was that their life's contribution was not protected. The most widely discussed aspect of pension plan legislation is the insurance feature and the complaints that have received the greatest publicity so far as I know have been the cases where a plant closed or was purchased and closed or something and you left a whole lot of people in that pension program without anything, any money to retire on.

I am just wondering when you say that not many people are involved, that there are not many banks that close either.

We have FDIC insurance which since the 1930's guarantees saving deposits but I can't recall any bank in modern history of my State closing. There might have been one but I don't recall it. And yet they pay their insurance to guarantee the investors in that bank which represent a tiny amount of the wealth of the country, deposits of the country, and a handfull of people, but it is their assets and what puzzles me is what is so much more difficult about designing a contribution factor for pension plans as contrasted with what is applied to the banks?

Mr. FASSER. Well, I certainly understand the insurance principle. Of course, the banking business is somewhat different than the pension fund business. Mr. Kleiler, who is with me this morning, has spent some time on these interagency studies and if I may, I will ask him to shed a little light on that.

Mr. KLEILER. Thank you. I think probably the toughest problem is defining the risk that you want to insure, pension plan termination.

Now, it is fairly easy when a pension plan terminates as a consequence of bankruptcy but if we only insure terminations where the employer becomes bankrupt we will not have licked the problem.

Now, we have looked at the bills pending in Congress, Senator Bentsen's bill, Senator Griffin's bill, and the Williams-Javits bill, and we don't think that they have dealt with the problem of defining termination in such a way that it would be feasible to administer the program.

For example, S. 4 doesn't contain any definition of the word "termination" at all. However, section 402(a) of the bill says that the insurance program shall insure participants and beneficiaries against loss of benefits derived from vested rights which arise from the complete or substantial termination of such plans as determined by the Secretary.

As we see it, that means that the Secretary is going to make a case by case determination as to whether the plan is terminated or not.

Now, S. 75 refers to involuntary plan termination, defined as termination due to insolvency under the Bankruptcy Act. They make a stab at it but still they don't really deal effectively in that bill with the problem of partial termination.

Senator Bentsen's bill doesn't really define termination, so presumably the Treasury Department, corporation, the administering agency, would have to make the determination on a case-by-case basis.

Now, there is a definition of termination in the Internal Revenue regulations. It is a complicated, complex definition. We think that any legislation to provide termination insurance should provide the same definition for purposes of the Internal Revenue Code that would apply for the insurance corporation because when a plan terminates, the IRS makes a determination which then requires the immediate vesting of all participants at that stage, and if we are going to have inconsistent rulings for Internal Revenue and insurance, things will get very badly muddled.

Now, there is also a problem of defining the accrued benefit which will be insured. There is inconsistency now among definitions in bills and there again we probably need to get some consistency between accrued benefits definition for purposes of Internal Revenue as well as for purposes of termination insurance.

Now, one of the great difficulties with these termination insurance bills is that they attempt to apply somewhat the same concepts to multiemployer plans as to single employer plans. We think it is more reasonably possible to like the termination insurance problems with respect to single employer pension plans but it is a whole new ball game when you are dealing with these large numbers of small employers in the construction industry where concepts of contingent liability such as you find in the S. 4 and in S. 75 simply can't be made applicable to small plastering and painting contractors coming and going all the time. They simply don't solve the problem with respect to multiemployer plans, yet they would cover multiemployer plans.

I have got a lot—many other technical problems but perhaps I have talked too long already.

Senator NELSON. You have told me the problems but I want a solution.

Mr. KLEILER. Well, as Mr. Fasser said, we haven't abandoned the effort. We are still working on it. We simply don't have a bill to offer.

Senator NELSON. I recognize that there are technical and complicated problems but it seems to me you ought to be able to work out some formula that guarantees the accumulated benefits that have vested. It is one thing, I understand, to guarantee a bank deposit because you are dealing dollar for dollar. Now you will be dealing with pension plans that have a great variety of benefits, so you could tackle that by guaranteeing the benefits that have accrued, total benefits that have accrued, or benefits that have accrued and vested for each individual plan, or you could take some, it seems to me, inbetween position and be sure you guaranteed some equal amount to everybody who is insured.

I realize it is complicated but it just seems to me we can't leave this question alone and not deal with it. Is cost a big factor?

Mr. KLEILER. I think that, based upon the results of our joint Treasury-Labor study, the losses are not all that tremendous that it would be a tremendous cost factor in levying premiums and paying the claims. But there would be cost in administration because if we are going to really develop a termination insurance program, we have got to build in some defense mechanisms to make sure employers are not terminating plans to take advantage of the insurance fund. And it leads you down the road to regulation much further than the administration's vesting and funding proposals would go, and when you go down the road of regulation, you do incur greater administrative costs.

Senator NELSON. You are going to have an annual audit of the plan

Mr. KLEILER. Well, the fiduciary plan now requires an annual audit by a CPA. It does not require an annual audit or an annual actuarial study. We do require some actuarial information which would be rather difficult to supply without the services of an actuary, so I don't think that is the problem.

What I am speaking about is to build in sufficient things like suicide clauses to make sure that an unscrupulous employer is not terminating his plan to get the windfall of insurance after having made pension promises of a large magnitude.

Senator NELSON. What would be so difficult about settling that problem in a court of law? All the facts would come out.

Mr. KLEILER. Well, we would want the specifications in the bill so that the ground rules are set forth in advance rather than have to struggle on an ad hoc basis.

Senator NELSON. That may be necessary and that was one of your objections to the provisions of S. 4, but I don't see why we couldn't draft a bill that took care of the major contingencies. There is always something that would fall through the cracks, but, on balance, the necessity for protecting people who have worked all their lives reaching retirement age with no benefits at all. seems to me to be of overriding importance. We may have to subsequently amend the law to protect against situations that were not completely handled but it seems to me the injustices that would arise out of an imperfectly drafted provision in the first place aren't nearly so great as those that arise out of the fact that people do spend their lives working and end up without any pension.

Go ahead, Mr. Fasser.

Mr. FASSER. That concludes my statement, Mr. Chairman.

Senator NELSON. Are you through?

Mr. FASSER. Yes, sir.

Senator NELSON. Yesterday the Secretary of the Treasury. Mr. Shultz, testified. Let me read a quote from his testimony and ask for your comments.

This is the quote: "The approach of the Nixon administration has been to build on the existing expertise of the Treasury and Labor Departments' using the Treasury in the area of its current knowledge and the Labor Department in the area of its current familiarity. We believe that it would be a serious mistake to attempt to transfer jurisdiction in either area to the Department which currently lacks the expertise, personnel, and experience to handle matters traditionally within the province of the other Department. For this reason, speaking as one who has headed both Departments in question, I cannot concur in the proposals which have been made to give jurisdiction to the Labor Department over vesting, funding, eligibility requirements, or the like."

Do you agree or disagree with that statement?

Mr. FASSER. I agree with that, sir. There are certain things that the Labor Department is competent to handle and there are certain things that IRS is competent to handle. Without trying to use his words, building on the base seems to be the proper way to put it. We in the Labor Department are in a position to deal with the fiduciary aspects.

Senator NELSON. Are or are not?

Mr. FASSER. We are. We are not prepared as well as Treasury is in regard to the tax aspects of the bill.

Senator NELSON. Are you saying that you do not have the expertise or that it would be difficult to acquire it for the Department to have jurisdiction over vesting, funding, eligibility requirements?

Mr. FASSER. It would be difficult to acquire them since Treasury has already acquired them and people that are apparently performing similar functions in Treasury would just expand on their operation. For the Labor Department it would be a brandnew responsibility and we would have to develop that.

Senator NELSON. What is your response to put-upon taxpayers who are always saying they are being investigated by dozens of different bureaus at the State and Federal level and particularly the little businessman who is sitting around all day long filling out forms, and Lord knows there is a tremendous number of them. How do you answer the question of having two huge Departments of the Government evaluating and taking responsibility for various aspects of one pension plan? Why can't we have it all in one place?

Mr. FASSER. Well, I can respond to that. Mr. Chairman. by saying that I sympathize with people in business who need to fill out, are required to fill out all sorts of forms and paperwork. of course, is endless. A great deal of the work in the labor-management relations aspect of the Labor Department is involved with forms and reports and things of that nature. But I don't really think that it matters that two separate people are asking for two different kinds of information. If all of it were in the Labor Department we would be asking for two different kinds of information and that would be just the same volume of work. It just happens to be different people, that is all. If it were all in the Treasury Department, they would be asking for both things.

Senator NELSON. Yes, but it would be one visit, not two. And one set of standards, not two.

Mr. FASSER. Well, it would be a set of standards for each kind of activity and perhaps it could be accomplished by one person but he would still be spending the amount of time that two otherwise would, and because we are in a situation in the Labor Department where we have the expertise and the mechanics to handle the fiduciary kinds of reporting. it just seems to make sense that we could deliver that product the best.

Mr. KLEILER. May I add something as a technician who has lived with this problem 10 years. We really explored with the Treasury Department staff this problem of duplication and overlap. We reached a partial solution of one part about it many years ago in which the IRS accepts a copy of our annual financial report form filed with the Labor Department in satisfaction of some of the annual reporting requirements of the Internal Revenue Service.

But keep this in mind, Mr. Chairman. The overlap and duplication has been greatly exaggerated. First. we have got about 179.000 plans on file under the Welfare and Pension Plans Disclosure Act and 75 percent of them are welfare plans that the Treasury Department has very little to do with. They have no special reporting requirements. We have about 45.000 pension plans on file and something like 16.000 of them—only about 16.000 are big enough to have an annual reporting problem because of the size exemption under the WPPDA at present.

Now. in the Internal Revenue Service. the biggest area of overlap and duplication is in the filing of the plan documents at the inception of a pension plan with the Internal Revenue Service. It is a voluntary thing on the part of employers who want a ruling that their plan is tax qualified and to get that ruling. they submit the plan documents. The welfare—and those. however, are not in the public domain. They are examined by the Internal Revenue staff to determine compliance with the nondiscrimination features of the Internal Revenue Code and similar purposes.

The purpose of the WPPDA is to make the plan description and the plan documents in a position where the plan participants and the general public can see it. The purposes of the reporting and disclosure requirements are vastly different than the purposes of the Internal Revenue Service.

One solution to the problem obviously would be to take the Labor Department out of administering the WPPDA and saddle the Treasury with that job which they do not now have. or the other way around it. but as Mr. Fasser and Secretary Shultz both said. we have got different purposes under the different reporting requirements and it makes much more sense to build onto what we now have rather than try to eliminate.

Senator NELSON. Senator Long?

The CHAIRMAN. No questions.

Senator NELSON. Senator Hartke?

Senator HARTKE. What are you saying? Are you saying you don't want the authority?

Mr. FASSER. Sir, for the tax bill?

Senator HARTKE. Yes.

Mr. FASSER. That is right. We do not. The Labor Department confirms the position of Secretary Shultz that the fiduciary bill would fall within the purview of the Labor Department, the tax bill would fall within the purview of the Treasury Department.

Senator HARTKE. Maybe we could set up an independent agency to take it over.

Let me ask you another question. You take the position, as I understand it, that there is no need for any type of insurance program at the present time. Is that right?

Mr. FASSER. We did not take that position exactly, Senator. We took the position that we know that there is a problem in regard to terminations, termination of plans without sufficient assets to take care of the equity of the employees who are displaced. We understand that that is a problem.

In our statement we have said that we have looked at the entire situation and from the studies that we have made in conjunction with the Treasury Department on the interim report we had determined that the problem, while significant and very important, and a most difficult one for the parties affected, in light of the large number of pension plans that there are and beneficiaries who are receiving benefits, that it is not that large a problem for pension plans countrywide. It is a severe problem where it occurs.

Senator HARTKE. What does your study show? How many people, who are participating in pension plans, ever receive a pension compared with those who do not?

Mr. FASSER. The study covered all of the pension plans that had terminated.

Senator HARTKE. I am just asking you how many people who participate in pension plans never receive a pension. Correct me if I am wrong. At the present time, only 1 out of every 10 receive their pension rights, of the people who participate. Is that right?

Mr. FASSER. That could well be the figure, but perhaps the reason that they did not, and certainly I think it is true, they did not receive their pension rights was not because there were insufficient assets in the funds.

Senator HARTKE. In 1972, one out of every 14 plans that was filed with Internal Revenue, failed. That is a pretty high rate, too, isn't it?

Mr. FASSER. I am not familiar with that figure, Senator.

Senator HARTKE. Do you think that that is a very good record? You say it is not a severe problem. It affected 125,000 employees in the first 7 months of 1972. There were some 600 plans which failed and affected 20,000 employees. What about those 20,000 employees? Are they supposed to be thrown on the junk heap like used automobiles?

Mr. FASSER. No, those plans—those 20,000 people, roughly half of them lost their benefits. That is right. They should not——

Senator HARTKE. They should not have lost them, right?

Mr. FASSER. They should not be thrown on the scrap heap, Senator. My point——

Senator HARTKE. What do you want to do with them?

Mr. FASSER. What we propose to do is to tighten up, of course, on the funding and the vesting under the tax proposal.

Senator HARTKE. Let me give you 1 of 1,000 examples. In Chicopee, Mass., the Cycles plant closed down and moved: 3,500 people lost their jobs because the plant moved all of their production over to Taiwan where they pay 25 cents an hour for labor. The company saved money and added to their profits. But, the 3,500 employees lost all their pension rights.

Now, what should happen to those people? What do you want to do with them? I mean, you have no plan for them whatsoever, right? And you don't think it is a major concern?

Mr. FASSER. No, it is not.

Senator HARTKE. I just want to go back to the people of Chicopee and tell them you think the Government has no responsibility for their failure: that everything is just glorious and the second coming is here for them now.

Mr. FASSER. You have pointed up the problem very well, Senator. There are things that can be done——

Senator HARTKE. Like what?

Mr. FASSER [continuing]. Prospectively.

Senator HARTKE. Like what? What do you propose to do?

Mr. FASSER. By appropriate investing, appropriate funding.

Senator HARTKE. How would investing save those people?

Mr. FASSER. If the pensions were vested and if they were properly funded and there were sufficient fiduciary standards to safeguard that fund, then there would have been a distribution of those assets when the plan went down.

Senator HARTKE. The plan has been terminated now.

Mr. FASSER. The plan has been terminated?

Senator HARTKE. The plan has been terminated. You don't recommend any vesting, do you? That is, when the sum of an employee's age and the period of his active participation equals 50.

Mr. FASSER. The rule of 50, yes, sir.

Senator HARTKE. That is a combination factor, right?

Mr. FASSER. That is a combination factor, yes, sir.

Senator HARTKE. You really don't think it is much of a problem, do you?

Mr. FASSER. Yes, sir, I do think it is a problem.

Senator HARTKE. But it is a problem that we shouldn't be concerned with now.

Mr. FASSER. No, sir. I do not believe that. I think it is a problem that we should be concerned with. The reason we are up here with the tax bill and fiduciary bills is because we are concerned about it. We do not think we are in a posture to recommend a termination insurance bill but that does not mean we are not working on it, concerned about it, sympathetic to it and are looking for a solution to the problem, and we did spend some time at the hearing today discussing some of the problems about termination.

Senator HARTKE. This administration with the help of Senate sponsor, Senator Jacob Javits, successfully passed in Congress, an insurance program for the securities people—stockholders, and bond people. Do you think that they are entitled to have their rights protected by insurance and the average workingman is not entitled to the same treatment? In other words, there is more reason to guarantee money than there is to guarantee a workingman's future?

Mr. FASSER. Well, sir, there is not more reason to guarantee money than there is to guarantee a workingman's future, but in regard to guaranteeing the securities and banks, the money is there and that is what is insured. In regard to the pension fund, the money is not there and that is the problem.

Senator HARTKE. So it was in the Studebaker plant closure in South Bend, Ind. Too many unfunded liabilities and 8,500 workers lost their pensions.

Mr. FASSER. That is a problem.

Senator HARTKE. That is what we are trying to correct.

Mr. FASSER. Yes, sir.

Senator HARTKE. Thank you.

Senator NELSON. Senator Bentsen.

Senator BENTSEN. Mr Secretary, I am sorry I didn't hear all of your testimony. I have been reading it here as quickly as I could. I have been attending a meeting of the Senate and House conferees on the Federal Aid Highway Act.

I have some concern with the remarks made on termination insurance. One of the points I understand that has been made is that there is no definition of termination. On the other hand, you referred to an IRS regulation that defines terminations.

Why isn't that definition just as applicable to termination insurance as to the present tax consequences?

Mr. FASSER. Senator, Mr. Kleiler did spend some time on that this morning.

Would you summarize briefly, Frank, please, for the Senator, what you said.

Mr. KLEILER. Well, the toughest problem in devising termination. insurance is to define the risk which is to be insured.

Senator BENTSEN. Well, let's get to that one, then. The risk we are talking about insuring is the vested interest of the participants and I think that that is true of Senator Javits' bill and that is true of my bill.

Mr. KLEILER. Well, when does the risk get insured? When does the plan terminate?

Senator BENTSEN. Well, we were just told that there is a definition under IRS regulations as to when it terminates. When does it get insured? It becomes insured at the time it becomes vested.

Mr. KLEILER. We had hoped that the statute, if there is to be a termination insurance program, would give us a definition for insurance purposes which would be consistent with that IRS definition. The trouble with the IRS definition, however, is that it is so long and complicated that frankly I can't understand it and I would hope that a better definition could be found. But the same better definition ought to serve both purposes.

Senator BENTSEN. Well, the Government and IRS at the present time are asking employers across this Nation to understand it. They are asking tax lawyers across this Nation to understand it. Now, if they can undertand it, it seems to me that the same applicability is due on the question of termination for insurance purposes.

Mr. KLEILER. The other technical problem, Senator, I think involves devising strategems to preclude employers from terminating plans to take advantage of the insurance program and that is a real tough problem. If you are only going to cover plan terminations which are a byproduct, bankruptcy of the employer, I think that is manageable, but it is not going to solve the termination problem because a great many plans terminate in connection with mergers, in connection with economic hardship short of bankruptcy, and sometimes simply because an employer wants to substitute a profit-sharing plan for a pension plan. There are all sorts of reasons for plan termination and in our own efforts as technicians to struggle with this problem, we are attempting to devise a mechanism which would go far beyond the bankruptcy problem and insure the victim of plan termination regardless of the cause, but we don't want to create a situation in which the insurance fund is a patsy for people who want to take advantage of the insurance program. That is our problem.

Senator BENTSEN. Well, I would be in total agreement with you on that but I would hope that we could devise language that would accomplish that.

Mr. KLEILER. It can be done but with regulation which the adminsistration feels would be excessive.

Senator BENTSEN. By the same token, some of these arguments, not all of them, of course, were made on the question of FDIC for banks. We were told at that time that we were talking about a common pool and that the maladministration of one bank in its investments policy and loan policy affected others and that is quite true. However, I don't think you would seriously argue there, I suppose, that a bank might be making bad loans with the idea they had a bail-out by FDIC and I would think in most of these instances that this would react to the detriment of the bank. I think we could write some punitive provisions in a termination insurance program to prevent abuses.

I have no further questions at this time, Mr. Chairman.

Senator NELSON. Senator Dole?

Senator Roth?

Thank you very much, Mr. Fasser. We appreciate your taking your time to come before us.

Mr. FASSER. Thank you, Mr. Chairman.

[A supplementary statement from the Department of Labor follows:]

EXPLANATORY STATEMENT OF AMENDMENTS TO THE WELFARE AND PENSION PLANS DISCLOSURE ACT MADE BY THE EMPLOYEE BENEFITS PROTECTION ACT

The fundamental purpose of the proposed amendments to the Welfare and Pension Plans Disclosure Act is the broadening and strengthening of the protection of rights and interests of participants and beneficiaries of employee welfare and pension benefit plans. This aim is accomplished in three ways. First, by the addition of two new sections: one setting forth responsibilities and proscriptions applicable to persons occupying a fiduciary relationship to employee benefit plans, including a "prudent man" standard for evaluating the conduct of all fiduciaries; the other barring from responsible fiduciary positions in such plans for a period of five years all persons convicted of certain listed criminal offenses. Second, by additions to and changes in the reporting requirements designed to disclose more significant information about plans and the transactions engaged in by those controlling plan operations and to provide specific data to participants and beneficiaries concerning the rights and the benefits to which they are entitled under their plans and their rights under the law. Third, by providing remedies through either State or Federal courts to insure that the protections provided by the Act can be effectively enforced.

I. FIDUCIARY RESPONSIBILITY

A fiduciary is one who occupies a position of confidence or trust. As defined by the amendments, a fiduciary is a person who exercises any power of control, management or disposition with respect to monies or other property of an employee benefit fund, or who has authority or responsibility to do so. The fiduciary responsibility section, in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts. The section was deemed necessary for several reasons.

First, a number of plans are structured in such a way that it is unclear whether the traditional law of trusts is applicable. Predominantly, these are plans which, although maintaining a fund of assets to finance benefit payments, are not established as trusts. Certain insured plans fall into this category. Administrators and others exercising control functions in such plans under the present Act are subject only to minimal restrictions and the applicability of present State trust law is sometimes unclear.

Second, even where the funding mechanism of the plan is clearly in the form of a trust, reliance on conventional trust law often is insufficient to adequately protect the interests of plan participants and beneficiaries. This is because the common law of trusts was deveolped in the context of testamentary and inter vivos trusts (usually designed to pass designated property to an individual or small group of persons) with an attendant emphasis on the carrying out of the instructions of the settlor. Thus, if the settlor includes in the trust document an exculpatory clause under which the trustee is relieved from liability for certain actions which would otherwise constitute a breach of duty, or if the settlor specifies that trustee shall be allowed to make investments which might otherwise be considered imprudent, the trust law in many States will be interpreted to allow the deviation. In the absence of a fiduciary responsibility section in the present Act, courts applying trust law to employee benefit plans have allowed the same kinds of deviations, even though the typical employee benefit plan, covering hundreds or even thousands of participants, is quite different from the testamentary trust both in purpose and in nature. It is expected that courts will interpret the prudent man rule and other fiduciary standards bearing in mind the special nature and purposes of employee benefit plans intended to be effectuated by the Act.

Third, a fiduciary standard embodied in Federal legislation is desirable because it will bring a measure of uniformity in an area where decisions under the same set of facts may differ from State to State. This uniformity of decision will help administrators, fiduciaries and participants to judge the legality and prudence of proposed actions by an established standard and will avoid the necessity of reference to varying State laws.

Finally, taken together, the funds of employee benefit plans constitute an enormous sum of assets and it is evident that the operations of such plans are increasingly interstate. The national public interest in the continued prudent management of these plans and in the integrity of their funds is direct and clearly warrants protective Federal legislation.

Section 14(a), when read in connection with the definition of the term "employee benefit fund," makes it clear that the fiduciary responsibility provisions apply only to those plans which have assets at risk. Thus an unfunded plan, such as one in which the only assets from which benefits are paid are the general assets of the employer, is not covered. However, if the plan does have assets at risk, the form in which those assets are held is deemed to be a trust, whether or not a trust agreement exists, and the trust assets may be used only for the two stated purposes; providing benefits for participants and defraying reasonable administrative expenses.

The next two subsections (14(b) and (c)) incorporate the core principles of fiduciary conduct as adopted from existing trust law, but with modifications appropriate for employee benefit plans. These salient principles place a twofold duty on every fiduciary: to act in his relationship to the plan's fund as a prudent man in a similar situation and under like conditions would act, and to act solely in the interest of the participants and beneficiaries of the plan; that is, to refrain from involving himself in situations or transactions (especially transactions with known parties in interest) where his personal interests might conflict with the interests of the participants and beneficiaries for whom the fund was established. Thus, section 14(b)(1) sets out the prudent man standard and the attendant affirmative duties to discharge responsibilities in conformance with instructions (as set out in the governing plan documents) and solely in the interest of the plan's participants and beneficiaries. There follows a list of proscriptions (section 14(b)(2)) which represents the most serious types of fiduciary misconduct which in one way or another have occurred in connection with employee benefit plans. Some of these situations have been found in the administration of the WPPDA. Others have been discovered by congressional investigations, newspaper reporters, audits, and miscellaneous sources. While the magnitude of these improper practices is small in relation to the total number of plans in existence, the seriousness of the improper practices disclosed indicates the need for additional precautions to insure that these specific examples do not become general conditions. The list of proscriptions is intended to provide this essential protection.

The exemption provision which follows the listed proscriptions has been included in recognition of established business practices, particularly of certain institutions such as commercial banks, trust companies and insurance companies which often perform fiduciary functions in connection with employee benefit plans. The Secretary will, by individual or class exemptions, provide exceptions so that the established practices of these institutions and others are not unduly disrupted, so long as they are consistent with the purposes of the Act. For example, the proscription in section 14(b)(2)(G), prohibiting a fiduciary from furnishing service to a party in interest is not intended, in the normal course of events, to bar a fiduciary bank from providing services to the employer whose employees are participants in the plan.

Next, there are listed transactions in which fiduciaries are expressly allowed to engage. This listing is necessary for reasons similar to those which required inclusion of the exemption provision. That is, the breadth of the proscriptions, while considered necessary for the reasons stated above, would operate in some cases to prohibit transactions which are deemed desirable to the sound, efficient functioning of employee benefit plans. It was therefore necessary to specify that certain transactions, likely to be engaged in by fiduciaries of virtually all plans, will be allowed notwithstanding the proscriptions. It is emphasized, however, that even with respect to the transactions expressly allowed, the fiduciary's conduct must be consistent with the prudent man standard.

Especially significant among the expressly allowed transactions is that which permits, in most types of plans, investment of up to ten percent of the fund assets in securities issued by the employer of the employees who are participants in the plan. Since such an employer will often be an administrator of his plan, or will function as a trustee or in some other fiduciary capacity, this provision creates a limited exception to the listed proscription against self-dealing. The exception is made in recognition of the symbiotic relationship existing between the employer and the plan covering his employees. Such investments are commonly made under provisions in a trust agreement expressly allowing them. In recognition of the special purpose of profit sharing plans, the limitation does not apply to such plans if they explicitly provide for greater investment in the employer's securities. Section 14(c) also recognizes the practice of including in trust instruments various authorizations governing the handling of the fund. Many such authorizations have been inserted by legal draftsmen because of questions in their judgment as to authority and are generally recognized as appropriate.

The next two subsections ((4) and (e)) are intended to codify, with respect to employee benefit fund fiduciaries, rules developed under the law of trusts. Thus a fiduciary is made personally liable for his breach of any responsibility, duty or obligation owed to the fund, and must reimburse the fund for any loss resulting from such a breach. He must also pay over to the fund any personal profit realized through use of fund assets. Where two or more fiduciaries manage a fund, each must use care to prevent a co-fiduciary from committing a breach or to compel a co-fiduciary to redress a breach. Plan business is to be conducted by joint fiduciaries in accordance with the governing instruments of the plan, or in the absence of such provisions, by a majority of fiduciaries, and a fiduciary who objects in writing to a specific action and files a copy of his objection with the Secretary is not liable for the consequences of such action.

The requirement (section 14(f)) that every plan contain specific provisions for the disposition of fund assets upon termination is necessary to avoid confusion on the part of fiduciaries and participants and beneficiaries alike as to the proper disposition of the fund assets upon termination of the plan. It is essential at such a time that the plan administrator (who is still, notwithstanding the termination, a fiduciary subject to the Act) know how assets remaining in the plan's fund must be distributed and it is important that the distribution plan be specified so that participants and beneficiaries can assess the propriety of the fiduciary's actions when the plan terminates. The requirement that liabilities to participants and beneficiaries be satisfied before claims on the fund by contributing parties will be heard is inserted to insure that the interests of participants and beneficiaries will be fully protected.

Exculpatory and similar clauses which purport to relieve a fiduciary from any responsibility, obligation or duty under the Act are expressly prohibited and made void as against public policy (section 14(g)). Whatever the validity such provisions might have with respect to testamentary trusts, they are inappropriate in the case of employee benefit plans. The large numbers of people and enormous amounts of money involved in such plans coupled with the public interest in their financial soundness, as expressed in the Act, require that no such exculpatory provision be permitted.

The basic three year statute of limitations (section 14(h)) for suits to enforce the fiduciary provisions or redress a fiduciary's breach may be extended up to an additional three years if the breach is not disclosed in a report required under the Act. No action may be brought more than six years after the violation occurred, except that if the breach involves a willful misrepresentation or willful concealment of a material fact, a suit may be maintained within 10 years after the violation occurs.

Finally, section 14(i) explicitly provides that a fiduciary is not liable for violations committed before he became or after he ceased to be a fiduciary.

The second all new section, section 15, prohibits persons convicted of certain listed crimes from serving, for a period of five years after conviction or the end of imprisonment for such conviction, in a responsible position in connection with an employee benefit plan. Coverage extends to consultants who receive direct or indirect benefits. This prohibition is considered necessary because of the large funds involved and the attendant great risk of a loss affecting a large number of persons. Section 15 is modeled after section 504 of the Labor-Management Reporting and Disclosure Act (LMRDA) which bars persons convicted of certain crimes from serving as union officers. The presence of the LMRDA prohibition is another reason for including a similar provision in the Protection Act. Without such a provision, persons barred from serving as union officers might take positions with employee benefit plans.

The crimes listed have been chosen with reference to three kinds of criminal activity. These are (1) activities which involve a wrongful taking of property, (2) activities which are related to and often occur in connection with the efforts of organized crime elements in the labor-management and securities fields, and (3) crimes of a nature so vicious that involvement in them casts grave doubt on the individual's responsibility. Thus, in addition to the specifically named crimes, the list includes crimes described in section 9(a)(1) of the Investment Company Act of 1940 (involving misconduct in the securities field), violations of section 302 of the Labor-Management Relations (Taft-Hartley) Act, certain violations of the LMRDA, violations of chapter 63 of Title 18, United States Code (mail fraud) and violation of sections 874 (kickbacks from public works employees), 1027 (false statements in documents required by the Welfare and Pension Plans Disclosure Act), 1954 (offer, acceptance or solicitation to influence operations of employee benefit plan), 1503 (jury tampering), 1505 (obstruction of government agency proceedings), 1506 (theft or alteration of court record or process; false bail), 1510 (obstruction of criminal investigations) and 1951 (interference with commerce by threats or violence) of Title 18, United States Code. The section contains its own criminal penalty, with a higher fine than that provided for other criminal violations of the Act. It is the same penalty as that specified in section 504, LMRDA.

To avoid confusion which has arisen over the similar LMRDA provision, section 15 states clearly that the term of imprisonment does not include the period of parole, if any, and the problem of unequal application of the restoration of citizenship rights clause due to varying State laws has been obviated by removal of the clause.

II. REPORTING AND DISCLOSURE

The underlying theory of the Welfare and Pension Plans Disclosure Act to date has been that reporting of generalized information concerning plan operations to plan participants and beneficiaries and to the public in general would, by subjecting the dealings of persons controlling employee benefit plans to the light of public scrutiny, insure that the plan would be operated according to instructions and in the best interests of the participants and beneficiaries. The Secretary's role in this scheme was minimal. Disclosure has been seen as a device to impart to participants and beneficiaries sufficient information to enable them to know whether the plan was financially sound and being administered as intended. It was expected that the knowledge thus disseminated would enable participants to police their plans.

But experience has shown that the limited data available under the present Act is insufficient even though the burden of enforcement has been partly assumed by the Secretary. The Amendments therefore are designed to increase the data required in the reports, both in scope and in detail. Experience has also demonstrated a need for a more particularized form of reporting, so that the individual participant knows exactly where he stands with respect to his plan—what benefits he is entitled to and what steps he must follow to secure his benefits. Moreover, the addition of fiduciary responsibility provisions has increased the need for both generalized and particularized data. On one hand, participants will be able to ascertain whether the plan's fiduciaries are observing the rules set out in the fiduciary responsibility section only if they have access to sufficient data about plan transactions. On the other hand, the prophylactic effect of the fiduciary responsibility section will operate efficiently only if fiduciaries are aware that the details of their dealings will be open to inspection, and that individual participants and beneficiaries will be armed with enough information to enforce their own rights as well as the obligations owed by the fiduciary to the plan in general.

-The existing exemption from coverage under the Welfare and Pension Plans Disclosure Act for plans of tax-exempt private organizations has been removed. Substantial numbers of persons are not participants in plans established by these organizations and they are entitled to the same assurances and protection as participants in other private plans. In addition, nonpension type funds subject to section 302(c) of the Labor-Management Relations Act, such as funds for apprenticeship, scholarship and day care center programs are included within the definition of "employee welfare benefit plan."

To provide the flexibility necessary to avoid hardship and duplicative reporting, as well as unnecessary paperwork for both plan administrators and the Secretary, the Act includes exemption and variation authority which the Secretary may apply on a class basis.

There are four significant changes designed to impart more information about the plan and its operations in general. First, administrators will no longer be required to include the trust agreement or other instrument governing the plan in the plan description. However, the description must be written in layman's language so that participants and beneficiaries will be able to understand their plan's schedule of benefits and requirements concerning eligibility, nonforfeitability, and procedures for claims and remedies. Second, the annual report must include the opinion of an independent accountant based upon the results of an annual audit. Such information will allow better assessment of the plan's financial soundness by administrators and participants alike (the exemption for the books of institutions providing investment, insurance and related functions and subject to periodic examination by a government agency will prevent duplicative audit examinations of these institutions).

Third, plans other than those which are unfunded must include in their reports information pertaining to leases, party in interest transactions and investment assets other than securities in addition to information about securities investments and loans. Finally, actuarial information is now required so that participants and beneficiaries can judge the progress of the plan's funding scheme and its overall financial soundness.

Amendments to provide particularized information to individual participants and beneficiaries are found in section 8. In addition to the plan administrator's obligation to make available copies of the plan description and latest annual report, the Secretary may require the administrator to furnish reasonable notification in layman's language to all participants of their rights under the Act, and to furnish to any participant or beneficiary so requesting in writing a fair summary of the annual report and a statement of what benefits (including nonforfeitable benefits, if any) have accrued in his favor or both. This will enable a participant to find out where he stands with respect to the plan at any given time. Administrators must make good faith efforts to supply to a participant (or his survivor), upon his termination of service under a plan, a notice explaining exactly what procedures must be followed to secure benefits due.

Further, the administrator must furnish to participants and beneficiaries upon request complete copies of the plan description, annual report, or bargaining agreement, trust agreement, contract or other instrument under which the plan is established and operated. He may make a reasonable charge to cover the cost of such copies. If a plan is subject to a Federal vesting requirement and is exempted from providing preretirement vesting for benefits earned during a year of financial hardship participants must be informed of the lack of vesting in that year.

III. ENFORCEMENT

The changes in the enforcement provisions have been made so that the rights given to participants and beneficiaries elsewhere in the Act will be enforceable in an appropriate forum. The enforcement section reflects the addition of the fiduciary responsibility provisions and provides remedies of two kinds: those designed to rectify fiduciary breaches and those to insure that participants and beneficiaries, and the Secretary, will receive the information required by the reporting and disclosure provisions. Authority for the Secretary to call for and review underlying plan documents is explicitly provided. Certification by an accountant as a prerequisite to the Secretary's investigation is no longer necessary because the annual audit requirement allows an assumption that the plan report is accurate.

Suits to redress breaches of duty by a fiduciary may be brought by the Secretary or by a participant or beneficiary. The Attorney General, as well as the Secretary or a participant or beneficiary, may sue to remove a person who is serving in violation of the criminal conviction bar provision. The provision for equitable relief would allow, among other things, the imposition of a constructive trust over fund assets transferred to a third person in breach of the fiduciary's duty.

Participants and beneficiaries may sue in any State court of competent jurisdiction. For actions in Federal courts, nationwide service of process is provided in order to remove a possible procedural obstacle to having all proper parties before the court. Federal and State courts are given discretion to award attorney's fees and court costs to any party in actions brought by a participant or a beneficiary. The court also has discretion to require the plaintiff to post security for court costs and reasonable attorney's fees. Suits by a participant or beneficiary to redress a fiduciary breach or remove a fiduciary must be brought as class actions where the jurisdiction permits class actions and the requirements for such an action can be met.

Fiduciary breaches may be rectified through civil suits only. Criminal penalties for such breaches are inconsistent with the principles established under the common law of trusts. However, criminal penalties remain available in cases of reporting violations, and, under Title 18, United States Code, in cases of embezzlement, false statement, bribery and kickbacks in connection with employee benefit plans.

IV. EFFECT OF OTHER LAWS

The Act provides for a uniform source of law for evaluating the fiduciary conduct of persons acting on behalf of employee benefit plans and a singular reporting and disclosure system in lieu of burdensome multiple reports. However, State law will continue to apply to plans not subject to the Act. This application of State law will include actions brought by participants and beneficiaries to recover benefits due under the plan or to clarify rights to future benefits.

States may require the filing with a State agency of copies of reports required under the Act, and actions in State courts for accountings are expressly allowed if certain conditions are met, including adequate notice to participants and the

Secretary. Furthermore, the Act expressly authorizes cooperative arrangements with State agencies as well as other Federal agencies and provides that State laws regulating banking, insurance and securities remain unimpaired.

Senator NELSON. Our next witness will be Senator Hartke.

STATEMENT OF HON. VANCE HARTKE, A U.S. SENATOR FROM THE STATE OF INDIANA

Senator HARTKE. All I need is 5 minutes of your time. I shall ask that the entire statement be placed in the record.

I want to discuss with you my own pension bill; the Federal Pension Plans Protection Act of 1973. It goes the farthest to right the present wrongs. At the present time, I feel that the pension plans before the Congress are far too weak. I don't think they go far enough. I think it is wrong to have the expectations of our American labor force dashed on the altar of failed pension plans, the lack of proper funding and insufficient vesting rights.

Mr. Woodcock, I am glad you are here. As you know my interest in pension reform began with the Studebaker plant failure in which over 8,500 people lost their jobs and pensions. One man who was 59 years of age, and who had worked in the plant since he was 16 got only 15 percent of his ultimate pension benefits.

There are 30 million workers covered by private pension plans and 30 million who are not covered. Of those who are covered only one out of every 10 receive any benefits. Vesting is at the crux of the problem. My bill calls for an eventual 100 percent vesting after 5 years. The condition for participation is a period of service no longer than 2 years or age 25, which ever occurs later. This is the most liberal of all vesting measures before the Congress.

With regard to funding; every pension plan must pay normal or current costs and amortize any unfunded liability for past service over a period not to exceed 25 years.

Termination insurance is also provided by my bill. The legislation provides that every eligible pension plan shall pay a uniform premium based upon the unfunded obligations of each insured fund but in no case will this premium exceed 0.5 percent for each dollar of unfunded obligations.

The technical difficulties they are talking about just frankly do not exist. They are excuses for non-performance and I would say that the pension plan we enact here, and we are going to enact one, could be so weak that it would be a disgrace to this industrialized nation. We cannot do less for our people than the rest of the industrialized nations of the world. All the Western European countries and Japan have better pension plans than offered here. And if the Japanese can do it and still cause us many headaches in our balance of trade I think it is high time that we start doing it in the United States. I just want you to know that I want to go farther than any of you people want to go.

The CHAIRMAN. Could I ask the Senator just one question?

Senator HARTKE. On your time or mine?

The CHAIRMAN. On my time.

Senator NELSON. He has got all the time.

The CHAIRMAN. Why would you want to introduce a bill and speak for it if you think it has no chance whatever of passing, and if you think the bill has a chance of passing, why would you want to condemn it before it ever gets on the statute books?

Senator HARTKE. I think you have to have a proposal before you which really means something to the people. But as so often happens, truly liberal and innovative legislation does not become law because it is proposed before its time and more suffering must follow until these necessary changes are forced upon us.

You see, by assuming a skeptical attitude, maybe we will be able to change the minds of some of the people. I may even be able to convince the Chairman of the full Committee, the Chairman of the Subcommittee, and my distinguished friends to join with me and do something meaningful for the working people of this nation. I hope that I will be more successful than I think.

Senator NELSON. Thank you, Senator Hartke. Your full statement will be printed in the record.

[The statement referred to follows:]

STATEMENT OF HON. VANCE HARTKE, A U.S. SENATOR FROM THE STATE OF INDIANA

Mr. Chairman, never has the need for pension reform been greater. In 1940, only 4 million employees were covered by private pensions; in 1950, the figure more than doubled to 10 million; in 1960, over 21 million employees were covered; in 1973, over 34 million wage and salary workers rely on the private pension's promise of retirement income. By 1980, their number will have reached 42 million.

The assets controlled by these private pension funds have also grown. From a mere $2.4 billion in 1940, their funds now stand at a record $152 billion. By 1980, assets are estimated to reach $250 billion. This is the largest concentration of wealth with the least regulation in the country.

The growth and development of the private pension system in the past two decades has been substantial. Yet, regulation of the private system's scope and operation has been minimal and its effectiveness a matter of debate. The assets of private plans, constitute the only large private accumulation of funds which have escaped the imprimatur of effective federal regulation.

Although the assets controlled by private pensions are large, they do not give a comparably large return. Only 1 out of 10 employees who enroll in a private pension plan, will receive pension benefits. As a Government official put it: "In all too many cases the pension promise shrinks to this: 'If you remain in good health and stay with the same company until you are sixty-five years old, and if the company is still in business, and if your department has not been abolished, and if you haven't been laid off for too long a period, and if there's enough money in the fund, and if that money has been prudently managed, you will get a pension'."

In almost every instance, participants lose their benefits not because of some violation of Federal law, but rather because of the manner in which the plan is executed with respect to its contractual requirements of vesting or funding. Courts strictly interpret the plan indenture and are reluctant to apply concepts of equitable relief or to disregard the technical wording of the pension document. Thus, under present law, accumulated pension credits can be lost even when separated employees are within a few months or even days, of qualifying for retirement.

Statistics indicate that one in every fourteen plans qualified by the Internal Revenue Service terminates. In 1971 alone, 3,335 plans folded affecting more than 125,000 workers. The Internal Revenue Service only requires that when a plan terminates, the employer must pay out all the money in the fund. But the funds generally cannot cover all of its liabilities. Many people lose all their money and there is nothing they can do about it. These statistics do not reveal the severity of the problem as they only include those employees who are participants in pension plans at the time of termination. Most employees are laid off prior to termination, during production cutbacks and other employment changes that usually go along with plan terminations.

On the average, 20,000 workers a year are affected by pension failures. The participants hit hardest by these close-outs are those between the ages of 40 and

60. This age group usually has many years of service for which they were paid little or nothing in pension benefits, and they have considerably less chance than younger persons in finding new jobs with pension coverage.

My own interest in private pension reform dates from 1964—the year in which the Studebaker plant in South Bend, Indiana closed its doors and over 8,500 employees lost their pensions because there was not enough to fund them. The company remained in existence, but various laws allowed it to escape its obligation to these employees. Those between forty and fifty-nine with ten years of service got fifteen percent of their promised benefits; everyone else got nothing. One fifty-nine year old employee who had worked for the company since he was sixteen ended up with only fifteen cents for every dollar of pension he thought he was earning during those years.

Since that time, I have fought for Federal termination insurance, liberal vesting rights and minimum standards for funding. Earlier this week, I submitted my latest proposal dealing with these issues, "the Federal Pension Plans Protection Act of 1973." (S. 1858).

THE HARTKE SOLUTION

A. Plan termination insurance:

In the first seven months of 1972, 683 pension plans failed affecting 20,700 pension participants. My bill would protect these workers by guaranteeing to them the payment of pension obligations if a plan should fail. It establishes a Federal Insurance Program which would be self-financing through premiums assessed on the unfunded liabilities of all eligible pension plans. A pension plan would be eligible for this Federal Insurance Protection only if it met present qualifying requirements of section 401 of the Internal Revenue Code. These are the same requirements which determine the eligibility of pension funds for tax exempt status.

The legislation provides that every eligible pension plan shall pay a uniform premium based upon the unfunded obligations of each insured fund, but in no case will this premium exceed one-half of one percent for each dollar of unfunded obligations. Vested benefits would be insured to a maximum of 80 percent of the highest average wage over a five-year period or $500 monthly, whichever is less.

The Secretary of Labor, whose Department is given jurisdiction over the reinsurance program, is given general authority to set the premium rate. The program is specifically placed under the direction of the Secretary of Labor since his department is charged historically with the protection of workers' interests and already collects detailed annual information on assets, costs and actuarial liabilities under the Pension and Welfare Plans Disclosure Act.

It is with grave concern that I note that the administration's pension proposals contain *no* provisions for termination insurance.

B. Vesting:

Vesting, or the nonforfeitable right or interest which an employee participant acquires in the pension fund, is at the heart of the current battle over pension reform. This legislation calls for an eventual 100 percent vesting after five year, the condition for participation is a period of service no longer than two years or age twenty-five, whichever occurs later.

The Hartke vesting approach is the most liberal of all the bills presently before Congress. The Williams-Javits bill would not require full vesting until after fifteen years. Senator Bentson's legislation would require twenty years, and the administration's proposal would only begin to vest when the sum of an employee's age and the period of his active participation equaled fifty years.

My more liberal rules on vesting will open the way for more frequent job changes, increases in work satisfaction, a more mobile and a more effective labor force. We owe this to the working men and women of this country.

C. Funding:

Funding refers to the accumulation of sufficient assets in a pension plan to assure the availability of funds for payment of benefits due to the employees as such obligations arise. Far too many pension plans are under-funded and when the demand exceeds what is there, benefits have to be cut.

The tragedy of Studebaker was the lack of adequate funds in their pension plan. The problem today is as pressing as it was in 1964. The Western Union Telegraph Company had only twelve percent of its liabilities in their fund as of July 30, 1969- Uniroyal, Inc., was under-funded to the extent that its assets amounted to less than thirty-five percent of its liabilities. A recent United Auto Workers study of failed plans showed that thirty-nine percent of the workers covered by these plans received no benefits at all because of the lack of adequate funding.

Under my bill, every pension plan must pay normal or current costs and amortize any unfunded liability for past service over a period not to exceed twenty-five years. This will put an abrupt halt to the unfair practice of unfunded pension plans.

Critics of pension reform claim that it would boost costs which would result in stifling the growth of private pension plans. This is clearly incorrect. The enormous increase in the number of plans since 1940 with a parallel increase in their worth, is indicative of their tremendous popularity. A proposal which would better guarantee that these plans will not disappoint the expectation of those they are supposed to benefit, should not materially hinder their expansion.

As I indicated above, there are over 20,000 workers yearly who are adversely affected by pension plan failures. I do not consider this to be insubstantial. I do not consider this to be minimal. I do consider it to be wrong.

My legislation will right these wrongs. Less than three years ago. I was impressed by the speed with which the Congress acted to protect the livelihood of those who would invest in the stock market. I am sure that the Congress will not do less for the average American worker whose future security depends upon the strength of his pension.

Senator NELSON. Does anybody want to ask any questions?

Our next witness is Leonard Woodcock, president of the United Auto Workers, accompanied by Jacob Hurwitz, UAW social security department consultant, and three UAW members, Mike Daly, Vivienne Hampson, and Ray Battestilli.

STATEMENT OF LEONARD WOODCOCK, PRESIDENT, UNITED AUTO WORKERS, ACCOMPANIED BY JACOB HURWITZ, UAW SOCIAL SECURITY DEPARTMENT CONSULTANT, AND THE FOLLOWING UAW MEMBERS: MIKE DALY, VIVIENNE HAMPSON, AND RAY BATTESTILLI

Senator NELSON. Glad to see you here this morning, Mr. Woodcock. We are trying to operate under some time constraints. Your full statement will be printed in the record. We hope the major points could be summarized.

I have been asked by Senator Harry Byrd to announce that he is tied up in a meeting of the Armed Services Committee at this time and is unable to be present.

Go ahead, Mr. Woodcock.

Mr. WOODCOCK. Mr. Chairman, as you have said, the statement will be printed in the record. I do not propose to summarize it. I would like to make some very brief comments, and then, with your permission, have the individuals who are with me tell through their own experience what lack of termination insurance means to human beings.

We have a private pension system because of the relative failure of the social security system. If the social security system were adequate in terms of the benefits it pays relative to the average wage while working, we would not have a private pension system. As a matter of fact, until 1947, employers refused to bargain with us on pension plans, claiming that that was not within the province of collective bargaining. It was not until the Supreme Court, in the Jones and Loughlin case, held that unions were free to bargain for wages and then divert those wages for the sustaining of pension plans that it became a proper subject for collective bargaining. Thus the private pension plans constitute the equivalent of money individuals contribute on a collective and pooled basis.

Senator Hartke just made reference to the Studebaker plant. Most of the UAW plans call for 30-year funding of past service costs and, of course. 100-percent payment on current costs, providing for vesting after 10 years, and are more stringent in their privately negotiated features than any proposal before the Congress. We have made studies, however, of UAW plans that are vested, that are funded, in a sensible way and they are not proof against termination. Termination because of bankruptcy is one thing. Termination because an employer, sometimes conglomerates, deliberately walks away from a community and their workers and leaves them stranded is a different matter.

The point is made that multiemployer situations are in a different field. I don't see any difference between a multiemployer pool plan and a multiplant plan for a major corporation. Let us take General Motors. If a single plant of General Motors terminates, that is no problem because they are under the umbrella of the total plan. If you have a pool plan involving multiemployer situations. then so long as the plan itself is viable. the fact that one particular employer goes out of existence does not qualify that plan for any type of termination insurance. that is because the very fact they are pooled means they can share the risk among those who agree to belong to the pool. Therefore I see no difference between that type of situation and the multiplant situation of General Motors, Chrysler or Ford. We urge that the Congress grant some form of termination insurance and to do it on the service to date. Doing it prospectively accomplishes nothing at all.

Some of the most difficult situations I face as President of the UAW are in trying to explain what we mean when we say you have a funded plan—we even sometimes use the words guarantee, we mean these benefits to which wages have been contributed will be available under certain conditions at certain ages. Then when that plan is washed out, our members say. "What happened?" How do you explain it? They are very. very bitter.

I would. with your permission. like to begin with Mr. Daly, who will very briefly tell you of his own particular situation.

Senator NELSON. Thank you. Mr. Woodcock.

Mr. Daly. would you identify yourself. full name for the record?

Mr. DALY. Yes. Gentlemen. my name is Mike Daly. I am the chairman of Local 250. UAW Retirees Chapter. which represents the people who retired from the Gar Wood plant. We took a 60-percent reduction in pension. My pension was reduced from $93 per month to $37.50 a month. Our life insurance was cut from $1.000 to $403 death benefits. Our hospital insurance will be discontinued December 1.

What happened to me happened to the others. and I wish the Congressmen here could have been in attendance at a retiree meeting where we had to tell the people what had happened to them.

I saw heartbreak and fear in the people's eyes. Many broke down and were unable to speak. There were wives of retirees to voice their husbands' despair. many who had never spoken in public before. Their lips moved but not a sound. These are memories I will never forget.

Where do they go from here? Scrap heap? Mental institutions? Welfare? Sponging off relatives? Or many other degradations inflicted by this loss of dignity through the loss of jobs? Why?

This is eating the very moral fiber of our Nation.

I would like to cite some actual cases for you gentlemen. The case of Albert Davenport who retired at age 68 under compulsory retirement. He is now 86 and almost totally blind. He did not have 25 years' retirement credits at the time of retirement. Since the cut, he will probably get around $30 a month.

Two. take the case of Malcolm McLellan, 85 years old, and in good health. but with a bad hearing problem. The case of another worker, Chester Gira, who is handicapped, but who gave 100-percent performance over the years. He had 32 years' seniority and is now only 55 years old. He had a flawless attendance record. He received nothing but a paltry amount in severance pay.

By the way, I forgot to add that I myself had 32½ years seniority in Gar Wood.

No. 4, take the case of the widow of Walter Miller, who was buried on Saturday 2 weeks ago, May 5. She stood before her husband's casket and asked me does his pension cease, and must I pay for my own Blue Cross, and I had to answer yes.

Bismarck once said of the enemy, leave them nothing but their eyes to weep with. I have seen more tears, not from the enemy but from the soil of America, these people who made America great, these people who have worked hard all their lives believing they were building some security for the years when they no longer would be working. Now, their world has dropped from under them.

Gar Wood Products, now Sargent Industries, is still in business in other parts of the country. It is one of the new conglomerates that thrive on the liquidation of small companies with huge tax writeoffs. These tax writeoffs were made possible by an act of Congress. I say to the Members of Congress and the Senate that it is time that you gave protection to the people whose lives are destroyed when these things happen.

If our Government can insure bank deposits, why is it so difficult to get Congress to understand the need to insure pension credits?

Most of the people I represented had little in the way of bank deposits. They had been unable to save very much and their pension credits represented the security for the years they would no longer be productive, and now it is all gone.

We still have our meetings. We generally end up singing. One retiree suggested that we not sing the National Anthem or Solidarity but sing Nearer my God to Thee. Paraphrasing the late John Kennedy, think not what I can do for myself, but what I can do for my country, to read, think not what I can do for my country but what can my country do for me. I have been asked that many times.

In conclusion, I hope that every church in America, regardless of denomination, who has heard this testimony will take to the pulpits to espouse this just cause to eliminate a cancer that has grown steadily in the United States.

One more thing I would like to add to this. Last Sunday one fellow called me on the telephone, a fellow by the name of Fraser, and asked me could we just increase our pensions $10. If we could just increase it $10. it would be the difference between poverty and living.

Thank you.

Senator Nelson. Thank you, Mr. Daly.

Senator Curtis. Mr. Chairman, I really should wait for the panel, but I do not have the information as to the company and what happened and that part of it. I think it ought to be right at this point in the testimony, if somebody can supply it.

Mr. Woodcock. May we supply that in writing?

Senator Curtis. Just briefly what was it and then you can enlarge upon it.

Mr. Woodcock. This particular situation was where a conglomerate bought out an existing plant employer and then moved the operation to other places. One of our difficulties, Senator, is that as the work force gets older and the pension costs build up, the competitive pressures to go to some place where it is cheaper become operative.

Senator Curtis. Who is the conglomerate?

Mr. Daly. Sargent Industries.

Senator Curtis. You will supply the further details.

Mr. Woodcock. We will; yes, sir.

Senator Nelson. That will be put in the appropriate place in the record.

[Mr. Woodcock subsequently supplied the following:]

Gar Wood is one of the oldest and best-known names in the manufacture of refuse truck bodies in the nation.

For many years Gar Wood Industries maintained their truck body manufacturing facilities in the Detroit area, most recently in Wayne, Michigan, a western suburb. Local 250, UAW represented from 500 to 600 workers there.

Sargent Industries, a conglomerate, purchased Gar Wood in April 1970.

In January, 1972, UAW was notified by Sargent that manufacturing operations at Wayne would be discontinued on or about October 1, 1972, and the work moved to other Sargent facilities located in Exeter, Pennsylvania, and Enterprise, Alabama. Although some work would be retained in Wayne, Michigan, there would be jobs for no more than about 10% of the employees in the bargaining unit. In accordance with the terms of the Pension Agreement between the Company and the Union, the pension plan was terminated, effective July 1, 1972, after employment in the bargaining unit had been reduced below 100 workers.

Mrs. Hampson. My name is Vivienne Hampson. I am financial secretary of 985. I was employed in Macord Industries from 1942 through 1969. Our company was bought out by Howell Industries and they in turn closed the Detroit plant and moved to Pennsylvania.

At the time our plant was closed we had 200 employees and there were 20 on normal pension. 10 on early retirement, and 1 on disability.

Since they moved to Pennsylvania, Howell Industries closed that plant completely and our people have had a cut in pensions. Their life insurance has been completely dropped. That happened in 1970. Our plant closed in 1969. Their life insurance and their Blue Cross was completely dropped and they have been told that their pension will run until 1977. those who are on pension.

From 1969 I went to work at Procon Pump and that, too, moved out of town and I am now employed at Walway Corp., and I started there in 1972. I was 54 years of age with 27 years of seniority at the time that Macord Industries closed.

We have in the UAW a slogan. 30 years and out at $500. Well, at my company we topped that. I was 27 years and out with nothing. And there were others worse off than I was. There were others that were older than I was and had 37 years or more of seniority. They got nothing.

I have been fortunate that through my connections with the union I have been able to get jobs in other industries, at a greatly reduced hourly rate than what I had. My experience is like Mr. Daly's, except that they would be different names, different faces, but equally tragic, gentlemen, as everyone that he has mentioned. Some of the employees that are now unemployed from my plant subsist on their social security and baby sitting jobs and try valiantly to pay for the taxes on their homes. They seem to sense that there is a security in owning a home and yet how long they can do this I do not know. It is one thing for themselves to be faced with this, but it is another thing to tell the people that you yourself have sold them a mess of pottage.

My pension plan was funded, as General Motors, a 30-year-supposedly secure pension plan. Life sometimes seems a comedy of errows. It has been for me, and we do urge that you gentlemen see fit to pass the Williams-Javits bill, not that it will do any good for the people that I represent or represented, rather, or for myself, but for the thousands that come after me. I believe they are entitled to it.

Certainly, gentlemen, with the pensions that you have, and yours is a well funded pension as you well know, you come to the taxpayers to fund your pension. Could you deny the taxpayers this which you yourselves take?

Do not hesitate, gentlemen, or do not procrastinate. Justice delayed is justice denied.

Thank you.

Senator NELSON. Thank you.

Mr. WOODCOCK. May I have Mr. Battestilli tell you of his experience?

Mr. BATTESTILLI. Senator Nelson, and members of the committee, I am Ray Battestilli and I am a citizen of the great State of Michigan right now. I don't have a prepared statement and I am not going to go into a lot of statistical rhetoric here. I think Brother Woodcock who is the president of the union to which I belong, and by the way, I think is a great one, has done a pretty good job providing the committee with all the statistics you need.

I want to talk to the distinguished Senators today about the human suffering and the despair that comes to a community when situations such as have been described here by the people who I am following, when plants close down and people are relegated to the scrap heap, so to speak, when they are told this is it.

Stop and think for a minute. I worked for better than 20 years with the Packard Motor Car Co. which later became the Studebaker-Packard Co. and moved to South Bend, Ind. No reflection on Senator Hartke from the great State of Indiana, but you know, when your roots are as deep as some of ours were in Michigan, it was pretty hard to just pick up and move to Indiana.

Fortunately for us, we didn't move because it didn't last too long in Indiana. They finally moved to Canada for a little while and then went into oblivion.

But when that happened, when they closed the door in 1956 in the city of Detroit, the Packard Motor Car Co. had been what we referred to as a prestigious company. It was what everybody thought of as solid as the old proverbial Rock of Gibraltar. But lo and behold, one day they closed the doors on some 10 or 12 thousand people, some like myself who had worked there for years—some of them started at the ages of 15 and 16 and had not reached retirement age. I was a part of the bargaining committee that helped negotiate a pension plan at Packard in 1950, but as was pointed out by Brother Woodcock, most of these plans are funded over a 30-year program and, of course, the pension plan at Packard was only some 6 years old when the company folded. There was only a limited amount of money in escrow. They divided that money among those who were over 60 years old. There was an agreement reached between the company and the union that they would distribute the money to persons who were over 60 who had not yet retired. Those people got a little out of it, but persons who were less than 60 years old didn't get 1 red cent. And some of those guys had worked for the company some 25 or more years. They were production type workers. Their world came to an end.

I want to relate to you that I had the sad experience—I don't think any of you have had to confront the situation where a good friend or a fellow worker came up to you and asked you to be a pallbearer at his own funeral. This actually happened to me. One of the workers was so depressed and felt that there was nowhere to turn, and he actually asked if I would be a pallbearer at his funeral because he was contemplating suicide. Some of the Packard workers did commit suicide. They had nowhere to go. So this is the story of what happened to Packard.

As Brother Woodcock here has pointed out, the time is past due. The time is past due for something to be done, something to prevent repetition of these kinds of situations in America. I think, gentlemen, that that task lies in your hands as the lawmakers, as the leaders of this great country.

I don't think that I have to remind you, but I am going to, and one of the Senators here, I think it was Brother Hartke again, mentioned Japan and what has taken place. I think all of us know that in European countries, Germany, Italy, and, yes, Japan, too, that were devastated by great wars but were rebuilt, and they were rebuilt, I don't think I have to remind you gentlemen, primarily with the tax dollars of the American working people. I see nothing wrong with this. I am not an isolationist. I think we should help other nations out. But certainly I think charity starts at home.

I think we should do something for the American people, for it was the American people who made America great and I think that we should do something to preserve the dignity of the American worker when he has reached that point where he is too old to continue to work and yet too young to die. I think the Congress has a responsibility.

The conglomerates that we talk about here that make windfall profits when they create these situations are making this money because of laws that are on the statute books. They are protected by laws that were enacted by the U.S. Senate and House of Representatives. And I think that since these conglomerates, these multinational corporations that are bringing all the heartbreak and the tear shedding situations to the American workers, if they can be protected by law, certainly I think that the time is now, the time has come for the Congress of the United States to enact legislation that will protect the American worker. I think the time is now. Tomorrow may be too late because we have a young generation that is coming up, and I don't think that generation is going to take these situations as lightly as some of us took them. I really fear for what could happen if these kinds of situations continue to develop and go by unattended.

Thank you for the opportunity to speak before you and I certainly hope that something is going to be done.

Senator NELSON. Thank you, Mr. Battestilli.

Senator Curtis?

Senator CURTIS. No questions at this point.

Senator NELSON. Senator Hartke?

Senator HARTKE. It is quite commonly known but let me congratulate the UAW anyway for the great amount of pioneering work you have done in this field. I have been working with you for quite some time in an attempt to secure effective legislation.

I would like to take the privilege of referring to your statement which deals with our Elkhart, Ind., situation. I would like to have it read into the record in addition to being placed in the record. This is where the Conn Saxophone Co. established their plant in 1950 and terminated in May 1972.

One and a half million dollars of assets of the pension fund were only sufficient to guarantee about 65 percent of the annual $236,500 pension payments for 204 persons who were then either retired or over age 65 and eligible to retire. From October 1969 to October 1970 active employment dropped from 611 to 368 persons for whom the cost of full pensions at the time of closing would have required additional assets of approximately $1,550,000. Of the final group of 368 there were 218 persons with sufficient service under the terms of the plan to qualify for vesting. None of them will ever receive a benefit. Thus, in the aggregate, C. G. Conn workers, that is the Conn saxophone people, and retirees lost pension benefits that would cost more than $2.3 million to replace.

That is from Mr. Woodcock's statement.

I want to point out also in your statement; "Let it be noted that the bulk of the terminated plans included in our study, including Studebaker, unable to fulfill their benefit commitments would not have been considered poorly funded."

That is a fact which is forgotten on the question of termination. Plans consider themselves well funded but are not. My legislation would set definite minimum standards.

I want to commend you for the work you have done in this field. Your studies have been very helpful. For example, the fact that Sweden has an experienced rate of two-tenths of 1 percent and that has been more than adequate as a premium for termination insurance. Is that right?

Mr. WOODCOCK. That is correct.

Senator HARTKE. In other words, they have had pension insurance since 1962.

Mr. WOODCOCK. Sixty-two.

Senator HARTKE. And it has worked effectively. I think that really demolishes all these arguments. Most of these people just don't want to have pensions regulated and there is $152 billion in private pension funds at the present time, and there will be $250 billion by 1980. These funds must be regulated for the best interests of the workers as well as the pension plan creators.

I am willing to support S. 4. I think it is not a timid step. But I don't think it goes nearly far enough and so I have introduced my own legislation. I don't condemn my own bill and I am not condemning myself to failure. I will give you all a chance. I just hope when we pass some kind of bill that is satisfactory. Congratulations on fine work.

Mr. WOODCOCK. Thank you, Senator.

Senator NELSEN. Senator Dole?

Senator DOLE. I have no questions. I would only state as a new member of the committee and subcommittee I am very pleased to hear the testimony. I think it does point up many of the human tragedies involved when there is a bankruptcy or relocation or for some other reason the employer moves or shuts down a plant. And I accept the responsibility as a member of the committee that we have an obligation to try to come up with some legislation, but I would say, as Mr. Woodcock has said, we are not suggesting that this is a panacea for all the ills but it at least is a goal we can strive to attain.

I appreciate very much particularly the testimony of the three who have had personal experience because it underscores the need for good legislation.

Mr. WOODCOCK. Thank you.

Senator NELSEN. Senator Bentsen?

Senator BENTSEN. Thank you very much, Mr. Chairman.

Congratulations on your testimony, Mr. Woodcock, and those who have appeared before us. I thank you for your comments concerning my work in preparing pension legislation. I think what we are proposing here and what we must keep sight of is the fact that we are talking about minimum standards. We are trying to take care of some major abuses in pension plans. We have had a great increase in the number of private pension plans over the years and we want to continue to encourage that.

You have commented concerning my 5-year vesting at 25 percent as early vesting, that you felt that was good, and I appreciate that. The reason it was put there was to provide, in effect, a little more portability in a practical way.

On the other hand, you felt that 20 years was too long for 100 percent vesting, and I can understand that kind of a comment, but once upon a time I used to sell pension plans and I know how tough some of these salesmen work in trying to get employers to put them in and I want to see them continue to grow and to see employers continue to put them in.

That is why I look at this as a minimum standard, a standard that could be improved on certainly, but that this ought to be the starting point which would be a major improvement over some of the things that we see today in effect in some of the pension plans.

I think the vast majority of pension plans do a good job but there are many abberations that are terribly important tc the individuals involved. To them it can mean 100 percent involvement and 100 percent failure.

Now, insofar as the tax credit, you don't favor that idea in my legislation, but what I am trying to do again is to encourage the puritan ethic of saving. I have not proposed this as a tax deduction because I think that would favor persons in the higher income tax brackets. Instead I have proposed this as a tax credit.

An individual can contribute up to $1,500 and get a tax credit up to $375. I would hope that more and more we could get people to save up to that amount of money.

Now let's get to this point of termination insurance and what the administration has said and what you in turn have said in your testimony.

The main objection, it seems to me, on the part of the administration is that there will be abuses. You have recommended a 2-year waiting period for insuring increases in benefits. I have provided in my bill for 5 years before the termination insurance goes into effect and that protects against one of the possible abuses. But then I think you make a particularly strong and good recommendation, one that I don't have in my piece of legislation, and that is this question of employer liability in the event of a voluntary termination of a plan that is not fully funded. I really think when a company terminates an inadequately funded plan they are morally wrong because I think the employee is entitled to feel that all of the liability that has been accrued has actually been funded so that he should be able to receive what is vested. If a solvent company terminataes a pension plan it should reimburse the termination insurance fund for benefits paid out.

If a company acquires another company, the purchaser should be required to, in effect, consider in determining the purchase price the obligation of funding accrued liabilities of the seller's pension plan. These safeguards would prevent abuses. I would support this kind of approach.

So I think you make a contribution with your testimony and I think we can overcome these so-called problems of termination insurance with just a little creative thought and we have seen some of it here today.

Thank you very much.

Senator NELSON. Thank you very much, Senator.

Senator Roth.

Senator ROTH. I have a couple of questions. I am not an expert in this area, but I am very much interested in your testimony and generally sympathetic to what you have to say.

Like Senator Bentsen said, I feel that we ought to try to promote pensions, particularly among the self-employed. Isn't it possible for us to develop some kind of legislation that will encourage these groups without running too grave a risk of creating new loopholes? Isn't this desirable from the national point of view?

Mr. WOODCOCK. Well, if there could be protective devices——

Senator ROTH. There are always a few that will take advantage of whtaever you do.

Is it right to sacrifice what I would consider legitimate needs of the many because there might be a few that would exploit it?

Mr. WOODCOCK. I must confess, Senator, that my eye is upon the greater objective that we have our honestly negotiated plans protected in their operative features. The other is really a separate problem about which we have concern but about which I am not disposed to make great argument.

Senator ROTH. Do you see portability as a long-range objective in pension plans?

Mr. WOODCOCK. If we can get the vesting provisions in the proper form and particularly if we have termination insurance, then we will have gone a long way toward portability. We have, of course, a magnificent instrument for portability, the Social Security System, almost completely portable, almost completely universal, almost completely universal coverage. Unfortunately, it is the failure of that system in terms of adequacy that has given rise to the private pension system, and when you talk about portability to be grafted upon the private pension system so that in effect you then have to get an individual policy for every separate person, the costs are going to go out through the roof. It is very, very difficult.

Senator ROTH. I won't take more time but I join my colleagues in thanking you for your help and testimony.

Mr. WOODCOCK. Mr. Chairman, may I make one point. It is in the statement but I want to emphasize it.

Reference was made here to the UAW 30 and out program. We are not asking for termination insurance for that kind of supplementary feature. We are talking only about the basic pensions that would normally accrue on a vesting basis or at given retirement age. Those supplemental features we are not concerned with reinsuring.

Senator NELSON. Thank you very much, Mr. Woodcock and your associates.

Mr. DALY. Mr. Nelson, could I leave some copies of my presentation for your committee's consideration?

Mr. BATTESTILLI. One point I overlooked, an editorial that appeared in the Detroit Free Press. This is a Knight newspaper. They make reference to the Williams-Javits bill in the Senate and the Dent bill in the House. I think this editorial really hit the nail on the head. They really point out what has happened to many, many people and, of course, they give encouragement and support to both these bills.

Senator NELSON. We will receive that editorial for the record. Thank you all very much.

[The article referred to and Mr. Woodcock's prepared statement follow:]

[From the Detroit Free Press, May 3, 1973]

JUDD ARNETT SAYS: U.S. MUST ACT TO HALT INJUSTICE TO PENSIONERS

The text for today's outrage comes from Mike Daly, chairman of United Auto Workers Retiree Council for Region 1E, who has penned the following letter to this outpost. . . .

"On April 14, I testified before the Congressional Subcommittee on Pension Reinsurance at the City-County Building and called attention to the hardship and heartbreak suffered by the workers and pensioners of Garwood Products, now operating in other sections of the country as a part of Sargent Industries.

"We took a 60 percent reduction in pensions and my own pension was reduced from $93 a month to $37.75. Our life insurance was cut from $1,000 to $430 death benefits. Our hospital insurance will be discontinued as of December 1, 1973.

Sargent Industries will continue to prosper because Congress has taken care of them.

"Who took care of us? The answer is—'no one.' We worked hard all of our lives believing we were building security for the years we would no longer be working. Now our world has dropped out from under us. Why?

"If our government can insure bank deposits, why is it so difficult to get them to understand the need to insure pension credits? President Franklin D. Roosevelt said, 'All we have to fear is fear itself.' How I wish that were true. Older workers in the plants and our pensioners live in fear. An illustration of the fear generated by the loss of pensions, or even reduced pensions, is a constant query—'do you think it can happen to us?' * * *

". . . Congress enacted the tax laws that make it profitable to move plants. Isn't it time for Congress to enact a law to protect the workers and retirees? . . ."

Thank you, Mr. Daly, for your timely reminder of a glaring weakness in our system. I do not argue that a company should not have the right to move, or to cease operations. But you are certainly on firm ground when you insist that in the event of either happening, the pensions of workers should be protected to the fullest extent.

What has become, one wonders, of all of the millions of dollars paid into pension systems that malfunctioned? Somebody benefited from it: Earned money does not simply vanish into the thin air. Either the corporations in question pocketed the payments, or pledges, or the pension underwriters made vast profits out of unconscionable arrangements. There was money; it disappeared; the worker was left holding the sack; how can such an arrangement be supportable in this day and age?

Furthermore, what sort of a system is it which decrees that if you spend 10 or even 20 years with one outfit, then decide to move to another, you must forfeit your contributions into the pension plan? Why can't you take them with you, to the next job?

After all, if the company moves it does not necessarily sacrifice the assets it has accumulated. Why should a conglomeration of interests, known as "the company," have more rights than an individual in this respect? Mike Daly is absolutely correct: This is a form of "ducking out," of leaving the worker high and dry, that has long since been outmoded among bank depositors through a federal insurance program.

When you come right down to it, what is the difference whether a worker creates savings through a pension plan or bank deposits? In neither instance should he be subject to avarice, misrepresentation, the mishandling of funds. It is difficult enough for the average citizen to prepare for retirement. He should not have the added burden of pension disappearance for reasons far beyond his control.

Congress has been looking into this situation and already the Subcommittee that heard Mr. Daly has received testimony which excites contempt for the manner in which some pension funds have been mismanaged. One hesitates to invite still another intrusion of the government into private affairs, but what alternative is there?

Upon retirement, a worker should have coming what he has earned and saved without question. It is bad enough that much of this accumulation will be eaten away by inflation, but it makes a joke of "democracy," or any other form of government, that he should run the risk of being cheated. Yet this is what has been happening and it should be stopped—now.

Prepared Statement by Leonard Woodcock, President, International Union UAW

SUMMARY

Many of the widely acknowledged shortcomings in the operation of the private pension plan system would be less troublesome for our nation if we placed greater reliance for achieving individual retirement security on the public Social Security system. Virtually universal coverage, portable benefits, liberal vesting, efficient administration and solid assurances of permanence and continuity are all characteristics of the Social Security system. In our dual public-private system, however, national legislation is necessary to make the private sector function more reliably for the benefit of covered workers.

Reform of the private pension system is an issue of fundamental social justice and a necessary ingredient of any comprehensive national program to combat poverty in old age. American workers need assurances that their pensions will be protected if their employer goes out of business, that pension plans will be adequately funded, and that they will accrue a nonforfeitable right to a pension after a reasonable period of service. They should feel secure that pension funds will be managed in their interests and that information concerning their plans will not be withheld from them.

The only appropriate remedy for the well documented and publicized shortcomings of the private pension plan system is comprehensive reform legislation, rather than piecemeal reforms that attempt to isolate individual facets of the total problem. Pension reform should not be sidetracked by linking it to other problems, the solutions to which are not clearly perceived.

The UAW has been a pioneer, an innovator, and a trend setter in the development of pension plans for industrial workers over the past quarter century. Our membership has been keenly aware of the importance to them of pension plans. Over the years, they have allocated for pension purposes substantial portions of the economic gains made available through collective bargaining. We have tried to make these plans responsive to the needs of our members and to build them on sound principles of plan design, prudent management and adequate financing. Yet we are constantly made aware of individual plans that terminate and are unable to fulfill all of their benefit obligations.

Benefit losses occur in plan terminations—whether the result of business failure, plant movements, consolidations of operations, plants being purchased and closed by conglomerates, or other economic contingencies—because almost no private plan is free at any time of unfunded past service liabilities. These liabilities are usually attributable to both service before introduction of the plan and plan amendments granting benefit increases for service prior to the date of amendment.

When a plan terminates with insufficient assets to assure full payment of accrued benefit rights, the effects on individual workers, active and retired, and their families can be devastating. In addition, terminations impose serious welfare burdens on local communities.

It appears inevitable that pension plans will continue to terminate with significant attending benefit losses. Any purported pension reform legislation failing to address itself to that problem, or relying solely on mandatory funding to solve it, is at best unresponsive to the overriding concerns of workers for the safety of their pensions. Effective pension reform must include a federal program of plan termination insurance (sometimes also called pension reinsurance) similar in concept to well established government programs reinsuring bank and savings deposits, and housing mortgages, and protecting investors against losses caused by financial difficulties to brokerage houses.

A. Basic Pension Reform Program

In our view, the essential requirements for meaningful pension reform include the following:

1. Pension reinsurance based on the following concepts:

(*a*) Coverage of pension plans should be mandatory and effective promptly after enactment of legislation.

(*b*) Plan participants and beneficiaries should be protected against loss of vested pension benefits, including benefits based on service before and after enactment of legislation.

(*c*) Premiums should be assessed against all plans at uniform rates based on the unfunded vested liabilities of each plan.

(*d*) Insured benefit guarantees should cover all types of plan terminations, including partial discontinuances, subject to reasonable safeguards to prevent abuse and "unloading" of liabilities.

2. Vesting standards that would:

(*a*) Require full vesting after 10 years of employment;

(*b*) Recognize all service with an employer or covered group, including service prior to enactment of legislation; and

(*c*) Limit mandatory coverage to lifetime benefits of the kind generally provided at a plan's normal retirement age.

3. Establishment, along with pension reinsurance, of appropriate funding standards to assure that contributions to each pension plan will be sufficient to

meet current service costs and to amortize unfunded past service costs over periods not longer than 30 years.

4. Clear cut federal standards of fiduciary conduct in the handling of employee benefit funds and measures to assure more intelligible disclosure of descriptive and financial information to covered workers and other interested persons.

B. Alternative Proposals for Pension Reform

1. S. 1179.

Senator Bentsen's bill, S. 1179, is a commendable effort to achieve needed reforms, and the UAW is able to support many of its provisions. We are unable to endorse S. 1179 without reservation, however, because:

(*a*) While we are fully in sympathy with one of the bill's objectives—to extend pension coverage to the millions of American workers not now part of the private pension system—we doubt the wisdom of attempting to accomplish that through the mechanism of individual tax credits. Our fear is that such an approach will create new tax loopholes for persons at high income levels without measurably influencing the extension of private plan coverage to low income workers.

(*b*) The proposal to begin to require vesting after 5 years of service is a progressive step. To vest no more than 25% of the accrued service at that time, and add 5% increments over each of the next 15 years, however, delays for too long the attainment of signficant vested pensions.

(*c*) Administration of pension reforms legislation by the federal Treasury Department, which is oriented to prevention of tax abuses, does not offer the most promising route for protecting workers' pension rights.

2. S. 4

Of the many bills on pension reform now pending before Congress, the UAW has chosen to support S. 4 as the most effective response to the problems that have been identified. We support S. 4 for the following reasons:

(*a*) It is a careful, comprehensive bill that covers all necessary items of pension reform including plan termination insurance, vesting, funding, disclosure and fiduciary responsibility.

(*b*) S. 4 would entrust the basic responsibility for protecting workers' pension rights to the Department of Labor whose historic mission and orientation is worker protection.

(*c*) It would protect the plan termination insurance fund against unilateral, voluntary plan terminations by solvent employers.

(*d*) It provides for a reasonable vesting schedule and offers greater flexibility to accommodate the varied approaches to vesting in existing private plans.

We believe the problems of the private pension system are known and that effective and equitable solutions to them are available. We hope that Congress will act in timely fashion to appove pension reform and forestall the kinds of personal tragedies of which we have spoken.

STATEMENT

I am Leonard Woodcock, President, International Union UAW with 1,600,000 members. Accompanying me are Jack Beidler, Director of our Legislative Department and Jacob Hurwitz, Consultant on the staff of the UAW Social Security Department. With me also are three UAW members, Mr. Mike Daly, Mrs. Vivienne Hampson and Mr. Ray Battestilli, who can speak from personal knowledge of the shortcomings of our private pension system. With your permission, Mr. Chairman, at the conclusion of my statement, Mr. Daly, Mrs. Hampson and Mr. Battestilli will tell you of their experiences, and those of some of their fellow workers, when the pension plan in which each of them participated was discontinued.

Mr. Chairman, on behalf of the UAW, I thank you for the opportunity to express our views about measures designed to improve our nation's private pension system. My fellow officers of the UAW and I have appeared on a number of occasions before Congressional committees in support of needed pension reform legislation. We welcome the opportunity to convey to you once more the deep seated anxieties of the workers we represent for the safety earned pensions and the urgency with which they view the need for reform.

I think you should know that we in the UAW have arrived at our position on pension reform not because we are frightened by the prospect of this nation placing greater reliance for the retirement security of its citizens on the public

Social Security system, but because we are convinced that the public system has too small a role. Many of the major shortcomings of the private system simply do not exist in the Social Security system which provides nearly universal coverage, truly portable benefits, liberal vesting, efficient scandal-free administration, and offers solid assurance of permanence and continuity. Social Security represents the most effective, least expensive approach to providing economic security in old age.

In sharp contrast to the apathy we found only a few years ago when our Union was one of the original handful doing "missionary" work on behalf of pension reform legislation, we are encouraged by its emergence as a prime current issue of public policy. It is an issue, moreover, that affects the lives and well-being of tens of thousands of workers and their families. It is an issue of fundamental social justice. The time is past due for the Congress to face it squarely and adopt effective measures to assure workers they will not be deprived of pension benefits they had every right to believe they had earned.

Pension reform, in all its aspects, is not a universal panacea for the ills of our society, but it is directed to a specific concern affecting millions of American workers and their families. It is not complete insurance against poverty in old age, but it is, in its essentials, a necessary ingredient of an effective contemporary policy against that possibility. American workers are entitled to the peace of mind that will come from the knowledge that their earned pension rights are protected if their employer goes out of business, and that contributions reasonably adequate to support their promised benefits will be made. They need to know they cannot be arbitrarily dismissed to prevent them from acquiring vested pension rights, or that they will not face unreasonable obstacles to earnings vested pensions. They should be assured that pension contributions presumably made to finance their retirement will not be manipulated in behalf of an ulterior objective, and that the benefit and eligibility conditions of the plans covering them will be clearly explained.

These are, of course, the stated objectives of pending reform proposals. I am happy to come before you to urge you to unite in a common effort with your colleagues in both houses to make reform a reality in the current session of Congress. It is our fervent hope that the level of interest shown in the new Congress and the impressive list of sponsors of reform bills mean that pension reform will now receive the priority attention which millions of working people in this country believe it deserves.

I propose to skip any recitation of the significance of private pension plans as a major economic and social institution in America today. The statistics, of which your Subcommittee is well aware, need no repetition from me. What is significant is the fact that accumulated pension reserves represent what has been appropriately cited as "the largest accrual of virtually unregulated funds in the country."

Your Subcommittee is equally aware of the system's observable shortcomings affecting significant numbers of those who look to it for security in retirement.

It should not be necessary to stress the fact that these shortcomings call for comprehensive, interrelated reform legislation, not piecemeal gestures.

Neither is it appropriate to evade the issue of pension reform by linking it with a host of other, related and unrelated, problems—achieving full employment, the balance of payments deficit, the destruction of small businesses by the activities of the conglomerates, tax reform, extending pension benefits to the currently uncovered portion of the workforce, and the like—so as to preclude any rational solution of even the currently manageable problem.

Your Subcommittee has properly addressed itself to the need for a broad and comprehensive approach to strengthening the performance of the private pension system. We are confident, Mr. Chairman, that measures of the kind you are considering, will enable the system better to fulfill its role as a meaningful and flexible part of total retirement security for millions of wage earners in addition to the basic still too minimal benefits of Social Security.

UAW PENSION PLANS—MEMBERSHIP STAKE

The concern and stake of UAW members and their families in the effectiveness of the private pension system is long-standing.

Our Union was in the forefront of the movement of the late 1940's and early 1950's which for the first time established private plan pension coverage for large numbers of industrial workers in America. Since that time, UAW-negotiated pension programs have been widely recognized as playing a significant, pattern-setting role in shaping and contributing to the development of plans in a variety of industries.

We have consistently sought to develop our plans on sound fundamental pension principles and to make them responsive to the needs of our members, both active and retired.

UAW members have regularly given a high priority to pension benefits in collective bargaining. Repeatedly, with membership support from all age groups, decisions have been made to direct substantial parts of a potential "economic package" into pensions. Understandably, the initial plans in the early 1950's put primary emphasis on the immediate income needs of workers then near or past normal retirement age. As the plans developed under successive contracts, vesting provisions were introduced and liberalized until, by 1964, full vesting after 10 years' service at any age had been achieved as a UAW pattern. Other improvements have included meaningful early retirement provisions with special supplements in addition to basic pensions, more adequate disability protection, and liberalized service crediting. We have also been innovators of subsidized survivor benefit elections with a substantial part of the cost borne by the plan rather than by an "actuarially equivalent" reduction in the worker's pension. In addition, we have recognized a continuing obligation to improve and protect the purchasing power of pensions received by our retired members.

As an outgrowth of the importance our membership has placed on pensions in collective bargaining, we have had considerable experience of plans running into trouble, particularly in the case of abrupt and unforeseen terminations.

It is inherent in private plans, if they are to provide meaningful retirement benefits supplementary to the Social Security system, that most such plans will always have unfunded liabilities. These liabilities exist because plans start "late"—i.e. when growing numbers of older and long-service workers make retirement needs self-evident. Meeting these needs requires creation of substantial "instant" liabilities to cover the cost of benefits for service before the plan started. The problem is magnified by additions to unfunded liabilities created because plans must be amended periodically.

Segments of the private pension system simply break down when business failures, market forces, acquisitions by conglomerates with subsequent shutdown or removal of plants, or other economic contingencies cause abrupt termination of pension plans and repudiation of significant portions of the employer's pension commitment.

The practical significance of these breakdowns can be seen in concrete form by citing some specific examples of what is lost in plan termination.

Garwood Division (Wayne, Michigan) of Sargent Industries, Inc.—When this employer drastically curtailed operations at this plant in suburban Detroit in 1972, moved them to other locations, and terminated the pension plan, the 231 retired workers (many in their 70's and 80's) of this firm had their pensions reduced by approximately 60%. Nearly 600 active workers, almost 500 of whom had worked long enough to earn a "vested" pension, lost all pension rights. The total present value of lost "vested" benefits and pensions approached $4,000,000.

Thompson Grinder Division of Waterbury Farrell Division of Textron, Inc.—When the conglomerate closed the doors of its Springfield, Ohio plant in 1972, pension assets were sufficient to provide full pensions to 56 retired employees, but the 135 active workers who were laid off can expect no more than 11% of the value of their accrued pensions. Their benefit losses are close to $700,000.

C. G. Conn., Limited, Elkhart, Indiana.—When this plan, first established in September, 1950, terminated in May, 1972, the $1.5 million of assets in the pension fund were only sufficient to guarantee about 65% of the annual $236,500 pension payments for 204 persons then either retired or over age 65 and eligible to retire. From October, 1969 to October, 1970, active employment dropped from 611 to 368 persons for whom the cost of full pensions at the time of closing would have required additional assets of approximately $1,550,000. Of the final group of 368, there were 218 persons with sufficient service under the terms of the plan to qualify for vesting. None of them will ever receive a benefit. Thus, in the aggregate, C. G. Conn workers and retirees lost pension benefits that would cost more than $2.3 million to replace.

I can recite any number of other plan terminations that were, or will be, equally devastating to the workers and retirees affected. Murray Body, Packard Motors, Midland Steel, Bower Roller Bearing Division of Federal-Mogul, as well as the frequently cited Studebaker closing, are a few that come readily to mind.

It is against this background of our members' stake in the system, Mr. Chairman, that I wish to offer specific comment today on the major issues of pension reform.

INSURANCE OF RISK OF PLAN TERMINATION

UAW subscribes without reservation to the view expressed by Senator Bentsen on the occasion of his introduction of S. 1179 when he said, "Pension reform without minimum funding standards and required insurance is really no reform at all." *

The problems associated with plan terminations have been widely studied. Two Senate committees have reviewed the matter. It has been studied in the House, too. Recently, a joint study of pension plan terminations by the U.S. Treasury and Labor Departments was released. We have also made a study of 100 UAW plan terminations in the period 1958–69. We concluded that significant numbers of private plans terminate and can be expected to continue to do so. In these terminations, large numbers of persons will not receive all—some instances, any—of their expected benefits. Frequently, workers with long service who have not reached retirement age will receive less than the full amount of their accrued benefits.

Let it be noted that the bulk of the terminated plans included in our study, including Studebaker, unable to fulfill their benefit commitments would not have been considered poorly funded. For the most part, they were funding on a schedule at least as stringent as any standard proposed in any of the pending pension reform bills that have attracted serious consideration.

It is simply absurd, therefore, to rely solely on funding as the solution to the problem or to dismiss the need for plan termination insurance as unnecessary because relatively few plans terminate. It is equally true that relatively few airliners are hijacked and relatively few banks fail.

The attitude of President Nixon towards termination insurance is scarcely more reassuring. By inviting the private sector to "devise protection" against the problem, the President has turned his back on the central issue troubling workers—loss of pension benefits. A moment's reflection, however, should persuade anyone of the dangers of a voluntary solution. Without the assurance of required participation by well-established, profitable employers—a number of whom have expressed no interest in, or outright hostility to, the concept—there is simply no chance for the less profitable, more vulnerable ones to develop a viable program that will not also further weaken them competitively.

Pension reinsurance is not a device to harass or interfere with the conduct of business, but it is a means of protecting benefits, with virtually no direct cost to the federal government, and with significant savings in Old Age Assistance and other welfare costs.

The principle of federal reinsurance has been well established and has proved effective in the matter of bank and savings deposits for almost 40 years. It has long been applied in the housing and mortgage fields. In 1971 it was again applied when the Congress passed the Security Investor Protection Act, creating a federal insurance corporation to guarantee stock market investors against losses stemming from financial difficulties to brokerage houses.

Without attempting a technical analysis of reinsurance, let me mention four principles we see as particularly important.

1. Reinsurance coverage of pension plans should be mandatory and effective promptly after enactment of legislation.

Mandatory and basically universal coverage of all pension plans is necessary to achieve the broadest possible sharing of risks and to minimize required premiums. Once termination insurance has been enacted, workers have every right to expect that their plans will be brought under its protection as soon as administratively feasible.

2. As a minimum goal, plan participants and beneficiaries should be protected against loss of pension benefits to which they have vested rights under the terms of a particular plan, including benefits based on service before as well as after enactment of legislation.

* *Congressional Record*; March 13, 1973; p. S4425.

The definition of the benefits to be guaranteed under the program, in the event of a plan termination with insufficient assets to secure them, is of critical importance. We believe a reasonable starting point is to focus protection on benefits of the type normally paid as life incomes to eligible employees or former employees and surviving beneficiaries. The benefits would include those for which they are eligible either immediately or on a deferred basis on meeting plan requirements for vesting.

3. Premiums should be assessed against all plans at uniform rates based on the unfunded vested liabilities of each plan.

We believe, on the basis of the conclusions of informed observers, as well as an independent review by UAW actuaries, that a maximum basic annual premium of .2% of unfunded vested liabilities for the first three years of operation of the program is a reasonable and appropriate starting point. The experience of Sweden, which has had reinsurance since 1962 and found a premium of .2% more than adequate, supports this view. In connection with any initially adopted premium, it is necessary to allow leeway for later revision in the light of experience. We would also regard favorably charging an additional premium not to exceed .2% with respect to vested unfunded liabilities incurred prior to enactment of legislation, for plans whose previous funding may have been inadequate.

4. To the broadest extent possible, insured benefit guarantees should cover all types of plan terminations, including partial discontinuances, subject to reasonable safeguards to prevent abuse and "unloading" of liabilities.

Perhaps the most frequent argument advanced by opponents of pension termination insurance is the one concerning potential abuses of the program. Fortunately, safeguarding features to provide effective deterrents against possible abuse are available.

One would be a three year waiting period, under which unfunded benefit liabilities of new plans, as well as additional unfunded liabilities resulting from plan amendments, would not be covered in the event of plan termination within three years after the liabilities were established.

The second would be a feature requiring a demonstrably solvent company (or its successor) terminating a pension plan to reimburse the reinsurance program for some portion up to 100% of the unfunded benefits which the program has paid off or guaranteed. We believe the concept underlying this feature not only protects the integrity of the termination insurance fund, but makes practicable the full implementation of insurance guarantees in virtually all plan terminations.

A further commendable aspect of the principle of employer co-liability is the salutary effect it may have in injecting a greater measure of social responsibility into some of the acquisition-and-discard transactions of conglomerate corporations.

VESTING AND FUNDING

While the concept of pension reform has enjoyed broad support in Congress, including members of this Committee, it is somewhat unfortunate that after so many years of effort there remain so many competing approaches to the issues of vesting and funding. If there is to be a serious effort to enact legislation in this session of Congress, therefore, I respectfully suggest to you that the time is at hand to begin efforts to harmonize conflicting views among the sponsors of proposed legislation.

A. Minimum Vesting Standards

Establishment of minimum vesting standards for all private plans to which workers look for retirement security is long overdue. It makes neither economic nor social sense to impose a penalty of loss of substantial earned pension rights on a worker who, after a significant period of service, is separated either voluntarily or involuntarily, from his job before retirement age.

We believe vesting standards should:

(1) require full vesting after 10 years of employment;

(2) require recognition of all service with an employer or covered group, including service prior to the enactment of legislation; and

(3) limit mandatory coverage to lifetime benefits of the kind generally provided at a plan's normal retirement age.

Such standards are workable, entirely reasonable and would not—particularly in view of the apparent willingness to allow the administering agency to grant so-called "variances"—lead to excessive increases in costs. If these standards are impossible to achieve in the initial legislation, however, we are convinced of the availability of practical and effective alternatives that offer a reasonable start towards meeting the most urgent needs. One alternative the UAW has endorsed includes the following elements:

(*a*) recognition of pre-legislation and post-legislation service with an employer; and

(*b*) a vesting formula permitting either:

(i) graded vesting starting with 30% after 8 years and increasing by 10% increments for additional service up to 15 years; or

(ii) retention of an existing vesting schedule equal to, or better, in its overall effect, than the prescribed schedule.

The so-called "Rule of 50" proposed by the Administration is not, in our view, an acceptable alternative. It can only have a discouraging effect on the hiring of older workers, leave unprotected long periods of service by young workers and generate, to no very clear social purpose, large numbers of relatively insignificant pensions for older workers with short attachments to particular jobs. We also regard as unfortunate the fact that under the proposal only prospective service would be counted towards accruing a benefit.

B. Minimum Standards for Funding

A comprehensive approach to pension reform, including the essential element of plan termination insurance, must likewise include consideration of appropriate minimum standards to be followed in funding pension benefits.

The standard we support—requiring that plan contributions be sufficient to meet current service costs and to amortize unfunded past service costs over periods not in excess of 30 years—is a reasonable and practicable objective. For a great many plans, including most of those covered by UAW negotiated agreements, that standard would require little, if any, change in present practices. When changes are required, the time allowed for such changes, coupled with the "variance" provisions, should make compliance feasible.

It is worth noting that statutory funding standards, without plan termination insurance, already in effect in Canada for some years, are actually more stringent. In spite of that, I can tell you that Canadian UAW members have also suffered losses of earned pension benefits resulting from plan terminations. Our Canadian experience also convinces us that fears sometimes expressed that any legislated funding standards will stifle the development and flexibility of private pensions are groundless.

FIDUCIARY STANDARDS AND DISCLOSURE REQUIREMENTS

The UAW has long supported the enactment of federal standards of fiduciary conduct in the handling of employee benefit funds. We also support measures to assure more intelligible disclosure of descriptive and financial information to covered workers and other interested persons. The required measures are long overdue and should be effective, workable and scarcely controversial.

PENSION PORTABILITY PROGRAM

The concept of portable pensions has considerable appeal. So much so, that we sometimes fail to recognize that legislated minimum vesting standards and voluntary liberalization of vesting beyond minimum requirements, along with reinsurance of the risk of plan termination, are the most effective means of achieving practical and widespread pension portability.

It is conceivable that a legislated portability arrangement would be workable in retirement plans in the nature of profit sharing, money purchase or similar plans providing benefits based on individual accounts or individually purchased annuities. We have doubts, however, about its suitability in the more prevalent types of plans which operate with pooled funds of unallocated assets not assignable to individual participants.

ALTERNATE PENSION REFORM PROPOSALS

A. S. 1179

I wish to compliment Senator Bentsen for the careful thought and evident concern that went into the preparation of S. 1179. My earlier remarks suggest that the UAW would have no difficulty in supporting much of its basic thrust, but we also have several serious reservations.

1. It is unthinkable that anyone associated with the American labor movement would begrudge the extension of private pension coverage to those millions in the work force now without such protection. I have nothing but the gravest doubts, however, about the wisdom of attempting to solve that problem by according preferential tax treatment to individual contributions to approved retirement savings programs or pension plans. For those without coverage, the problem is not lack of incentive, but lack of resources. The tax incentive approach, moreover, carries with it the possibility of creating additional tax advantages for those Americans who are already the major beneficiaries of tax loopholes without offering the least assurance that those in whose name the proposal is justified can benefit from it in any significant numbers. We do not need additional advantages through tax shelter for higher income persons, when closing tax loopholes and enacting genuine tax and pension reform should be a high order of federal business.

2. There is much to be said in favor of beginning to require vesting at the end of 5 years. If the portion of the accrued benefit vested is no more than 25%, however, we have some question about the value of giving vested status to 1¼ years of service while withholding 100% vesting until completion of 20 years of service.

3. The Treasury Department, for all its expertise in administering the pension provisions of the Internal Revenue Code, has never demonstrated to us the necessary sensitivity to workers' interests in pension plans. Over the years it has been clear that the primary Treasury focus was to make certain that tax-favored funds are not used as a device to escape taxation. We have no confidence in the efficacy of enforcing pension reform standards through the mechanism of the tax qualification status of pension plans. Experience suggests that route is not promising for protecting workers' pension rights.

B. S. 4

Among the competing versions of proposed pension reform, on behalf of the UAW, I wish to express a decided preference for S. 4. We base this preference on a conviction that S. 4 is not only the product of a most diligent and painstaking study of the problem over a period of several years, but also represents a careful, comprehensive response to the major issues identified. While S. 4 may not be perfect, we feel it is superior to any of the alternatives offered for the following reasons:

1. It deals in significant and appropriate fashion with all of the essential elements of pension reform including plan termination insurance, vesting, funding, disclosure and fiduciary responsibility.

2. It would place major responsibility for protecting the rights of workers where it belongs in the Department of Labor which is historically oriented to that mission and which exists to carry it out.

3. It makes an effort to hold accountable a solvent employer now free to terminate a pension plan while there are unfunded liabilities with scarcely a thought to the havoc created among his workers dependent on that plan.

4. It includes a reasonable vesting schedule and offers greater flexibility to accommodate the many varied approaches to vesting in existing private plans.

I urge you, therefore, to join your Senate colleagues of the Committee on Labor and Public Welfare in support of S, 4 so that we may have an early and affirmative vote on it by the entire Senate. It would be tragic indeed if responsibility for failure to enact significant pension reform were attributed to two Senate committees becoming locked in a jurisdictional battle over proposed legislation. I implore you not to permit that to happen.

CONCLUSION

Let me conclude by saying that the present session of this Congress has a unique opportunity to adopt comprehensive, logical and constructive legislation to improve the effectiveness of the private pension system, make it more equitable in its distribution of benefits, assure that pension funds are managed in the interests of covered workers, and more fairly allocate the cost of plan terminations.

We believe that the principles on which pension reform must be based are well identified and have been presented before committees of the Congress for the past several years. They are more adequately reflected in the Williams-Javits Bill (S. 4) than any other measure now before the US Senate. I hope and urge this Committee and its individual members will help bring about its passage early in this session.

Senator NELSON. Our next witness is Mr. Robert Thompson, a member of the board of directors, Chamber of Commerce of the United States, and senior partner in the law firm of Thompson, Ogletree, Deakins and Vogt of Atlanta, Ga., accompanied by Mr. Andrew Melgard, staff executive of the chamber's private pension and social security committee.

The committee welcomes you here this morning, gentlemen. You have a prepared text. It will be printed in full in the record. If you would summarize the main points, we would appreciate it.

STATEMENT OF ROBERT T. THOMPSON, MEMBER, BOARD OF DIRECTORS, CHAMBER OF COMMERCE OF THE UNITED STATES, AND SENIOR PARTNER IN THE LAW FIRM OF THOMPSON, OGLETREE, DEAKINS & VOGT, OF ATLANTA, GA., ACCOMPANIED BY ANDREW A. MELGARD, STAFF EXECUTIVE OF THE CHAMBER'S PRIVATE PENSION-SOCIAL SECURITY COMMITTEE

Mr. THOMPSON. Thank you, Mr. Chairman, and gentlemen.

The chamber appreciates this opportunity to appear before you today to discuss these vital private pension issues.

I am Robert T. Thompson, a senior partner in the law firm of Thompson, Ogletree, Deakins and Vogt of Atlanta, Ga., and a member of the board of directors of the Chamber of Commerce of the United States.

My associate is Andrew A. Melgard, the committee executive of the chamber's private pension-social security committee.

We appreciate the opportunity to have our entire statement included in the printed record of the hearings, and I will make a summary of the main points which are covered by that statement.

The chamber believes that maximum encouragement should be given to the continued growth of private pension plans. Governmental restrictions which would hamper such growth should be avoided. Private pensions are good for employees, employers, and our economy. Therefore, the business community wants to see private pension plans improved and their benefits spread to more employers and employees.

Huge social and economic dividends are flowing from private pension plans. They are now making a significant and major contribution not only to retirement security but to the capital market.

Current estimates are that private pension plans are paying probably $10 billion a year to some 6 million retirees. Private pension assets exceed $160 billion. Employer costs exceed $15 billion a year and are growing. This growth has occurred voluntarily, not by compulsion. We believe that any action that would curtail this growth would be highly undesirable.

The long-term trend, over the last five business cycles, has been downward for after-tax profits as a percent of corporate wages and salaries, and upward for supplements—employee benefits—as a percent of such wages and salaries. From 1946 to 1972, corporate wages and salaries increased 460 percent, supplements to corporate wages and salaries such as pensions increased about 1,600 percent but corporate profits after taxes increased only 212 percent. During that period, supplements to corporate wages and salaries increased from about 20 percent of corporate after-tax profits to 115 to 120 percent of such profits.

During the 10-year period from 1961 to 1971, average weekly earnings increased 64 percent, but the cost of employee benefits rose 103 percent. This trend will continue.

Therefore, employers are vitally concerned with any legislation that would increase employer costs for private pension plans. Employers are equally concerned about the effects that new private pension controls will have on employee choice and free collective bargaining for private pensions, as well as the freedom and discretion management has to design such plans.

While there have been statements recently suggesting that there is little Government regulation in the private pension area, the record indicates otherwise. Some 11 Federal departments and agencies exercise some jurisdiction. The present rules and regulations are found principally in the Internal Revenue Code, and under the Federal Welfare and Pension Plans Disclosure Act.

The time has come, however, for Congress to enact additional constructive private pension legislation in those areas where there already exists substantial agreement among all interested parties. Such Federal legislative action should preempt State action to avoid the dangers and confusion of a piecemeal approach in 50 different jurisdictions.

This raises two questions.

First, what additional legislation is needed to promote private pension growth and to protect the interests of employees and their beneficiaries in private pension and related employee benefit plans?

Second. which agency or agencies of the Federal Government are best suited to administer such new laws?

The chamber thinks that two private pension bills should be enacted by the 93d Congress.

First, the tax-writing committees of Congress should amend the Internal Revenue Code to provide reasonable minimum Federal standards or regulation governing the vesting of private pensions. to encourage individuals to save for retirement, and to increase the present tax deferral available to the self-employed who have or establish pension plans for themselves and thier employees. This new law should be administered and enforced by the Treasury Department's Internal Revenue Service. We favor the approach used in S. 1631 by Senator Curtis and in S. 1179 by Senator Bentsen. We do not favor the S. 4 aproach.

Second, the labor committees in Congress should amend the Welfare and Pension Plan Disclosure Act and include in it a Federal Fiduciary Responsibility Act. The act, as amended, should continue to be administered and enforced by the Department of Labor.

The chamber supports the enactment of such legislation.

At the same time, the chamber opposes new and additional funding standards for private pensions, and proposals for reinsurance and portability.

Because of their impact on private pension plans. the committee in the course of its study may wish to consider related problems such as public employee pensions, social security costs and benefits, and inflation.

Finally, any new pension legislation, rather than imposing restrictive regulation, should encourage private pension growth so that our citizens will have adequate retirement income.

Gentlemen, the subject before you is most complex and involves numerous significant issues. The time has come to separate private pension reform rhetoric from private pension facts. We consider ourselves fortunate at the chamber in having available from the business community many pension experts from management, from the corporate trust and insurance areas, from the legal, employee relations, actuarial, and accounting professions to assist us with these difficult issues.

As your studies and deliberations on private pensions continue, we look forward to working with the members and staff of this committee in any way we may be helpful to you. And, we will be happy to help assemble our experts to assist you if you so desire.

Thank you.

Senator NELSON. Thank you very much, Mr. Thompson.

The Chamber opposes termination insurance, yet you recognize, of course, that there are going to be involuntary terminations with insufficient funds to pay accrued vested liabilities. If you oppose termination insurance, do you have any suggestions on how to take care of the problems arising from involuntary termination with insufficient funds?

Mr. THOMPSON. Mr. Chairman, we have spelled out in more detail in our statement the reasons that we feel that reinsurance or termination insurance at the government level is impractical. It is not that we are unmindful of the problems by any means. It certainly shouldn't be taken as an indication that we are unsympathetic to the problems that accrue when plants close down or companies go out of business.

As we understand the facts, the size of the problem and the perspective to the overall pension program, it is a relatively minor problem in the sense that you have less than one-tenth of one percent of the people covered by pensions who actually are affected by this type of problem. That doesn't mean for those people it is not a problem by any means, but we feel to crank up what would appear to us to be a huge government program to cover this small a problem would be a mistake. We think it would cost far more money to just administer such a program than it would to cover the losses that might come up.

Our feeling is that this is a problem that should be solved by industry. It should be solved ~~in~~ the private sector if at all possible. We think that a government program in the field not only would be impractical but is unneeded. We think the problem should be attacked at the bargaining table where you have collective bargaining. It should be attacked where there are no unions by the businesses themselves. We think the insurance industry could be a great help with a little ingenuity in coming up with solutions to this type of problem.

We recognize the problem. We simply hope that the solution doesn't come from another government bureaucracy. We would like to see the problem solved privately.

Senator NELSON. Thank you, Mr. Thompson. We appreciate your taking time to come here.

Mr. THOMPSON. Thank you, sir.

[The prepared statement of Mr. Thompson follows:]

PREPARED STATEMENT OF ROBERT T. THOMPSON, MEMBER, BOARD OF DIRECTORS, U.S. CHAMBER OF COMMERCE

I am Robert T. Thompson, a senior partner in the law firm of Thompson, Ogletree, Deakins and Vogt of Atlanta, Georgia. I am a member of the Board of Directors of the Chamber of Commerce of the United States.

My associate is Andrew A. Melgard, the Committee Executive of the Chamber's Private Pension - Social Security Committee.

Mr. Chairman, the National Chamber appreciates this opportunity to present its views on the broad range of issues involving private pension plans.

We are speaking today on behalf of the Chamber of Commerce of the United States, representing more than 46,000 business enterprises and 3,600 trade and professional associations, local and state chambers of commerce. The underlying membership is more than five million individuals and firms.

The time has come for Congress to enact constructive private pension legislation in those areas where there already exists substantial agreement among all interested parties. Such federal legislative action would alleviate uncertainty in state legislatures in areas such as disclosure, fiduciary responsibility and vesting, and avoid the dangers and confusion of a piecemeal approach in over fifty different jurisdictions.

Two bills should be passed by this 93rd Congress.

First, the labor committees of Congress, the Senate Labor and Public Welfare Committee and the House Education and Labor Committee, should report a bill to amend the Welfare and Pension Plan Disclosure Act. This bill should contain a federal fiduciary responsibility act and other provisions to strengthen and improve the protection of participants in, and beneficiaries of, employee welfare and pension plans.

Second, the tax writing committees of Congress, the Senate Committee on Finance and the House Ways and Means Committee, should amend the Internal Revenue Code to provide reasonable minimum federal standards or regulation governing the vesting of private pensions, to encourage individuals to save for retirement, and to increase the present tax deferral available to the self-employed who have or establish pension plans for themselves and their employees.

We support the enactment of such`legislation.

BASIC POSITION ON PRIVATE PENSION PLANS

The National Chamber takes a positive, clear-cut approach on private pension plans -- one which calls for maximum encouragement of continued growth and expansion of private pension plans. At the same time, the Chamber believes that every effort should be made to prevent needless governmental restrictions on private pension growth. In short, the business community wants to see private pension plans improved and their benefits spread to more employers and employees.

Employers and employees should remain free to work out pension plan arrangements best suited to their own needs and requirements. To accomplish these ends, basic principles applicable to the establishment and administration of private pension plans include:

1. A clear explanation to employees of the pension plan provisions, employee rights thereunder, and the extent of employer obligations and responsibilities.
2. The highest standards of fiduciary responsibility and effective and meaningful disclosure.
3. Provisions for vesting that will afford to a plan participant, who meets specified age and/or length of service conditions, a right to an accrued pension benefit based on his service to date of termination of employment, payable when he reaches the plan's normal retirement age.
4. A program of funding which can reasonably be expected to provide for the plan benefits.

In addition, as a matter of public policy, all individuals should be encouraged during their working lives to build private retirement income out of earnings either on an individual or group basis.

The growth of private pension plans is one of America's most recent success stories. Huge social and economic dividends are beginning to flow from these plans. Retirees are enjoying more economic freedom and independence as private retirement income increases.

In addition, our economy has benefited from the over $160 billion in assets that are held in trust for present and future retirees. Continuing additions to these funds help provide this Nation with the new capital that is vital for economic growth and high employment.

Overall, the business community has an obvious and continuing interest in all legislative proposals that would affect private pension plans and their growth. Furthermore, we are vitally concerned with any proposal that would mandate, through new Federal legislation, any burdensome and unnecessary increase in private pension costs.

TRENDS IN CORPORATE WAGES AND SALARIES, SUPPLEMENTS, AND AFTER TAX PROFITS

We are concerned about the economic impact of increasing costs of doing business and shrinking profits. Before looking at the growth of private pension and related employee benefits, we think it would be helpful to briefly review what has happened in the last quarter of a century to corporate wages and salaries, supplements, and after tax profits.

From 1946 to 1972 corporate wages and salaries increased from $66.5 billion to $372.3 billion, or 460%.

Supplements to corporate wages and salaries increased during the same period from $3.2 billion to $54.4 billion, or about 1,600%. (Supplements to corporate wages and salaries include employer contributions to private pension and welfare funds and employer contributions for social insurance such as old age, survivors and disability insurance, hospital insurance, state unemployment insurance, federal unemployment tax, railroad retirement insurance, railroad unemployment insurance, and cash sickness compensation funds. It is estimated that these supplements include about 60% of the costs of what are commonly considered employee benefits. The remaining 40% include items like paid vacations, paid holidays, paid sick leave and paid rest periods. The employer costs for these benefits paid for time not worked are included in the corporate wages and salaries figures.)

During this same period of time, corporate profits after taxes increased from $15.1 billion to $47.1 billion, or about 212%. (See Table I)

These figures show that corporate profits after taxes as a percent of wages and salaries have declined from about 25% in the 1946-50 period to about 12% in the 1970-72 period. (See Chart A)

At the same time, supplements as a percent of wages and salaries have increased steadily from 4.8% in 1946 to 14.6% in 1972.

By 1970 corporate supplements to wages and salaries were exceeding corporate profits after taxes. For 1972 employers' costs for supplements were $54.4 billion, some $7.3 billion more than corporate profits after taxes.

Chart B shows that from 1946 to 1972 supplements to corporate wages and salaries increased from about 20% of corporate profits after taxes to about 115 to 120% of such profits.

In summary, the long term trend, over the last five business cycles, has been downward for after tax profits as a percent of corporate wages and salaries, and upward for supplements as a percent of such wages and salaries.

These figures dramatically show why our membership is so vitally concerned with legislation that will increase employer costs for private pension plans. These statistics raise the question of the source of financing for any such increased costs, and the consequences to the business community, specific industries, and individual firms when increased pension costs are mandated by Congress.

EMPLOYEE BENEFIT COSTS

Private pension plans are but one part of the so-called "fringe benefit package". How employers' costs for employee benefits have increased over a recent ten year period is shown in Table II, which is based on the Chamber's study,

TABLE I

Trends in Corporate Wages and Salaries, Supplements, and After Tax Profits, 1946-1972

(Billions of Dollars)

	Corporate Wages and Salaries	Supplements to Corporate Wages and Salaries	Corporate After Tax Profits	Supplements as Per Cent of Wages and Salaries	After Tax Profits as Per Cent of Wages and Salaries	Supplements as Per Cent of After Tax Profits
1946	66.5	3.2	15.1	4.8%	22.7%	21%
1947	78.1	3.9	19.5	5.0	25.0	20
1948	86.9	4.2	21.8	4.8	25.1	19
1949	84.4	4.4	17.7	5.2	21.0	25
1950	92.9	5.7	23.9	6.1	25.7	24
1951	107.4	7.1	20.4	6.6	19.0	35
1952	115.4	7.6	18.5	6.6	16.0	41
1953	125.7	8.2	19.2	6.5	15.3	43
1954	123.4	8.7	19.1	7.1	15.5	46
1955	134.7	9.9	25.4	7.3	18.9	39
1956	146.8	11.3	25.3	7.7	17.2	45
1957	153.8	12.6	24.1	8.2	15.7	52
1958	151.1	12.8	20.6	8.5	13.6	62
1959	164.5	15.1	26.7	9.2	16.2	57
1960	172.1	16.7	24.8	9.7	14.4	67
1961	174.3	17.5	24.9	10.0	14.3	70
1962	186.1	19.8	28.7	10.6	15.4	69
1963	194.9	21.4	30.5	11.0	15.6	70
1964	208.7	22.9	35.3	11.0	16.9	65
1965	224.5	25.2	43.2	11.2	19.2	58
1966	246.1	29.5	46.7	12.0	19.0	63
1967	260.6	31.2	43.0	12.0	16.5	73
1968	284.3	35.2	43.8	12.4	15.4	80
1969	311.7	39.7	40.4	12.7	13.0	98
1970	325.5	43.2	35.4	13.3	10.9	122
1971	340.2	48.6	40.1	14.3	11.8	121
1972	372.3	54.4	47.1	14.6	12.7	115

Source: Survey of Current Business, U.S. Department of Commerce. Percentages computed by Chamber of Commerce of the United States.

Note: Supplements to corporate wages and salaries include employer contributions to private pension and welfare funds and employer contributions for social insurance, such as old age, survivors and disability insurance, hospital insurance, state unemployment insurance, federal unemployment tax, railroad retirement insurance, railroad unemployment insurance, and cash sickness compensation funds. It is estimated that these supplements include about 60% of the costs of what are commonly considered employee benefits. The remaining 40% include items like paid vacation, paid holidays, paid sick leave, and paid rest periods. The employer costs for these benefits paid for time not worked are included in corporate wages and salaries figures.

Chart A

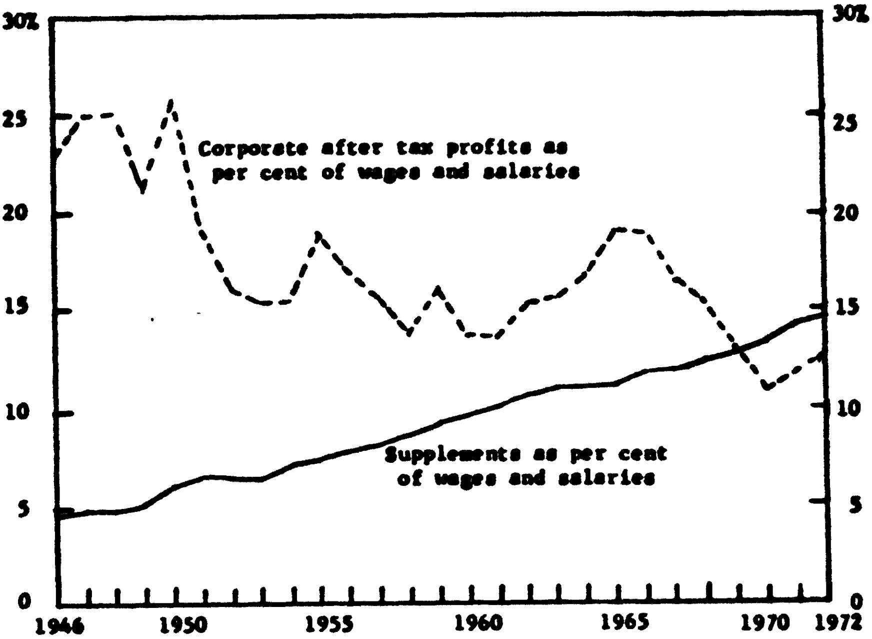
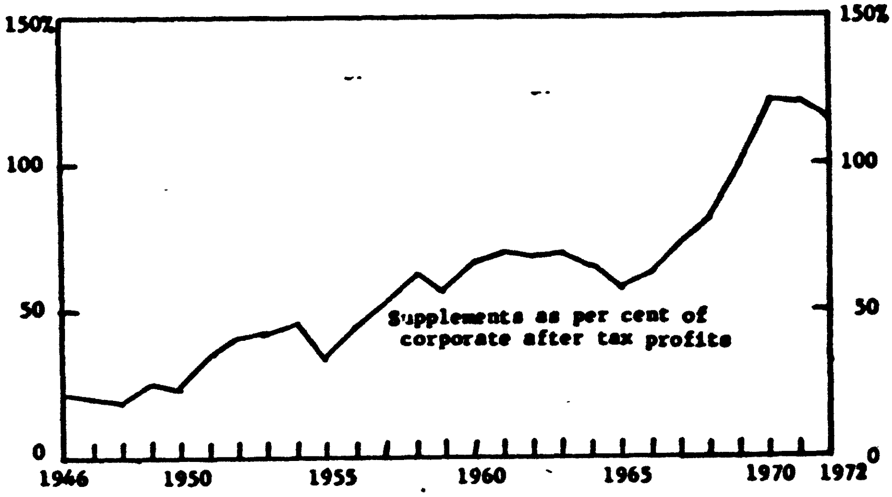


Chart B



Employee Benefits 1971. This thirteenth biennial study of employee benefits was based on information reported by 885 employers.

There is a clear trend for the cost of increased benefits to rise almost twice as fast as the cost of increased wages and salaries. During the 10-year period from 1961 to 1971, average weekly earnings increased 64%, but the cost of employee benefits rose 103%.

In the retirement area, employers costs for Social Security rose 177%. At the same time, private pension costs rose 90% and profit-sharing costs rose 114%.

In 1971, the maximum Social Security tax was $405.60 per employee. It rose to $468 in 1972, to $631.80 in 1973, and will rise further to $702 in 1974. (Employees, of course, make matching contributions.) Therefore, these trends in increased employee benefit costs are expected to continue.

It should also be noted that the cost of employee benefits varies significantly as shown in Table III. While employee benefit costs averaged $48.92 per employee per week, these costs varied among various industries from $66.21 to $25.90.

In our free society, we have developed a pluralistic approach to providing economic security. Individuals, employers, unions and all levels of government share in the responsibility for the continuing success of this great, interdependent system. The above statistics help show the degree to which employers are increasingly providing economic security against hazards such as disability, unemployment, premature death and inadequate retirement income. With respect to private benefit programs, there is a continuing need for an employer to be assured both flexibility and discretion in designing or negotiating a "benefit package" that will best meet the needs and wishes of all his employees. The cost of any new or improved benefits especially those of a long range nature such as retirement income must be carefully considered.

Our membership, therefore, is vitally concerned with any legislation that would increase employer costs for private pension plans. We are equally concerned about the effects that new private pension controls will have on employee choice and free collective bargaining for private pensions, as well as the freedom of management to design such plans.

TABLE II

WEEKLY EXTRA BENEFIT COSTS, PER EMPLOYEE

	1971	1961	Per Cent Change
Private pensions (nongovernment) . .	$ 7.73	$ 4.06	+ 90
Paid vacations	7.69	4.06	+ 89
Old Age, Survivors, Disability and Health Insurance taxes	7.15	2.58	+177
Insurance (life, sickness, accident, hospitalization, etc.)	7.10	2.62	+171
Paid rest periods, lunch periods, wash-up time, etc.	5.38	2.52	+113
Paid holidays	4.69	2.42	+ 94
Profit-sharing payments	1.65	0.77	+114
Workmen's compensation	1.58	0.77	+105
Paid sick leave	1.56	0.67	+133
Unemployment compensation taxes .	1.15	1.46	− 21
Employee meals furnished free	0.25	0.15	+ 67
Discounts on goods and services purchased from company by employees	0.23	0.12	+ 92
Other employee benefits	2.76	1.92	+ 44
TOTAL EMPLOYEE BENEFITS	$ 48.92	$24.12	+103
AVERAGE WEEKLY EARNINGS . . .	$158.85	$96.85	+ 64

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TABLE III

WEEKLY EMPLOYEE BENEFITS COST BY INDUSTRY—1971

	Per Employee Per Week
ALL INDUSTRIES	$48.92
MANUFACTURERS:	
Petroleum industry	66.21
Chemicals and allied products	58.23
Transportation equipment	55.37
Primary metal industries	53,10
Food, beverages and tobacco	51.31
Machinery (excluding electrical)	48.19
Stone, clay and glass products	47.46
Instruments and miscellaneous products	46.71
Electrical machinery, equipment and supplies	46.67
Fabricated metal products (excluding machinery and transportation equipment)	45.14
Rubber, leather and plastic products	44.04
Printing and publishing	43.69
Pulp, paper, lumber and furniture	42.87
Textile products and apparel	28.87
NONMANUFACTURING:	
Public utilities	58.42
Banks, finance and trust companies	52.08
Insurance companies	48.33
Miscellaneous industries (mining, transportation, research, warehousing, etc.)	45.83
Wholesale and retail (not department stores)	35.44
Department stores	25.90

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PRIVATE PENSION GROWTH

A further fact of major importance is the growth of private pension plans. While pension plans were first adopted by industry as early as 1875, they began their major growth in the 1940's and 1950's. As the following tabulation indicates, they are now making a significant and major contribution not only to retirement security but to the capital market.

Private Pension Plans

Year	Coverage (millions)	Number of Pensioners ('000's)	Private Plan Assets (billions)	Benefits (millions)
1940	4.1	200	$ 2.4	$ 100
1950	9.8	450	12.0	370
1960	21.2	1,780	52.0	1,750
1971 (Est.)	over 35.0	5,250	151.8	8,600

These figures show the phenomenal growth in private pensions, and particularly the increase in the number of pensioners receiving benefits -- some five million retired employees receiving monthly checks totaling over $8 billion a year by 1971.

The Institute of Life Insurance reports that payments into private pension and retirement plans in 1971 amounted to $16.9 billion, of which employers contribute nearly 90%.

Current estimates are that private pensions have over $160 billion in assets and are probably paying some $10 billion a year to some six million retirees. The April 1973 Social Security Bulletin reported that average annual benefits per private pension beneficiary increased 70% from 1960 to 1971, from $1,020 to $1,730. Equal or greater growth is expected in this decade.

We believe the statistics on private pension growth show the concern of employers with helping to provide adequate retirement income and their willingness and ability up to now to assume the heavy and long-range financial burdens that are involved. This growth has occurred voluntarily, not by compulsion. Any action that would curtail this growth would be highly undesirable.

EXISTING REGULATION OF PRIVATE PENSION PLANS

While there have been statements recently suggesting that there is little government regulation in the private pension area, the record indicates otherwise. The present rules and regulations are found principally in the Internal Revenue Code and under the Federal Welfare and Pension Plan Disclosure Act.

The Internal Revenue Service provisions help assure that bona-fide, definite, and essentially non-discriminatory plans are established. These provisions require, for example, that in order for a plan to be qualified:

(a) there must be a trust, contract or other legally binding arrangement.
(b) there must be a permanent and continuing program.
(c) it must be for the exclusive benefit of employees.
(d) it must not discriminate in favor of officers or highly compensated employees.
(e) it must have definitely determinable benefits.
(f) all employer contributions must be irrevocably committed.

The Federal Disclosure Act, passed in 1958 and amended in 1962, was initially passed on the theory of self-enforcement through public disclosure of a plan's operation. The 1962 amendments to the Act gave the Secretary of Labor enforcement authority, required bonding of administrators and added criminal provisions against embezzlement, bribery, kick-backs, etc. There have been almost no indictments under the criminal provisions of the Act. The required Annual Report (D-2 Form) has been considerably broadened into a most comprehensive and detailed fifteen page document. There are, however, areas where some additional disclosure may be helpful as outlined later.

In addition to Internal Revenue Service Regulations and the Disclosure Act, pension funds are subject to certain provisions of the Securities Exchange Act of 1933, the Securities Exchange Act of 1934, the Labor Management Relations Act of 1947 and, in many cases, to state laws and regulations.

In 1971, the General Accounting Office furnished the Senate Subcommittee on Labor with a summary of the jurisdiction exercised by the federal government over private pension plans through eleven federal departments and agencies. The listing included the Department of Labor (acting under seven separate laws), the

Department of Justice, the Securities and Exchange Commission, the Equal Employment Opportunity Commission, the Department of Housing and Urban Development, the Department of Defense, the National Labor Relations Board, the Cost of Living Council, and, of course, the Department of Treasury and the Internal Revenue Service.

This raises the question of what additional legislation is needed to promote private pension growth and to protect the interest of employees and their beneficiaries in private pension and related employee benefit plans. It also raises the question of which agency or agencies of the Federal Government are best suited to administer such new laws.

AMENDMENTS TO THE WELFARE AND PENSION PLANS DISCLOSURE ACT
(S.1557, S.4, H.R.2 and related bills)

The Chamber seeks the highest standards of honesty in the administration of employee benefit plans. Also, we believe that employees need to better understand the values of private pension and other employee benefits. We, therefore, support suitable amendments to the Disclosure Act.

Specifically, we:

1. support the concept that administrators of pension funds should observe the highest standards of fiduciary responsibility, and favor the concept of a federal fiduciary responsibility act for pension plan administrators and trustees.
2. support an amendment which would bar persons convicted of certain crimes from serving as a fiduciary or consultant to a welfare or pension fund.
3. support an amendment requiring annual audits of funds, with appropriate exceptions for those plans already subject to adequate audits by various federal or state insurance or banking regulatory agencies. Actuarial certifications would be of value.
4. support the principle of applying a "prudent man rule" as the standard for the investment of employee benefit funds, and oppose any attempt to limit its effectiveness or flexibility.

5. support adequate investigatory powers for the Secretary of Labor where he has reasonable cause to believe a violation of the Act has occurred or is about to occur, but oppose giving the Secretary of Labor added powers to regulate or interfere in the management of plans in the absence of a proven need for such additional powers.
6. support certain improved meaningful disclosure amendments, but oppose additional unnecessary disclosure requirements.

These amendments of the Disclosure Act should have a first priority of attention in Congress. We testified in support of such legislation before the House General Subcommittee on Labor in both the 90th and 91st Congress, and before the Senate Subcommittee on Labor in the 92nd and 93rd Congress. This legislation presents a number of difficult matters of a highly technical nature. However, the fact is that for a number of years all interested parties -- the business community, organized labor, banks, insurance companies, actuaries, CPA's and others -- have supported such legislation. As a matter clearly in the public interest, we see no reason for any further delay in having this type of legislation reported by the labor committees. We are certain that Congress will first want to assure that pension plan participants and their beneficiaries are protected against dishonesty and abuse.

Furthermore, we see no reason why an amended Disclosure Act should not continue to be administered by the Labor Department, although the Comptroller General of the United States did in March 1967 issue a report to the Congress critical of the Department of Labor's administration of the reporting and bonding requirements of the 1959 Welfare and Pension Plans Disclosure Act. The Comptroller General called for improved administration and enforcement of the provisions of that law.

We believe that since then there has been some improvement in the administration of this law. Certainly, if the Department of Labor is entrusted with a vastly expanded Disclosure Act that includes a federal fiduciary responsibility act, the Congress and all other interested parties will wish to be assured of a faithful administration of such law.

APPROPRIATE AGENCY FOR ADMINISTRATION OF NEW LAWS

Except for amendments to the Disclosure Act, additional private pension legislation should be tax legislation. The tax system is the appropriate mechanism for new standards or controls in areas such as encouragement for individuals to save for retirement, increased tax deferral for the self-employed and their employees, vesting and funding. We support the approach used in the Administration bill (S. 1631) and Senator Bentsen's bill (S. 1179), but oppose the approach used in Senator Williams' bill (S. 4). In other words, the Treasury Department and the Internal Revenue Service are the appropriate agency for administration and not a new bureau in the Labor Department.

The reasons why the Internal Revenue Service should be charged with the administration of new, additional requirements include the following:

1. The legislative history of laws and regulations affecting private pension, profit-sharing, stock bonus and annuity plans clearly shows that the Internal Revenue Service has been the agency administering these complex laws.
2. The growth of private pension plans and the benefits being received by retirees is a tribute to the wisdom with which the tax-writing committees have formulated sound statutes on such retirement income and entrusted their enforcement to the Internal Revenue Service.
3. There is no appropriate and concrete way to encourage individuals to save for retirement or increase the tax deferral for self-employed pension plans except through amendment of the Internal Revenue Code with appropriate administration by the Internal Revenue Service.
4. The tax law is largely self-enforcing. For all practical purposes, an employer cannot afford a pension plan unless the contributions to such a plan are tax-deductible on a year-to-year basis throughout the duration of the plan. In simple terms this requires qualification or approval by the Internal Revenue Service. Plans cannot qualify for the special benefits in Sections 401 through 404 and the tax

exemption in Section 501(a) of the Code unless current tax rules are met. The danger of loss of qualification for pension plans has guaranteed outstanding compliance with the complicated statutes and regulations for over thirty years.

5. Over these last thirty years, the Internal Revenue Service has developed vast expertise and an outstanding capacity to analyze and fairly enforce the complex laws, involving complicated actuarial issues, relating to the vesting and funding of pension plans. It is essential that this unmatched and invaluable expertise be used in the administration of any new rules in areas such as vesting.
6. Currently, the tax laws provide the only rules for vesting and funding. Any additional requirements should simply be added to the tax code with a continuity of administration and enforcement by the Internal Revenue Service. It would be costly, inefficient and potentially dangerous to the welfare of covered employees and their beneficiaries to create a new and inexperienced bureaucracy in the Labor Department with joint and conflicting authority in areas such as vesting or funding. Such a move would disserve the public interest in the growth of private pensions, the need for reasonable new legislation, and the goal of efficient government.

AMENDMENTS TO THE INTERNAL REVENUE CODE
(S.1179, S.1631, S.4, H.R.2 and related bills)

Promoting Private Pension Growth and Expanding Coverage

To a large extent, the number of retiring persons who will receive pensions is in direct proportion to the number of private pension plans that are in existence and the number of employees covered by those plans. In other words, continued growth in the number of pension plans and the number of employees covered under them will lead to more retirees receiving monthly private pension checks. Between 1940 and 1971, private pension plan coverage grew from 4.1 million employees to over 35 million, or from 9% to 50% of the private labor force, excluding agricultural employees.

There are some estimates that perhaps as much as 70% of the private work force is covered if certain exclusions are made. For example, the 50% coverage figure could be corrected for part-time workers where a work related pension is hard to plan, or young workers still seeking their occupational niche. But even then, at least 30% of all private employees still are not covered under voluntary private pension plans.

In promoting private pension growth and expanding coverage of employees, it is difficult to determine just which employees are not covered by private pension plans. Early in the 1960's the Chamber determined that the two primary areas where further pension growth was needed was among small corporate employers and the self-employed and their employees. We have no exact figures but we believe that between 18 and 20 million working Americans are self-employed or are the employees of the self-employed.

Many of the employees not covered by private pensions can be found among several million small firms. In some cases, of course, many of these firms have been recently established and have not had an opportunity to succeed to the point where they can assume the cost burdens of a pension or profit-sharing plan. In addition, many other small firms may be marginal businesses.

If the percentage rate of coverage for private pensions is to be increased, ways must be found to encourage pension growth among the employees of small, and in some cases marginal, businesses on either a group or individual basis, and among the self-employed and their employees.

This is exactly what some of the major provisions of S.1631 are designed to do.

Therefore, the Chamber does in general support proposals such as are contained in Sections 3 and 4 of S.1631, the "Retirement Benefits Tax Act", that would provide income tax deferral for employees who defer income for their retirement, and that would increase the present tax deferral available to the self-employed who have or establish pension plans.

Section 3. Deduction for Retirement Savings, S.1631

In general, we support the provisions of Section 3 of S.1631, the "Retirement Benefits Tax Act". It will encourage individual employees, not covered by employer plans, to establish retirement plans of their own choice and to save for their retirement. It will also help many employees covered by employer plans to increase their retirement income through individual savings.

Specifically, the National Chamber:

1. Favors the concept that there should be some mechanism in the tax laws to provide for tax deferral for individual contributions to employer-sponsored plans.
2. Favors the concept that there should be some tax deferral for employees who establish an individual retirement plan on a purely voluntary basis.
3. Supports a differential for those employees who do not pay Social Security taxes.
4. Supports reasonable disincentives to premature withdrawals of funds from such plans before retirement.
5. Supports the principle that the limitation of the amount of tax deductibility be expressed as some percentage of the Social Security wage base with respect to individual employees.

Section 219 (b) (2) of S.1631 uses a figure of 7% of an employee's earned income as an estimate of the amount of employer contributions to a pension plan. Our *1971 Employee Benefits* survey showed that average pension payments -- as a percent of payroll -- for companies having pensions was 4.9%. The 7% figure seems high. An alternative solution may be to allow all employees some tax deferral for the amount of their contribution to an employer plan, but allow a larger tax deferral to employees not covered by a plan.

Section 4. Contributions on Behalf of Self-Employed Individuals, S.1631

We support this legislative proposal that would increase the present tax deferral available to the self-employed who have or establish pension plans. Section 4 would increase the amount of tax deferral for self-employed pensions from the present $2500 or 10% of income to $7500 or 15% of income, whichever is less. We think this is a step in the right direction, that it will lead to more pensions for the self-employed and their employees, and that the increased deferral will mean larger pensions and more adequate retirement income for this large group of Americans. It seems obvious that the self-employed and their employees have as great a need for adequate retirement income as do corporate employees. As a matter of equity, we believe the self-employed should have this opportunity for increased tax deferral.

Mandatory Vesting

Vesting is a right given a plan participant who meets specified age and/or length of service conditions to receive, when he reaches normal retirement age, a proportionate pension benefit based upon his service to date of termination. That right is not dependent upon his continued employment.

We support sound programs of vesting. The majority of plans do have some form of early vesting, and vesting periods are becoming shorter.

During the past few years, various proposals have been made for a vesting standard for all qualified plans. There have been proposals for a "rule-of-50"; 10 or 15 year vesting; graded vesting of 10% a year from the sixth to fifteenth years of participation in a plan; 30% after 8 years and 10% a year thereafter; and 25% after 5 years and at least 5% each following year.

We support reasonable minimum federal standards or regulation governing the vesting of private pensions. If mandatory vesting is legislated it should embody certain criteria, as follows:

1. It should be accomplished through an amendment of the Internal Revenue Code, as a condition for qualifying a plan.
2. The reasonable minimum vesting standards should apply to all private pension plans, including multiemployer plans.
3. It should allow employers a reasonable time, including the duration of existing collective bargaining agreements, to comply with the Act from the date of its enactment.
4. Vesting provisions may vary from any standard prescribed by law provided they result in as liberal vesting as under the standard.

5. Federal law should preempt state laws.
6. Special laws should not be enacted that would give preferential treatment to selected groups on matters such as special early vesting and portability.

Statistics that are available now show that vesting provisions are included in the majority of plans. There continues to be a most favorable trend toward voluntary inclusion of vesting. A Department of Labor survey showed a 29% increase in the proportion of employees covered by vesting from 1962 to 1969. Seventy-six percent of all participating employees were in plans with vesting -- up six percent in about 18 months. Eighty-seven percent covered by single employer plans were eligible for vesting rights. There was a dramatic increase in employees covered by vesting in multi-employer plans, up from 23% in 1962-63 to 51% in 1969. Additionally, it is our understanding that most newly qualified pension plans contain vesting provisions.

A study by the Bureau of Labor Statistics, reported in the May 1971 edition of the Monthly Labor Review, showed that about 90% of some 20 million employees covered by pension plans in 1969 were in plans with early retirement and/or vesting provisions. This study also showed a lowering of age and service requirements during the 1960's. By 1969, 71% of the workers in multi-employer plans were in plans providing for early retirement compared with 29% in 1962.

A survey, made by A. S. Hansen, Inc., of 864 plans it services as consultant, reveals that of 881,000 employees under these plans, over 30% already have a vested benefit and over 35% more will qualify. Of the remaining 34% who will leave their present employer before vesting, 78% are under age 35 and 17% are between 35 and 45 years old. It can therefore be expected that a large percentage of these younger groups will qualify for a pension in subsequent employment.

The financial costs of meeting some mandatory vesting standard are not clear. Initially, the Treasury Department estimated increased costs to meet various proposed standards ranged from 5.0% to 18.0% of plan costs, or 0.3% to 0.9% of payroll costs. The Senate Labor Committee Study projected increases of 0.0% to 53% of plan costs, or 0.0% to 1.4% of payroll costs. The comprehensive study sponsored by the House General Subcommittee on Labor concluded that mandatory vesting would impose a wide variation of costs ranging from 0.0% to 1.0% of plan costs for those plans that already have liberal vesting to a high of 33% of plan costs for the plans costed out in the study.

The first step therefore is to determine more accurately the costs of a mandatory minimum vesting standard and its varying impact on different industries and specific companies. Only after the likely range of such costs is determined can reasonable minimum standards be adopted.

One paramount point to bear in mind is that the enactment of a vesting standard will mean, inevitably, some loss of freedom of choice and some restriction on free collective bargaining.

When an employer adopts early vesting, that decision is the result of thoughtful deliberate consideration of the merits and cost as compared with the cost and advantages of some other benefit, benefit improvement, or higher take home pay -- a decision made only after consideration is given to how it will affect all employees.

When more money is available for employee compensation, employees may prefer that such money be used to increase the pension benefit or provide a survivor or disability pension, and that the money not be used for earlier vesting. Or, they may prefer that the money be used for an improved health plan or longer vacations. Or, they may choose to have such money used for more take home pay.

When Congress mandates a vesting standard, employees, unions and employers will obviously lose to some degree the freedom of choice they now have to decide or negotiate what they want. This argues for restraint in legislating a reasonable minimum vesting standard.

Other Issues: Funding and Reinsurance

The Chamber opposes new and additional funding standards for private pensions and proposals for reinsurance such as are contained in S.4. Present information shows no overriding need for such legislation. Furthermore, to add new unknown costs for funding and reinsuring private pensions on top of the unknown and varying costs of a vesting standard would compound the danger of forcing some plans out of existence.

The Internal Revenue Service does require that the cost of current benefits be funded plus the interest on the unfunded past service cost, i.e., the cost of benefits for credited prior service of employees before the plan was established or when it is improved. Failure to meet these requirements is treated as a termination of the plan and the benefits must then vest in the participating employees. In addition, Accounting Principles Board Opinion No. 8, entitled "Accounting For the Cost of Pension Plans", requires the disclosure of pension plan liabilities on the corporate balance sheet and provides an appropriate time period for funding fully accrued liabilities.

In 1969, the Pension Research Council issued a funding study showing that "a very high degree of security" had been reached by the 4,000 private pension plans, covering nine million employees, that had been surveyed. Pension plans which had been accumulating funds for 15 years or more had assets sufficient to cover 94% of all accrued benefits, and 99% of vested accrued benefits.

A survey of employee pension funds by the State of Wisconsin for the period 1/1/71 to 5/1/72 showed an even more favorable picture of funding. For the 142 plans examined by the State, assets were sufficient to cover over 107% of vested benefit liabilities.

Under current IRS regulations, there are adequate requirements for current service funding. Restrictions on prior service funding are now unnecessary in view of existing practices in managing funds. Further restrictions imposed by law would only serve to create more obstacles to pension fund operations. All the evidence, such as indicated above, shows no need for any additional funding requirements. In fact even the present IRS regulations on the minimum period of funding may have had deleterious effects.

Reinsurance proposals contemplate an elaborate and potentially costly mechanism which would involve the most detailed regulation of every aspect of private pension plan operations. It would require:

1. uniform actuarial assumptions;
2. controlled benefit formulas;
3. standardized plan design;
4. standardized vesting; and

5. detailed restrictions on investments, with a consequent serious loss to the whole economy.

It is important to point out that this kind of program would try to insure non-existent assets. This is distinctly different from an FDIC-type arrangement which insures deposited funds or savings. It is questionable whether pension insurance for unfunded liabilities is workable. Certainly, it would require the most stringent and complex regulations imaginable.

Furthermore, a program of reinsurance to cover unfunded liabilities would in the long run result in inadequate funding. Sound plans would be financing unsound plans, and this would result in the loss of benefits to employees in sound plans.

The recent interim report by the Treasury and Labor Departments of plan terminations covering a 7-month period in 1972 shows that claimants losing benefits represent about four one-hundredths of one percent of all workers covered by pension plans. Any such losses, even if minimal, are regrettable. However, the best approach to this problem at this time is to take up the President's challenge to employers, unions and private insurance companies to devise "protection against the small termination loss problem".

As to portability, sound vesting in all private pension plans will effectively meet the needs in this area. In other words, adequate vesting makes the question of portability academic. Portability would increase administrative costs. Additionally, investment yields in current plans would be less because of necessary changes in investment practices. This would lead to smaller retirement benefits.

OTHER AREAS OF CONCERN

Public Pensions

In 1970 during hearings on "Investment Policies of Pension Funds" held by the Subcommittee on Fiscal Policy of the Joint Economic Committee, Chairman Martha W. Griffiths said, during a colloquy with New York State Comptroller Arthur Levitt:

> 'My personal opinion is since all of us are public employees that the day is going to come when the next revolution is going to be those who are going to oppose the payment for a favored group of public employees of such tremendous pensions that are so much greater than anything they will ever get themselves and that is true whether we are Congressmen or Comptrollers or Presidents or whatever. I feel that this is one of the great burdens that is being borne by American society."

Mrs. Griffiths also thinks the cost of public employee pensions is "one of the things that is destroying America's cities".

In 1972, Senator John A. Stennis, chairman of the Armed Services Committee, said of military retirement:

> "We cannot continue indefinitely retiring men in their middle and late forties at the prime of their experience and hope to have any retirement system within reasonable cost bounds."

On public employee pension problems in New York City, the New York Times editorialized:

> "City officials have done a poor job of safeguarding the taxpayers' interest in the pension field and the state's help is necessary to protect them against some of the consequences of their own folly."

On April 24, 1973, the New York Times again editorialized against the pyramiding of public employee pension benefits "beyond either equity or réason". The editorial stated, in part:

> "No rational argument can be advanced for requiring city and state taxpayers to foot the multibillion-dollar bill for pension programs that give civil service workers more income in retirement than they earn while working. Even if the ultimate costs of these overfat benefits do not push communities into bankruptcy -- as indeed they might -- so much tax revenue will have to go into sustaining them that vital public services will have to be cut and active workers laid off."

The retirement fund for federal civilian employees has unfunded liabilities estimated to be $65 to $85 billion. In April 1972, Senator Stennis estimated the unfunded liability for retired military pay at $129 billion. Disregarding current costs to maintain these two federal retirement funds, future taxpayers will have about $200 billion in unfunded liabilities to pay off -- that is about $1,000 for every American man, woman and child. No one seems to know what the figure is if you add unfunded liabilities of state and local public employee funds.

Veteran newsmen have been reporting that hefty pension increases are being given to public employees before the future costs of such gains are known to public officials and taxpayers.

Comments such as these from members of Congress and the media have caused some people to wonder whether it is public employee pensions, rather than private pensions, that need reform.

The Subcommittee may wish to consider this problem.

Social Security Changes

The 92nd Congress passed two Social Security measures that have caused major changes in the costs and benefits of that system.

Employers and employees will pay an additional $14 billion in Social Security payroll taxes this year. It is estimated that the total tax this year will be about $65 billion. The maximum tax on each employee has increased from $468 in 1972 to $631.80 in 1973, and will increase to $702 in 1974 -- with matching contributions by employers. This means that each $12,000 a year job in 1974 will impose $1,404 in Social Security taxes on the employee and his employer.

These increased taxes are financing higher benefics. Beginning in 1975, these higher benefits will automatically be adjusted in line with increases in the Cost-of-Living Index. This means significant increases in primary benefits will be made in the future. Furthermore, Congress has reserved the right to raise benefits independently if it so desires.

These changes in Social Security costs and benefits are forcing all employers to reexamine the costs and benefits of their private pension and profit sharing plans, as well as benefits under disability income plans, medical plans, and survivor income and death benefit plans. Some preliminary studies indicate that the new higher Social Security benefits when combined with private pension benefits would give some individuals higher income after retirement than before.

We suggest the Subcommittee may wish to review how private pensions will be affected by the new Social Security tax and benefit increases before it finally proposes further legislation that will increase employer costs for private pensions.

Inflation

Inflation, of course, is the real thief of pension values. The rate of inflation based on the Consumer Price Index (December to December, each year) during the recent past has been:

1966 -- 3.4%

1967 -- 3.0%

1968 -- 4.7%

1969 -- 6.1%

1970 -- 5.5%

1971 -- 3.4%

1972 -- 3.4%

A 4% rate of inflation will destroy $400 million of the purchasing power of the current $10 billion a year in private pension retirement benefits. Successful efforts by Congress and the Administration to control inflation will directly and immediately help all Americans who are retired and living on fixed incomes, as well as working Americans who are looking forward to retirement.

The Subcommittee may wish to consider this problem of inflation in relation to its study of helping to provide adequate income through private pension plans.

CONCLUSION

The time has come for Congress to enact constructive private pension legislation in those areas where there already exists substantial agreement among all interested parties. Such federal legislative action should preempt state action to avoid the dangers and confusion of a piecemeal approach in fifty different jurisdictions.

Maximum encouragement should be given to continued growth and expansion of private pension plans. Governmental restrictions which would hamper such growth and expansion should be avoided. Public policy should encourage all individuals to build private retirement income out of earnings either on an individual or group basis.

Therefore, the tax-writing committees of Congress should amend the Internal Revenue Code to provide reasonable minimum federal standards or regulation governing the vesting of private pensions, to encourage individuals to save for retirement, and to increase the present tax deferral available to the self employed who have or establish pension plans for themselves and their employees.

The labor committees in Congress should amend the Welfare and Pension Plans Disclosure Act and include in it a federal fiduciary responsibility act.

Finally, any pension legislation, rather than imposing restrictive regulation, should encourage private pension growth so that our citizens will have adequate retirement income.

Senator NELSON. Our next witness is Mr. Willard Bland, assistant corporate secretary and director of corporate benefits of GENESCO, on behalf of the National Retail Merchants Association.

STATEMENT OF WILLARD BLAND, ASSISTANT CORPORATE SECRETARY AND DIRECTOR OF CORPORATE BENEFITS OF GENESCCO, ON BEHALF OF THE NATIONAL RETAIL MERCHANTS ASSOCIATION, ACCOMPANIED BY MARTIN AMDUR, ESQ., AND GERALD GURALNICK, PRESIDENT OF ISI-WOODWARD, RYAN, SHARP & DAVIS, INC., NEW YORK CITY

Senator NELSON. Your statement will be printed in full in the record and if you will summarize your main points it would be helpful in the presentation. We have received testimony a number of times on the statistics of how many plans there are, how many people involved, so it would be most helpful if you would zero in on the main issues of concern to the association.

Mr. BLAND. We were going to ask your permission to do that, sir, rather than go through the whole statement.

Senator NELSON. Your statement will be printed in full in the record.

Mr. BLAND. My name is Willard Bland, assistant corporate secretary and director of corporate benefits, GENESCO, Nashville, Tenn. I am also chairman of the pension and social security committee of the National Retail Merchants Association known as the NRMA. On my left is Martin Amdur, counsel to the NRMA, and on my right Mr. Gerald Guralnick, president of ISI-Woodward, Ryan, Sharp & Davis, Inc., of New York, who are pension actuaries.

The NRMA, a non-profit corporation, represents over 26,000 department, chain and specialty stores in the United States, Canada and 48 other foreign countries, many of which are operated by small retailers. Our members have a combined annual sales volume of over $50 billion. In the light of our vital interest, we in retailing are pleased to testify on pension reform legislation, particularly the relationship between such legislation and the special conditions of retailing.

Retailing is a labor-intensive industry employing a significant percentage of the country's labor force and operating on a profit margin lower than that of many other industries. Not only do we employ a number of part-time employees, but also a substantial number of all of our employees—particularly our "new hirees"—are older than the national average. Additionally, retailing is uniquely and quickly sensitive to changes in the economy, in consumer buying habits and in prices, and also is highly competitive with many different sized business operating in proximity. As a result, any universal legislation can have an extremely adverse impact, especially if it does not consider the special characteristics of industries such as ours.

We are not against necessary reform legislation. We have heard the problems that you have been considering in the Congress and we know that it is a complex situation. Our concern is how much is needed by legislation.

In the case of fiduciary responsibilities, the NRMA favors legislation requiring both increased disclosure to employees of plan provisions and of the annual status of the trust or other funding medium and also more stringent fiduciary responsibility, assuming such legislated requirements not only are reasonable in light of the benefits to be obtained from the significantly increased administrative costs which necessarily would result, but also do not unduly restrict desirable flexibility by the plan administrators.

The NRMA, however, is concerned that certain of the proposals appear to impose unnecessary reporting requirements—for example, inclusion in the plan's annual report of a schedule of each receipt and disbursement—or to overly restrict the plan administrators' flexibility—for example, required diversification by profit-sharing plans which invest in employer securities—or to overly discourage service as a fiduciary—for example, intertrustee liability and imposition of an excise tax on a breach by a fiduciary whether he was aware of the breach or not.

On vesting, the NRMA believes that a single uniform mandatory vesting requirement may affect the dollar benefits to long term employees. But if vesting is to be mandated, such vesting formula should be purely service-related and should not include an age factor. The inclusion of an age factor tends to discriminate against the hiring of older employees, common in the retailing industry, who comprise a significant part of retailing's work force. If mandated, an acceptable vesting formula would be both not retroactive and one requiring 50 percent vesting after 15 years of participation and 10 percent for each additional year.

On eligibility, if an eligibility requirement is to be legislated, an acceptable eligibility requirement in our industry would be one that provides that all full-time employees with 3 years of full-time service with the employer and who have attained age 30 are entitled to participate in the plan.

Senator NELSON. What do you mean by "entitled to participate"? You said 3 years of service and/or achieving age 30?

Mr. BLAND. An employer could not require that an employee have more than 3 years of service at age 30 to participate in the plan.

Senator NELSON. When you say "participate" what do you mean?

Mr. BLAND. Become a member of the plan, enter the portals.

Senator NELSON. And when does he have vesting rights?

Mr. BLAND. Well, vesting would start after that.

Senator NELSON. When?

Mr. BLAND. After he is a member of the plan.

Senator NELSON. How long——

Mr. BLAND. In accordance with whatever vesting requirement is set up.

Senator NELSON. Would you give him any accrued rights for that 3 years?

Mr. BLAND. I do not think you would.

Senator NELSON. Go ahead.

Mr. BLAND. As a result of current requirements of the Internal Revenue Service and of recommendations of the accounting profession, the NRMA believes that a mandatory funding requirement is unnecessary. If, however, funding is to be mandated by legislation, the period for funding should be not less than 40 years, and such period also should be applicable to increased benefits resulting from amendments to the plan.

On reinsurance, I think the matter has been well debated here this morning and our statement really takes into consideration some of the things we heard here this morning. In the light of present lack of adequate data and expertise, plan termination insurance should not be mandated by legislation at this time; consideration of any such reinsurance requirement in no event should be undertaken until the Labor and Treasury Departments have completed their study of plan terminations and have determined on a course of action. From what we heard this morning—and I believe you asked some very good questions Mr. Chairman—we do not think the people have the expertise to establish reinsurance now; it would just create a great bureaucracy to solve a problem which is not as great as the expenditure would be.

On portability, because of both the complex nature of administering any legislatively mandated portability program, and the fact that it is unnecessary for reasonably vested benefits provided under plans having actuarily sound funding, no provision requiring portability should be legislated.

On voluntary employee contributions, one of our great concerns is that stated in the preamble of S. 1631. We are greatly concerned about the 50 percent of the employees in this country who have no benefits and do not have a promise of any benefits. Only two of the pending bills propose to do anything about this. To help this 50 percent of employees who have no benefits, the NRMA strongly supports legislation providing for the tax deductibility of voluntary employee contributions to either an employer established plan or to an individual retirement plan. We, however, question several of the restrictions and limitations accompanying the current legislative proposals, namely the maximum limitation on the tax deductible contributions and the offset for any contributions made by the employer to a plan in which the employee participates.

On administration, regulation and enforcement of any new pension vesting and funding requirements should be by the Internal Revenue Service, not by the Labor Department.

And finally—a miscellaneous item—we support the proposals in S. 1631 for nontaxability to a terminating employee who reinvests his lump sum distribution and for deductibility by all employers on a cash or accrual basis of timely post-year-end plan contributions.

This concludes our statement, Mr. Chairman.

Senator NELSON. Your statement will be printed in full in the record. I appreciate your taking the time to come here and present us your statement.

Mr. BLAND. Thank you for allowing us to do so, sir.

[The prepared statement of Mr. Bland follows:]

PREPARED TESTIMONY OF WILLARD BLAND, CHAIRMAN, PENSION AND SOCIAL SECURITY COMMITTEE, NATIONAL RETAIL MERCHANTS ASSOCIATION

Good morning. My name is Willard Bland, and I am Director of Corporate Benefits of Genesco, Nashville, Tennessee and Chairman of the Pension and Social Security Committee of the National Retail Merchants Association ("NRMA"). I am accompanied by Gerald Guralnick, President of ISI-Woodward, Ryan, Sharp and Davis, Inc. of New York City, pension actuaries, and by Martin Amdur, Esq., of Weil, Gotshal & Manges of New York City, counsel to the NRMA.

This morning I am happy to testify before this Committee on behalf of the NRMA. The NRMA, a non-profit corporation, represents over 26,000 department, chain and specialty stores in the United States, Canada and 48 other foreign countries, many of which are operated by small retailers. Our members have a combined annual sales volume of over fifty billion dollars. In light of our vital interest, we in retailing are pleased to testify before this Committee on pension reform legislation, particularly the relationship between such legislation and the special conditions of retailing.

Retailing is a labor-intensive industry employing a significant percentage of the country's labor force and operating on a profit margin lower than that of many other industries. Not only do we employ a number of part-time employees, but also a substantial number of all of our employees—particularly our "new hirees"—are older than the national average. Additionally, retailing is uniquely and quickly sensitive to changes in the economy, in consumer buying habits and in prices, and also is highly competitive with many different sized businesses operating in proximity. As a result, any universal legislation can have an extremely adverse impact, especially if it does not consider the special characteristics of industries such as ours.

GENERAL POSITION

The concept embodied in the numerous pension reform proposals now pending before Congress is, as we understand it, to better the realization by employees of the work-related non-contributory voluntary private pension arrangements which many of us in private industry have been providing over the past several decades on an accelerated basis, and with constantly increasing benefits. Reasonable reform legislation should, we believe, balance on the one hand the desire to encourage those few employers, whose plans do not meet reasonable objectives of fairness and security to their employees, appropriately to revise their plans with, on the other hand, the need not to discourage other employers either from continuing to revise their plans to improve the dollar benefits for their long-service employees or, as to those employers who do not have pension plans, from instituting them.

Pension reform legislation which proposes to enact all-encompassing restrictions on the private system is inconsistent with one of the basic strengths of that system, namely its flexibility and its resulting ability to meet the differing needs of the numerous industries and their varied employer and employee makeups which comprise our complex society. Such all-encompassing legislation, particularly in light of its probable effect on benefits for long-term employees seems to us to be self-defeating even as to its declared social purpose. Because at least one-half of the country's employees work for employers without pension or profit-sharing plans. It is important to recognize that restrictive legislation will discourage those employers from adopting *any* retirement plan. This is particularly true in view of the constantly increasing cost of the Social Security system. As a result, the NRMA believes that the best approach is for pension reform legislation to attempt to encourage more universal pension benefits, particularly for those employees who have none.

PROPOSED LEGISLATION

In connection with its consideration of the many pension reform proposals to which I am sure the Committee will be giving attention, the NRMA would like to present the following proposals which represent to us a reasonable legislative step towards reasonably securing the desired protection of the voluntarily provided private pension while at the same time retaining the desired flexibility which has made the pension or profit-sharing plan an important ingredient in the employee benefits program of many companies.

1. Disclosure and fiduciary responsibility

The NRMA favors legislation requiring increased disclosure to employees of plan provisions and the annual status of the trust or other funding medium and also more stringent fiduciary responsibility, assuming such legislated requirements not only are reasonable in light of the benefits to be obtained from the significantly increased administrative costs which necessarily would result. but also do not unduly restrict desirable flexibility by the plan administrators. In this connection, the NRMA supports several key aspects of the fiduciary responsibility and disclosure sections of legislation such as H.R. 2 (introduced by Congressman Dent), S. 1557 (the Nixon Administration's Employee Benefits Protection Act) and S. 4 (the Williams-Javits bill), particularly the "prudent man" rule, the requirements for clear and informative booklets to employees, for annual audits by certified public accountants, for actuarial certification and for adequate termination of service information notices to the employees and limitations on dealings with parties in interest.

However, certain provisions of the proposed legislation appear to impose unnecessary reporting requirements or to overly restrict the plan administrator's flexibility. For example, some of the proposals (*e.g.*, in H.R 2) appear to require that the plan's annual report contain a schedule of each receipt and disbursement from the trust fund during the plan year, and that all employee benefit plans diversify their investments. The former requirement not only is overly burdensome and expensive, but also would be of almost no utility to the plan participants; moreover such data would be available in any event on an audit. Any mandatory diversification requirement, if made applicable to all plans (including those profit-sharing plans which either traditionally have, or under their trust agreements are required to, invest in employer securities), would make an unnecessary fundamental change in the manner in which these plans have operated, a change which appears counter to the desires of most of the participants in the effected plans. In recognition of this fact, most of the pension reform proposals specifically have exempted profit-sharing plans from any maximum limitations on the amount of employer securities which employee benefit plans could acquire.

In addition, the NRMA is concerned that certain proposed fiduciary responsibility requirements—such as inter-trustee liability and the especially wide area for lawsuits by beneficiaries—may discourage talented individuals, many of whom serve gratuitously, from continuing to serve as fiduciaries or administrators of pension or profit-sharing plans. This problem is particularly acute if the administrator also may be subject to an excise tax as a result of such violation—as is proposed in Section 6 of S. 1631—whether or not he knew of its occurrence. It is possible that only banks and trust companies—who in light of the vastly increased liabilities will charge large fees—in the future will be serving as pension plan administrators. Therefore, the NRMA recommends that the Committee closely examine the various proposals before adopting its own position in this area. If the Committee so desires, I would be happy to expand on these matters in greater detail.

2. *Vesting provisions*

The NRMA is in favor of the utilization by all pension plans of reasonable vesting schedules. Since a large percentage of the country's benefit plans have vesting, and since such vesting constantly is being improved by reason of both collective bargaining and the need of employers to attract qualified employees, the NRMA questions the need for legislating a general mandatory vesting standard.

We are deeply concerned that the effects of a Federal requirement of a mandatory and uniform vesting schedule do not appear to have been completely analyzed, especially with respect to the likely cost impact on the various industries in our complex economy and on retailing in particular. We have seen numerous estimates as to what this or that vesting proposal would cost an average employer. Unfortunately, there are no "average employers". Even if there were, such hypothetical employer would not be a retailer. It is clear, based on an NRMA study of the retailing industry, that most of the various vesting formulae in the pension reform proposals would increase significantly the pension costs of retailers. As a result, if any such vesting formula were to be mandated by legislation, industry in general and retailing in particular probably would be required to hold the line on any improvement in the dollar benefits proffered to employees, despite the reduction in the real dollar value of such benefits caused by inflation. In such. legislation mandating a specific vesting formula, in effect, is changing the bargain between the employer and the employee and in the process may well thwart the essential purpose of a pension program—to reward employees for loyalty over a period of years.

If, however, this Committee and Congress believe that a mandatory vesting schedule be enforced and uniformly applied to all benefit plans, then the Committee should search for standards which are less stringent than some of those so far proposed. To the extent that vesting requirements are formulated, the NRMA recommends alternative vesting schedules so that industries with different employee profiles can choose vesting formulae appropriate to their employee profiles. The NRMA certainly suggests that any such vesting formula be purely plan-participation related and not include any age factor. The inclusion of an age factor would create a pressure which might well lead to discrimination against the hiring of older employees. This is particularly relevant to retailing which employs a number of older employees. Although the NRMA is not in favor of legislcting any one uniform vesting standard, if a single standard were enacted, we believe that a vesting formula requiring 50% vesting of a plan participant's normal retirement benefit after fifteen years of participation in the plan, and 10% for each additional year of participation, would not be overly disruptive of the existing private pension system. This is similar to the proposal made in the January 1965 report of the Cabinet Committee on Corporate Pension Funds, which had been appointed by President Kennedy in March 1962. Any such mandatory vesting only should apply to that portion of a plan participant's normal retirement benefit which is attributable to service rendered after the effective date of the legislation (rather than being retrospective as is proposed in S. 4) and the enacting legislation should provide for a reasonable transition period. We also believe that if any vesting requirement is enacted, it is important for employers to be permitted flexibility, *i.e.*, an employer should be entitled to demonstrate to the appropriate agency that the vesting schedule he proposes to use is in substantial conformity with that established in the enacted legislation.

Because of the high turnover in the retail industry, the NRMA supports the eligibility proposal contained in S. 1631 for 30 years of age as the minimum age requirement and three years of service as the minimum period of employment. Shorter service or younger age eligibility requirements would impose an unnecessary administrative burden by requiring inclusion in the plan of short-term young employees who never will vest in any benefits; long-term employees will obtain their vested interest even with longer and older eligibility. Further, only full-time service with the employer should be required to be counted towards minimum service under the eligibility requirement. This is of significance to industries, such as retailing, which have a large percentage of part-time employees, for many of whom the part-time job is a second source of income.

3. Funding provisions

Because the current requirements of the Internal Revenue Service and of the accounting profession, along with the improved actuarial methods being utilized by most pension plans, provide more than ample assurance that pension obligations will be met when they mature, the NRMA believes that legislation mandating a specific funding schedule for all pension plans is unnecessary. In addition, the NRMA is concerned that a mandatory funding system requiring overly rapid funding of the unfunded liability not only may result in a significant increase in pension costs without a corresponding benefit to the pension fund participants but also might require regulation of both actuarial methods and investments, likewise resulting in unnecessary cost increases.

If, however, funding is to be mandated by legislation, the period of time for funding the unfunded past service liability should not be less than forty years. Such period also should be applicable to any increase in benefits resulting from any amendments to the pension plan. This, in fact, is the period recommended by the American Institute of Certified Public Accountants to account for the unfunded accrued liabilities.

4. Plan termination reinsurance

The NRMA urges that the matter of "reinsurance" requires considerable further study before any legislation is considered. The body of data and theory accumulated to date, if anything, speaks eloquently against the feasibility of requiring any reinsurance program in the private pension plan area. To work adequately, detailed Federal control of many operational and financial aspects of pension plans would be required, with a concomitant curtailment of the private pension plan system. Adequate disclosure provisions make reinsurance substantially unnecessary.

Finally, consideration of any such plan termination reinsurance requirement in no event should be undertaken until the Labor and Treasury Departments have completed their joint study of pension plan terminations. Without such completed study, it is far from clear that the problem is of enough significance currently to merit restrictive legislation and the added costs involved. The recently released Interim Report on the joint study substantially bears out this conclusion.

5. Portability

In light of the complex nature of administering any legislatively mandated program for the portability of vested pension benefits, as well as the undesirable impact on pension plans from the transfer of fully funded vested benefits (even if actuarially reduced), the NRMA is opposed to the legislating of either a mandatory or voluntary portability program. The desirability of any governmentally-imposed portability requirements has yet to be demonstrated.

Adequate notification to the terminating employee as to his vested benefits, strengthened fiduciary responsibility and clear disclosure of his rights—contained in all of the legislative proposals on fiduciary responsibility—should ensure that the participant is protected as to his benefits upon his subsequent retirement. Furthermore, to the extent that the employer finds it administratively desirable to distribute to the terminating employee his account balance in a lump-sum at the time of termination, portability would become unnecessary were the transfer proposal contained in Section 5 of S. 1631 (discussed below) adopted.

6. Voluntary employee contributions

The NRMA strongly supports the concept of the proposal contained in H.R. 7157 (Congressman Patten) and S. 1631 (Senator Curtis)—the Nixon Administration's Retirement Benefits Tax Act—for a tax deduction for voluntary employee contributions, either to an individually-designed plan and/or to an employer established plan. Such a tax incentive, along with reasonable mandatory conditions covering those few areas which merit legislative action, should serve as the best motivator towards providing not only pension benefits for the many employees not presently covered by any pension program but also adequate pensions for covered employees. The NRMA, however, questions several of the restrictions and limitations which accompanied the proposal.

Any legislation which enacts the highly-desirable concept of providing a deduction to individuals for contributions should replace the maximum of $7,500 of earned income—proposed in S. 1631—with a dollar limit which is consistent with the retirement needs at least of middle-management level employees. The proposed limitation not only is inconsistent with the rules governing contributions to plans which have no such maximum dollar limitations—*e.g.*, plans providing for employer contributions as a percentage of pay, for integration with social security and/or for mandatory or voluntary employee contributions—but also is counterproductive to the basic intent of the proposal to adequately provide for employee retirement security. The proposed limitation also will serve to significantly limit the usefulness of the retirement savings deduction.

Similarly, the proposed reduction or "offset" to the maximum deductible amount by reason of employer contributions to qualified pension or profit-sharing plans also should be eliminated. The "offset" not only is not productive in encouraging the primary objective of personal thrift but also serves to reduce the individual's ability to provide for his future retirement security. Funds contributed either to a qualified individual retirement account or to a pension or profit-sharing trust will play both an immediate role in the economic growth of the country as well as a future role in relieving Government of the need for more massive old age support; the combination of these occurrences should offset significantly the current individual income tax revenue loss resulting from the provision of an increased retirement savings deduction.

While both the replacement of the $7.500 maximum and the elimination of the "offset" will do much to stimulate and expand the private pension system and its ability to provide adequately for the retirement security of employees, the NRMA recognizes that there currently may be budgetary and revenue problems which militate in favor of retaining these two limitations on any retirement savings deduction. Accordingly, we recommend that, if these considerations should require present retention of the limitations, there should be a transitional rule allowing for their gradual elimination over a reasonable period of time. Certainly, the goal established by any legislation should be to permit all individuals, whether or not covered by employer-funded pension or profit-sharing plans, adequately to provide for their own retirement security.

7. Administration

The NRMA believes that, if pension reform legislation is enacted, regulation and enforcement of any new requirements should be by those Governmental agencies now having authority over the relevant pension areas. In other words, any vesting or funding standards should be added to the tax requirements for the qualification of pension and profit-sharing plans, rather than placed under the supervision of either a new agency or the Labor Department. The NRMA believes that a denial of a tax deduction for noncompliance is a more than adequate inducement to employers to satisfy any standards enacted by legislation and that any additional enforcement bureaucracy, outside of the Internal Revenue Service, not only is unnecessary but also would involve considerable additional expense, both to the Government and to the pension plans themselves. Likewise, it could be appropriate for the Labor Department to be responsible for any increased fiduciary responsibility and reporting requirements under the Welfare and Pension Plans Disclosure Act, but only if the proposal in S. 1631 to impose an excise tax on administrators who violate the fiduciary responsibility requirements is not enacted. If it is enacted, there would be no need for Labor Department enforcement.

In this regard, we believe that it should be brought to the Committee's attention that at least part of the pressure for pension reform legislation—particularly under the jurisdiction of the Labor Department—is from those who believe that the Internal Revenue Service is not enforcing adequately its functions in this area and who concede privately that, if enforced, the Service's rules and regulations would correct most of their complaints about the private pension system. While the NRMA does not subscribe to this view of the Service's past performance, we do suggest that the Committee consider ways to enable the Service to improve its fine record in the pension and profit-sharing area.

8. Miscellaneous provisions

The NRMA supports two new proposals contained in S. 1631 to which it would like to draw the Committee's attention. Section 5(a)(2) of S. 1631 proposes to add a new subsection (7) to IRC § 402(a) which permits a terminating employee, who terminates his employment prior to reaching retirement age, to avoid taxation on a lump-sum distribution from a qualified retirement plan by timely reinvesting the funds in either his new employer's qualified retirement plan or his own individual retirement account. Adoption of this proposal would encourage employees to provide more fully for their retirement. Likewise, the proposal contained in Section 7(g)(4) to amend IRC § 404(a)(6), so as to permit cash basis (as well as accrual basis) employers a deduction for post-year contributions, corrects a hardship now imposed on employers who are unable to determine by the end of their taxable year the amount to be contributed under the plan.

CONCLUSION

On behalf of the NRMA I want to thank the Committee for giving me the opportunity to present our views on pension reform legislation. It is an area not only which we deem to be particularly significant both to our members and to their employees, but also in which we feel retailing has unique problems. Representatives of the NRMA would be pleased to render assistance to the Committee and its staff in any manner which the Committe deems useful. Again, I thank you for the opportunity to testify and for your kind attention.

Senator NELSON. Our next witness is Mr. William Hand, president, American Society of Pension Actuaries.

STATEMENT OF WILLIAM W. HAND, PRESIDENT, AMERICAN SOCIETY OF PENSION ACTUARIES, ACCOMPANIED BY WILLIAM EVANS, COCHAIRMAN, NATIONAL LEGISLATIVE COMMITTEE, AMERICAN SOCIETY OF PENSION ACTUARIES, AND SOLAMAN LIPPMAN, GENERAL COUNSEL, AMERICAN SOCIETY OF PENSION ACTUARIES

Senator NELSON. If you will identify your associates for the record.

Mr. HAND. Mr. Chairman, I am William W. Hand. On my right I am privileged to have our co-chairman of our National Legislative Committee of the American Society of Pension Actuaries, Mr. William Evans from Orangeburg, S.C. On my left and privileged to have with me our general counsel, Mr. Solaman Lippman, from Washington.

Mr. Chairman, the American Society of Pension Actuaries for which I speak today, is a nonprofit professional organization of approximately 900 individuals who specialize in pension and profit-sharing plan design and administration. Our members now administer approximately 60,000 retirement plans in the United States covering approximately 2.5 million employees. This would mean that we now administer approximately 20 percent of all pension plans established under the Internal Revenue Service Code.

However, as you can see from the statistics, we specialize in the smaller plan. We have generally been under the impression that most of the witnesses that have appeared before this committee as well as most of the committees investigating pension plans now over 10 years have represented the interests of the larger employer and we appreciate this opportunity to make the problems and views of the smaller employer and the smaller employer administrators known to you and other members of the committee.

The intensive investigation that has taken place in the private pension system over the past 10 years has revealed very serious deficiencies which can be divided broadly into two categories—those dealing with current plan abuses and those dealing with the fact that only 50 percent of our employees in America are currently covered under private pension plans. Our testimony today will cover primarily the current plan abuses. However, we think the fact that 50 percent of the workers in America are currently not covered by private pension plans presents an equally important problem and challenge to Congress as does the current plan abuse area.

Let me succinctly state that, in the current plan abuse area, we support all legislation that is aimed at curing these plan abuses. Primarily there are two areas of plan abuses, as we see it. First, inadequate vesting provisions, and second, plan termination when the assets are not sufficient to cover the vested liabilities.

Now, those are two broad categories and there can be a lot of things put under those subheadings. For example, we support very strongly stronger mandatory minimum vesting requirements. We think that is absolutely necessary. We support stronger funding requirements. We support plan termination insurance. We support full disclosure to the employee. We do, however, question some of the disclosure requirements.

I would like to comment on each one of these individually, but before getting started let me say, while we support these things wholeheartedly, we believe that Congress must use care and restraint in enacting legislation to cure these problems without overly complicating the private pension system and burdening the small employer with excess reporting requirements.

If I may, I would like to touch on each one of these categories briefly.

Starting with vesting, each of the bills that is proposed before Congress has a little different vesting formula. H.R. 2, proposed by Congressman Dent, requires after a period of adjustment for the plans currently in existence, 100 percent vesting after 10 years. We call this the all-or-nothing approach to vesting. We think that is extremely dangerous. Any employer who terminated an employee after 9 years of employment would certainly be most suspect under this type of vesting requirement.

The administration and S. 374, has proposed use of the rule of 50. Now, as pension plan administrators we have no problem living with the rule of 50. I do not think many employers will have too much difficulty living with the rule of 50. However, I think Congress should recognize that the rule of 50 has a very heavy bias toward the older employees and we feel that this cannot help but further complicate the problem of employment of older employees. We feel that this will add to the discrimination against older employees rather than really help.

S. 4, the Williams-Javits bill, takes, in our opinion, a more logical approach to the problem, requiring 30 percent vesting after 8 years and 100 percent vesting after 15 years. Senator Bentsen's bill, S. 1179, however, takes even a better approach to the problem in our opinion. This bill requires 25 percent vesting after 5 years of plan participation. This gives the employees a quicker vesting.

Vesting in this bill does extend to 20 years which may be objectionable by some. If this becomes an objectionable feature then we would recommend taking Senator Bentsen's approach of providing 25 percent vesting after 5 years, increasing to 50 percent after 10 years, and then 10 percent a year rather than the 5 percent a year straight through so that you would again accomplish 100 percent vesting after 15 years.

We realize that the matter of vesting will ultimately have to be solved by compromise. We submit our ideas on this in the hope that they will be helpful but the important thing is that there must be some minimum vesting standard. Without this we cannot continue to tell the American people that their private pension system is secure.

The next area I would like to turn my attention to is funding. Again, we have various proposals. H.R. 2 proposed by Congressman Dent requires the payment of normal cost plus the maintenance of a ratio of assets to vested liabilities, which increases at the rate of 4 percent a year.

This would mean that after a plan had been in existence 10 full years, the ratio of assets to vested liabilities would have to be only 40 percent. As an individual practictioner, I do not know of a single plan that I would consider adequately funded that had only a 40 percent ratio of assets to vested liabilities after 10 years. In our opinion, this is completely inadequate.

Senator NELSON. Forty percent of the accrued liabilities you are talking about.

Mr. HAND. Yes, sir. Under Congressman Dent's bill, the ratio of assets to vested liabilities would have to be 40 percent after 10 years. It would increase at the rate of 4 percent a year. We think that is entirely inadequate. I do not believe that this offers any safeguards whatsoever to the great majority of plans.

Senator Bentsen's bill and the Williams-Javits bill, S. 4, both take an identical approach to the problem of funding. They require the payment of normal costs plus amortization of the unfunded past service liabilities over a period of 30 years.

Senator NELSON. Unfunded past service over 30 years?

Mr. HAND. Yes, sir.

Senator NELSON. Current service——

Mr. HAND. Current service they must fund.

Senator NELSON. Fully.

Mr. HAND. Fully. And then the unfunded past service liability would be funded over a period of not more than 30 years under both the Williams-Javits bill and Senator Bentsen's bill.

Now, we think this is a step in the right direction but I do not think anybody should be fooled by what it accomplishes. I would like to give you an example.

If we started a plan today, where we used a 5 percent interest assumption and that plan had a $1 million unfunded past service liability, we would be required under the Internal Revenue Service Code, at the present time, to pay the normal cost, that is, the current service cost, plus a minimum of interest on the unfunded past service liability. If we were using a 5-percent interest assumption in the plan, this would mean that we would currently pay $50,000 a year on the unfunded past service liability. If Senator Bentsen's bill or S. 4, then Williams-Javits bill, are adopted, this would increase that payment only to approximately $62,000. In other words, on a million dollar past service liability we really have increased the funding requirements only about $12,000.

Now, please do not misunderstand me. We think this is a step in the right direction. I doubt the wisdom of making it much more stringent but I do think that Congress and the people of the United States should know that this is not within itself a cure-all to the funding problems. If you are really going to safeguard the benefits of the people that are working under these pension plans, you must couple funding requirements and minimum actuarial assumptions together. Any actuary in the United States can very easily overcome the funding requirements by changing any one of the five or six actuarial assumptions that he is using. If you do not establish some minimum safeguards, some minimum actuarial assumptions, in our opinion, your funding requirements will not adequately safeguard the American public.

Senator NELSON. What would you recommend as a minimum obligation for prior service?

Mr. HAND. I think that 30-year funding is very adequate but I think coupled——

Senator NELSON. If they stay in business 30 years.

Mr. HAND. Oh, as I have said, we definitely support plan termination insurance and I will get to that in a minute. I definitely think that has to be a part of the overall security package. But what I am saying is that if you have a 30-year funding requirement and have no minimum actuarial requirements that an actuary can overcome the increased funding requirement very easily by increasing his interest assumption by one-half of 1 percent. You really accomplish nothing in the funding area without some minimum actuarial assumptions.

Now, we say these things, Mr. Chairman, with full knowledge that many of the actuarial firms are going to scream their heads off and say, well, this is terrible. You are putting us in a box.

The American Academy of Actuaries conducted a survey in late 1972, I believe in November, and they found that practically all small pension plans use only two mortality tables today. Likewise, interest assumptions and plan terminations fall within a very narrow range. From a practical standpoint when we establish a pension plan we take an actuarial table off the shelf. Not very many actuaries like to admit that but unless the plan is very large it simply is not practical to study the turnover that that company has had over a 10- or 15-year period and the mortality that that company has had over a 10- or 15-year period to devise a mortality and turnover and salary projection scale that would be precisely applicable to that company.

Now, having pulled the table off the shelf, we do not ignore it. We constantly review that plan, at least once a year, to see what deviations we are having from the assumptions used, but the point that I am making is that if standard actuarial assumptions are made part of funding and a plan is large enough to prove that the use of these standard actuarial assumptions will impose an injustice on them, that they really do have higher turnover than is proposed in the standard actuarial assumptions, or they really can earn more interest than proposed in these standard actuarial assumptions, it should then be the burden of that company's actuary to prove the adequacy of such tables to Secretary of the Treasury and obtain special approval for their use. We are proposing that these standard actuarial assumptions would apply in the great majority of cases and particularly to the small employers who cannot afford to employ a wide variety of experts to make these studies.

The next area that I would like to touch on is disclosure. S. 4 and H.R. 2 both require that pension plans be registered with the Secretary of Labor. This has been discussed here this morning and I will not elaborate on it to too great an extent except to say we think this will materially increase reporting requirements of the small employer and will materially retard progress of the private pension system. When you are reporting for a large company, the cost of that reporting is relatively small compared to the cost of funding, but when you are talking about a company with 24 or 30 or 35 or even 100 employees, the administrative cost of that program is a very significant matter to the employer.

We are currently overburdened in the small pension plan field with too much reporting. We think it is entirely unnecessary to require the type of reporting that is called for in S. 4 and H.R. 2, particularly for small plans.

On the other hand, we think the small plans deserve the protection that is offered by these bills. We think they must have the protection offered by these bills. So what we are saying is that we think that if you leave primary jurisdiction in the hands of the Treasury Department, and you pass laws requiring minimum funding, and requiring minimum vesting, and make these plans subject to audit, that you can eliminate a lot of the reporting requirements that are called for in S. 4 and H.R. 2. By doing this you will greatly enhance the private pension system by encouraging the small employers to adopt plans.

Bear in mind that the 50 percent of the employees not currently covered by these private pension plans are mostly employed by small employers.

Senator NELSON. Do you make a distinction between the reporting requirements for a small plan and a large one?

Mr. HAND. Well, we currently do make distinctions, yes. A company with less than 100 employee participants, for example, does not have to file a D-2 report with the Department of Labor. We think that this is reasonable. The larger plans can more easily afford to file this type of report. But frankly, from our vantage point as pension plan administrators we cannnot see that the filing of all these D-1's, D-2's, and now the D-1 supplements that are being required by July 31 without the availability of forms, has done anything but increase the cost of plan administration for the employer. Maybe it supplies some statistics to somebody but from a practical standpoint the pension participants are not coming to Washington to get their information. There is a requirement in almost every plan that is in existence in the United States, that the documents be made available to the participants and they can go to the office of their company to get this information, and generally speaking, they are supplied this information.

Now, if you would like to strengthen the language requiring that they be supplied full information, we would support that 100 percent. We believe in full disclosure to the employees. A close examination of the small pension case will reveal to you that pension benefits are much more fully disclosed, much more fully understood by the participants. The basic reason behind that is that the small employer cannot hide behind 15 levels of vice presidents and plant managers and supervisors. The president of the small corporation that we are talking about, employing 50 to 100 employees, works with his employees. They are one family, or they try to be. A small amount of turnover of five employees makes a big difference to that employer. Most of my clients and the clients of my colleagues are constantly asking us to help them make a fuller disclosure of their pension benefits to their employees. They want the employees to understand. So we have no hesitancy whatsoever in saying that we think that the law should require that employees be given full and complete knowledge of their benefits.

Senator NELSON. Would you submit in writing for the record specifically what reporting requirements you think there ought to be and why, and what reporting requirements required in S. 4 and any of the other bills you think are burdensome and unnecessary?

Mr. HAND. Well, we did not cover the reporting requirement that we think probably should be required in our report. We did cover in our report the things that we feel are burdensome in S. 4 and H.R. 2. Specifically, though, we think that when the primary jurisdiction is with the Labor Department rather than with the Treasury Department, that excess reporting requirement cannot be avoided.

Senator NELSON. Repeat that.

Mr. HAND. We feel that if you transfer the primary supervision to the Labor Department, that is, you require pension plans to be registered with them as required in both H.R. 2 and S. 4, that the excess reporting requirements are just there. There is no way to avoid the excess reporting requirements. That is the reason we are so opposed to transfer primary jurisdiction from the Treasury Department to the Labor Department.

Senator NELSON. That is on vesting, funding, and so forth?

Mr. HAND. Yes, sir.

Senator NELSON. You would leave them in Treasury?

Mr. HAND. Yes, sir; verv definitely. Again, this has been mentioned before this morning, but the Treasury now has the expertise and the manpower to deal with these problems and that was not always true. Even in my short experience of some 17 years in the pension field, we did not always have very competent IRS men in the field to deal with these problems. However, they have finally built up a very competent staff to handle these problems.

The next subject I would like to turn by attention to is one that is very close to our hearts and we think is a very serious problem. This deals with actuarial certification or actuarial accreditation, if you will.

S. 4 and S. 1179, Senator Bentsen's bill, both require that certain reports be submitted, one to the Department of Labor or to the Secretary of Labor and the other to the Secretary of the Treasury, but basically the same reports, and that these reports be certified by "a qualified actuary."

Now, S. 4 and Senator Bentsen's bill leave it completely up to the various secretaries as to who would and would not be considered a qualified actuary. However, in the subcommittee report on S. 4 it was recommended that a member of the American Academy of Actuaries be deemed to automatically have met any qualification requirements.

H.R. 2 is must more specific on the point than that. It says that these reports will be certified to by a member of the American Academy of Actuaries or by some other person that may be deemed to be qualified by the Secretary.

We strongly oppose these provisions in these bills for several reasons. First of all, there has not to our knowledge been one iota of testimony submitted to this committee or any committee over the last 10 years investigating the private pension system that has indicated that any plan abuse whatsoever, or any loss of benefits, was a result of actuarial incompetence. To the contrary, it is very interesting to me to note that every single plan that has received any degree of publicity that we can find, that has received any amount of notoriety for having plan abuses, has been certified to by a member of the American Academy of Actuaries.

Now, we are not making this statement, Mr. Chairman, to in any way be derogatory toward that organization. Members of this organization are highly professional individuals. They are highly competent individuals. We make the statement only to emphasize that it has not been a lack of actuarial competence that has caused the plan abuses.

Over the years as the small employer has adopted these pension plans, there has developed a new profession of pension actuaries and administrators to handle the needs of the small employers. This is really the profession of members of the American Society of Pension Actuaries and there are hundreds of others like us. If Congress sees fit to establish any type of requirements for a person practicing in this field, we feel that they should establish requirements that would cover the total field of pension plan administration rather than just the pinhead called actuarial work. Competent pension plan design and competent pension plan administration require much more than just competency in the field of actuarial science. We think if you are going to establish tests and regulations that those tests and regulations should cover the broad aspects and that everybody in the United States, Mr. Chairman, should be subject to the same examination requirements.

We believe any time that you establish examination requirements you should have some type of grandfather clause to exempt those people who have been practicing in the profession in a competent manner for at least 5 years. This competence can be readily determined from your Internal Revenue Service offices that have to deal with these individuals.

Senator NELSON. I wonder if you could move on to your position on termination insurance because you have run over your time and I do have three more witnesses after you.

Mr. HAND. OK. One further statement on this, if I may, and then right to plan termination insurance.

If these measures are left as they are, it will disenfranchise hundreds, if not thousands, of competent pension practitioners in the United States and will materially increase the cost of pension administration for the small employer which we think will materially retard future growth of the pension plans for small employers.

In plan termination insurance, we agree primarily and basically with the approach taken by Senator Bentsen. We think that you cannot separate adequate funding from plan termination insurance if you are going to guarantee employees in this country that their pension rights will be there when they are expected to be there. We have heard the arguments against plan termination insurance this morning and I cannot help but agree with the man who said the technical problems involved are nothing more than an excuse for lack of performance. There are technical problems involved in everything.

Basically, we approve and support the approach taken by Senator Bentsen to establish a nonprofit organization. We think that it is very well thought out. I was delighted to hear him say this morning that he feels that his bill could be strengthened in the area dealing with voluntary terminations since in our opinion his bill does not cover that adequately.

S. 4 and H.R. 462 proposed by Congressman Dent both require that the assets of the corporation first be applied to pay for the unfunded past service liabilities. We think that this is a good provision. We think it is basically wrong for a corporation in America to promise an employee a benefit that they cannot pay for. We believe the problems of plan termination insurance can be worked out if established along the lines recommended by Senator Bentsen and with full recourse on the employer's assets if he voluntarily terminates a plan.

Senator NELSON. Thank you very much for your presentation. We appreciate your coming today.

Mr. HAND. We appreciate the opportunity to appear before you. Thank you, sir.

[The prepared statement of Mr. Hand follows:]

PREPARED STATEMENT OF WILLIAM W. HAND, PRESIDENT AMERICAN SOCIETY OF PENSION ACTUARIES

INTRODUCTION

The problem of pension reform can be divided into two major categories:

(1) Current plan abuses.

(2) Extending coverage to the 50% of our working force not currently covered by private pension plans.

This report deals primarily with proposed legislation designed to correct abuses in existing plans. The second problem of extending coverage of pension plans should be considered equally important as protecting the rights of individuals who are presently covered by pension and profit sharing plans.

Intensive investigations into the private pension system over the past ten years have uncovered certain abuses due primarily (if not entirely) to: (1) inadequate vesting provisions, and (2) plan termination at a time when vested liabilities have not been fully funded.

The American Society of Pension Actuaries (hereinafter referred to as ASPA) (see page 10) supports legislation which will correct these plan abuses. However, we feel strongly that care and restraint must be exercised in needlessly increasing reporting requirements. Such increased reporting requirements could materially retard the growth of pension plans among small and medium size groups upon which the future growth of the private pension system is largely dependent. If we lose sight of the basic problems involved and pass legislation which is overly complicated, we may find ourselves in the same position as the farmer who burned down the barn to get rid of a few rats.

SUMMARY

We support

(1) *Mandatory minimum vesting requirements* (see page 11). Contrary to the opinion expressed by some others, we do not believe that reasonable vesting requirements will adversely affect the growth of pension plans among small and medium size groups. These groups have led the way in adopting more liberal vesting provisions on a voluntary basis.

We support

(2) *Minimum funding requirements* (see page 14). However, to be effective, funding requirements must *also embrace minimum standards for actuarial assumptions and computation methods.*

We support

(3) *Disclosure* (see page 16). We support reasonable disclosure requirements and requirements to improve communications to employees. However, we believe reporting requirements should be kept to a minimum. *We support the provisions of S. 374 and S. 1179 which retain primary responsibility for the supervision of pension plans in the Treasury Department avoiding needless duplication.*

(4) Stronger Fiduciary Standards (see page 18).

(5) Increased limitations on deductible contributions for self-employed individuals as proposed in S. 374.

(6) Tax deductions for individual retirement savings.

(7) Plan Termination Insurance (see page 19).

(8) Coverage for all plans regardless of size, provided that reporting requirements are not materially increased.

(9) A voluntary system of Portability which should include (a) the direct tax-free transfer of assets from one plan to another, or (b) purchase of a single premium deferred annuity contract, or (c) purchase of a "Restricted Savings Certificate" which would be issued directly to terminated plan participants. This would eliminate the necessity for creating a new governmental agency.

We oppose

(1) The drastically increased reporting requirements of both S. 4 and H.R. 2 (see page 16). Excessive reporting requirements are unnecessary to obtain compliance with published laws, provided the individuals or companies to which such laws are applicable are subject to audit. This time-proven principle should be followed in the administration and supervision of pension plans.

(2) The federal government establishing regulations for "pension actuaries" or for any other profesisonal group because we believe this establishes a dangerous precedent. However, if such professional qualification requirements are established, all individuals who demonstrate that they have been successfully practicing in this field for a period of at least five years, or who can otherwise demonstrate proficiency, should be considered as having met such qualification requirements. We further submit that any standards established for pension actuaries should emphasize the need for competency not only in the field of actuarial science (which is in reality only a small part of pension plan administration) but also competency in other aspects of pension plan administration which requires a diversity of talents.

(3) Changing the method currently being employed in the certification of pension plan calculations.

(a) There has not been a single bit of evidence presented to indicate that any plan abuse or the loss by an employee of any promised benefit was the result of actuarial incompetence.

(b) Language contained in the proposed legislation could inadvertently disenfranchise hundreds of qualified pension actuaries who have competently performed pension computations over a long period of years.

(c) The current method for certifying to pension calculations has brought competent, economical service into the pension field for small and medium size groups. Any change in the current method will result in unnecessarily increased administrative cost for these small groups.

(d) The application of standard, published actuarial tables (used almost exclusively in small and medium size plans) does not require the services of an "actuary" as that term is generally recognized.

(4) Recognition of membership in a private organization such as the American Academy of Actuaries as automatically qualifying an individual to certify pension plan calculations as required in H.R. 2 and S. 4 (see page 21).

(*a*) As far as we have been able to determine, by conscientiously searching the D–2 reports on file with the Department of Labor, virtually all pension plans which have received publicity or notoriety because of plan abuses have had the actuarial computations performed by a member of the American Academy of Actuaries. We submit that the facts conclusively prove that certification of pension computations by a member of the American Academy of Actuaries has neither caused nor prevented plan abuses and loss of benefits by covered employees.

(*b*) The American Academy of Actuaries is made up of members of five different actuarial organizations. Many of its members have not been required to pass a single examination to obtain their membership status.

(*c*) A large percentage of the members of the American Academy of Actuaries have never performed pension plan valuations. Most of their members work in fields that do not require a workable knowledge of pension plans.

(*d*) Carte blanche recognition of the American Academy of Actuaries would essentially give a monopoly in pension plan certification to a relatively small group of people thus materially increasing administrative costs for the small and medium size pension plans.

(5) The provisions of Title III of S. 4, "Voluntary Portability Program" and Title I of H.R. 462, "Portability Program for Vesting Pensions" (see page 28).

BACKGROUND OF ASPA

ASPA is a non-profit organization with over 850 members who are engaged primarily, if not exclusively, in design, installation and administration of pension and profit sharing plans for small and medium size companies.

There are four categories of membership in ASPA designating the degree of skill and proficiency in all phases of pension planning which has been evidenced by each member's ability or inability to pass one or more of five examinations covering such diverse areas as law, IRS regulations, taxes, accounting, funding methods, actuarial cost methods, actuarial assumptions and techniques as related to retirement plans and investments. These examinations and related study material are prepared under the direction and supervision of Professor Lloyd A. Knowler of the University of Iowa, one of America's foremost authorities in the field of actuarial education. The preliminary results of a survey currently being conducted among our members indicates that members of ASPA administer in excess of 60,000 retirement plans covering approximately 2.5 million employees which have assets in excess of 10 billion dollars. This survey therefore indicates that our members now administer approximately 20% of all pension plans in the United States. However, these plans cover only about 5% of the total number of employees covered under all plans. These statistics indicate that our members administer primarily small and medium size plans. This same survey shows that members of ASPA have an average of over ten years of experience in the pension field and almost without exception have engaged in some type of specialized training in this field in addition to their basic academic training.

VESTING REQUIREMENTS

The greatest single fault in private pension plans, brought to light by the intensive investigations and hearings of the last ten years, is the *lack of vesting in a large number of plans*. While most employers (particularly the small employers who comprise the majority of clients of our members) have been rapidly moving toward the voluntary adoption of more liberal vesting requirements, it has become obvious that some minimum standard is required to provide uniform protection for all employees covered under Private Pension Plans. Each of the major Acts has slightly different requirements in respect to vesting. ASPA believes that the schedules set forth in all of the major proposed Bills represent a step in the right direction. With certain modifications applicable to existing plans, H.R. 2 establishes a basic requirement of ten years of service after age 30 as a condition for 100% vesting in all accrued pension benefits. S. 4 requires plan participants to have a vested interest in the accrued portion of their normal retirement benefit equal to 30% after 8 years of plan participation with such vested interest to increase at the rate of 10% per year for each year of plan participation in excess of 8 years. The "Rule of 50" vesting formula, as proposed in S. 374, provides for 50% vesting when a combination of age and years of credited service equal 50 with an increase in vesting of 10% per year thereafter.

S. 1179 introduced by Senator Bentsen would require 25% vesting after 5 years of plan participation with such vested interest to increase at the rate of 5% per year thereafter. In a memorandum explaining the major provisions of S. 1179, Senator Bentsen published a table comparing the vesting under his Bill with the vesting proposed under S. 4 and H.R. 2. This table is shown below.

COMPARISON OF VESTING REQUIREMENTS

[As percentage of accrued benefits]

		Years of participation in the plan															
		5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
S. 1179	"5/25"	25	30	35	40	45	50	55	60	65	70	75	80	85	90	95	100
S. 4	"8/30"	0	0	0	30	40	50	60	70	80	90	100	100	100	100	100	100
H.R. 2	"10/100"	0	0	0	0	0	100	100	100	100	100	100	100	100	100	100	100

The table shown below compares the vesting under the "rule of 50" with the minimum vesting proposed in S. 1179:

COMPARISON OF VESTING REQUIREMENTS

[As percentage of accrued benefits]

Age when hired	Plan entry age	Attained age							
		25	30	35	40	45	50	55	60
29[1]	30/30			0/25	50,50	100/75	100/100	100/100	100/100
34	35/35				0/25	100/50	100/75	100/100	100/100
39	40/40					50/25	100/50	100/75	100/100
44	45/45						100/25	100/50	100/75
49	50/50						50/0	100/25	100/50

[1] Age 29 or under.

Note: Figures shown above are percentages with those on left of slash applicable to the "rule of 50" and those on the right applicable to the provisions of S. 1179.

Senator Bentsen points out in his explanation of S. 1179 that the "Rule of 50" vesting formula could have the undesirable effect of fostering job discrimination against older applicants. After carefully comparing the minimum vesting requirements of the various proposed Acts and their impact on both pension plan participants and the general work force, we support the provisions of S. 1179.

FUNDING REQUIREMENTS

Minimum vesting requirements without adequate funding and plan termination insurance could prove to be an empty gesture in attempting to cure abuses in the Private Pension System. S. 4, S. 1179 and H.R. 2 all contain provisions which would establish minimum periods over which to fund past service liabilities. S. 4 and S. 1179 generally require payments into the plan each year sufficient to pay all normal costs plus an amount sufficient to amortize unfunded past service liabilities over a period of thirty years. H.R. 2 requires payments into the plan each year which are sufficient to pay all normal costs plus an amount sufficient to maintain the pension plan assets in a stipulated ratio to vested liabilities. In our opinion, the provisions of H.R. 2 would not adequately protect plan participants during the early years after the plan is established. For example, it would require that plan assets be equal to only 40% of the present value of vested liabilities after the plan has been in existence for 10 years. ASPA believes the provisions of S. 4 and S. 1179 represent a sounder approach to this problem. It is important to realize that the provisions of these Bills alone will not insure adequate funding of pension plans. Adequate funding depends on a combination of the following factors which should not be separated:

(1) Funding requirements such as those stipulated in S. 4 or S. 1179, plus

(2) Reasonableness of actuarial assumptions used to determine funding requirements and the value of the vested liabilities.

We strongly recommend that the legislation adopted require that minimum actuarial standards and procedures be established and published to insure uniform protection of all employees under private pension plans. Most pension actuaries currently utilize standard actuarial tables which are widely published. This is particularly true for small and medium size plans. It is customary to adjust required contributions each year to reflect deviations between actual plan experience and the actuarial assumptions utilized. In a survey conducted by the American Academy of Actuaries (the results of which were submitted to their Board of Directors in a report dated October 21, 1972) it was revealed that practically all small pension plans use either the 1958 CSO Table or the 1951 GA Table (sometimes with projections) as the basis of mortality. Interest rates and other actuarial assumptions used in these plans also fall into a narrow range. From a practical standpoint, it is not feasible to base actuarial assumptions in pension plans on actual experience except in the very largest plans. Variance from the published actuarial standards should be permitted only when it can be conclusively demonstrated that such standards will impose unreasonable funding requirements for a particular plan as compared to funding requirements based on actual experience of the plan or employer over the previous five year period. Publication of such actuarial standards and procedures will dramatically reduce the cost of administration both for the government and employers sponsoring private pension plans.

DISCLOSURE

Both S. 4 and H.R. 2 require pension plans to be registered with the Secretary of Labor thus drastically increasing the reporting requirements applicable to pension plans. S. 374 and S. 1179 would retain primary responsibility for the supervision of pension plans in the Treasury Department avoiding needless duplication. Over the years, the Treasury Department has developed a great deal of expertise in pension plan supervision among its staff members. It would take the Department of Labor many years to develop comparable expertise among its staff members. ASPA, therefore, strongly recommends that primary supervision of pension plans be maintained in the Treasury Department for the following reasons:

(1) Current plan abuse can be corrected by establishing minimum vesting requirements, minimum funding requirements (with published minimum acceptable actuarial standards and computation methods) and Plan Termination Insurance. Assuming plans will be subject to audit, the oppressive reporting requirements of S. 4 and H.R. 2 are completely unnecessary.

(2) The increased reporting requirements of S. 4 and H.R. 2 will result in prohibitive expense for most plans, will be impossible to comply with for some and will create an unmanageable avalanche of paper for the Department of Labor. It is extremely doubtful that enough pension experts exist in the United States to prepare and (on behalf of the Department of Labor) intelligently review the extensive reports required under these two Acts.

(3) The increased reporting requirements will materially retard future expansion of private pension plans. Most employees not currently covered by private pension plans work for small and medium size employers who cannnot afford the tremendous administrative expense these reporting requirements would entail. The increased reporting requirements are, therefore, in direct opposition to the second major objective of pension reform; i.e., expansion of the private pension system.

(4) Experience has proven that excessive reporting requirements are unnecessary to obtain compliance with published laws, provided the individuals or companies to which such laws are applicable are subject to audit. This time-proven principle, administered under appropriate IRS procedures, should be followed in the administration and supervision of pension plans.

FIDUCIARY RESPONSIBILITY

ASPA believes in strong enforceable fiduciary standards and basically agrees with the provisions of Title V, Section 510 of S. 4. While we agree with most of the basic provisions of Title I, Section III of H.R. 2, we question the wording in subparagraph (2) of Section III(a) which seems to prohibit death and disability benefits from being part of a pension plan.

SELF-EMPLOYED INDIVIDUALS

We recommend that limits on deductible contributions for self-employed individuals be increased to 15% of earned income not to exceed $50,000, as proposed in S. 374.

INDIVIDUAL RETIREMENT SAVINGS

We support tax deductions for individual retirement savings equal to at least 20% of the first $7,500.00.

PLAN TERMINATION INSURANCE

Adequate minimum vesting requirements and plan termination insurance cannot be separated if all employees under private pension plans are to be guaranteed uniform protection against loss of their expected pension benefits in the future. The provisions of H.R. 462 and S. 4 dealing with Plan Termination Insurance are almost identical. Both of these Bills provide for administration of Plan Termination Insurance by an agency of the federal government. S. 1179 sponsored by Senator Bentsen provides for the creation of a non-profit corporation to be known as the "Pension Guarantee Corporation," to administer Plan Termination Insurance. This corporation shall not be an agency or establishment of the United States government. ASPA fully supports the concept of having Plan Termination Insurance administered by a non-profit private corporation as specified in S. 1179. In connection with Plan Termination Insurance, we again respectfully call attention to the absolute necessity to publish tables based on standard actuarial assumptions and to set forth standard actuarial cost methods to be used in determining liabilities under this Section of the Act. While there may be very logical justifications for using varying actuarial assumptons (based on actual turnover experence, actual investment yields, actual death and disability experience and actual salary increases) to determine funding requirements of a plan that is to be continued, it must be realized that Plan Termination Insurance must be based on the situation that would exist if the plan was terminated on that day. Under such circumstances, the corporation or other governing body will not be able to look to actuarial gains based on future terminations, other than mortality, nor will it be concerned with projected future salaries, nor with the history of past investment earnings under the plan. It will be faced with a very real and factual situation; i.e., that of paying all vested accrued benefits under the plan at such time as they become due. When a pension plan terminates, the governing body can look only to actual assets under the plan, possible recovery from the employer, any possible mortality gains which could result if vested benefits are not paid to the participant's beneficiary, and investment gains that it (the governing body) can expect in the future.

It must also be remembered that each plan registered under the Act will be required to pay a "premium" or insurance "tax" on the difference between the present value of the vested liabilities under the plan and the market value of the plan assets. All of the proposed Bills are virtually silent on how the present value of the vested liabilities is to be determined. Failure to publish standard tables based on acceptable actuarial assumptions, as well as the procedures to be used in determining this liability, will result in gross inequities and ultimately the downfall of the entire pension insurance system. While certain except' ›ns to the use of standard actuarial assumptions could be granted by the Secretary for a plan which will be continued in effect, there can be no logical reason for allowing the administrator of any plan to use other than the standard published tables and procedures in computing the present value of vested liabilities for Plan Termination Insurance.

COVERAGE RE'QUIREMENTS

S. 4, S. 1179 and H.R. 2 exempt plans administered by the federal government from coverage under the major provisions of the Acts. In addition, S. 4 and S. 1179 exempt plans established or maintained by the government or a state or any political sub-division of any agency of a state. While there may be reasons for not including U.S. government employees and the employees of state and local government, we see no logical reason why employees covered under retirement plans, established by certain governmental agencies, which are subject to the provisions of Section 401(a) should not be afforded the same protection offered under the Acts to other employees. For example, we see no reason why vesting is not as important to an employee covered under a plan established by an agency of the federal government, such as Federal Land Banks, as it is to an employee covered under a plan established and administered by a private corporation or a labor union.

S. 4 exempts plans with 25 or less participants from coverage under the major provisions of the Act; H.R. 2 exempts plans with 8 or less participants from the Disclosure regulations of the Act; and S. 1179 applies to all plans covering non-governmental employees without any minimum number of lives. Assuming that our recommendations to simplify the reporting requirements are adopted, we see no reason why the employees under all small plans should not receive the same protection as employees who participate in larger plans. However, if the oppressive reporting requirements of the two Acts are retained in the legislation which is ultimately passed by Congress, we strongly recommend that such reporting requirements not be applicable to plans with 100 or fewer participants. This type of exemption for plans with 100 or fewer participants now exists for the filing of D–2 reports under the Welfare and Pension Plans Disclosure Act.

The provisions of S. 4 and S. 1179 exempt "fully insured" plans from certain requirements of the Acts. Many small and medium size plans utilize a "Combination Method of Funding" to build up the required assets under their pension plan. Under the combination method of funding, death benefits and the cost of providing retirement benefits are guaranteed by the life insurance company. Plans using the combination method of funding should also be exempt from the same requirements as "fully insured" plans, especially if the additional assets are accumulated under the level annual actuarial cost method (under which full funding is accomplished by the date of retirement) based on standard actuarial assumptions and procedures published by the Secretary of Labor, as we have heretofore recommended.

ACTUARIAL CERTIFICATION

The provisions of both S. 4 and H.R. 2 require reports to be certified by a "qualified actuary". While Section 101(b) of S. 4 provides that the Secretary is authorized to determine who is and who is not a "qualified actuary," the Senate Sub-Committee report recommends that members of the "American Academy of Actuaries" be deemed automatically to have met any required standards of a "qualified actuary". H.R. 2 is even more emphatic on this point. It stipulates "all statements required pursuant to this Sub-section 104(e) shall be certified as being in conformity with accepted principles of actuarial practice by an actuary who is a member of the American Academy of Actuaries or who meets qualifications as the Secretary may establish by regulation." S. 1179 stipulates "The Secretary or his delegate shall prescribe rules and regulations establishing standards and qualifications for persons responsible for performing actuarial services in connection with this Sub-section and, upon application of any person, certify whether such person meets the standards and qualifications prescribed".

(1) We object to the Federal government establishing qualification requirements for any professional group because we believe this establishes a dangerous precedent. However, if such professional qualification requirements are established, all individuals who demonstrate that they have been successfully practicing in this field for a period of at least five years, or who can otherwise demonstrate proficiency, should be considered as having met such qualification requirements. We further submit that any standards established for pension actuaries should emphasize the need for competency not only in the field of actuarial science (which is in reality only a small part of pension plan administration) but also competency in other aspects of pension plan administration which requires a diversity of talents. These include, but are not limited to:

(*a*) Ability to design a plan to meet the objectives of the sponsor.

(*b*) Knowledge of the laws and regulations governing pension plan qualification.

(*c*) Knowledge of the various tax laws and IRS regulations dealing with both contributions and benefits.

(*d*) Knowledge of the various funding media, computation methods and actuarial techniques involved.

(*e*) Knowledge of the various reports required by the Treasury Department and the Department of Labor and some states.

(*f*) Ability to establish and maintain records which will reveal any required information at a later date.

(*g*) Knowledge and skill in employee communications.

In recognition of the various areas of competency required by pension actuaries, each of the above-listed areas is separately tested in the current series of ASPA examinations.

(2) We also object to the provisions in the proposed Bills dealing with actuarial certification because we see no necessity to change the method currently being employed in the certification of pension plan calculations.

(*a*) There has not been a single bit of evidence presented to indicate that any plan abuse or the loss by an employee of any promised benefit was the result of actuarial incompetence. At the present time, pension plan computations are being certified by a pension actuary, selected by the Plan Administrator. Each Plan Administrator is at liberty to pick the pension actuary who he feels can render a competent service at a reasonable cost. This free and open selection of pension actuaries has developed healthy competition for professional competency in keeping with the highest standards of the free enterprise system·

(*b*) Language contained in the proposed legislation could inadvertently disenfranchise hundreds of qualified pension actuaries who have competently performed pension computations over a long period of years. Actuarial science generally encompasses vast areas of knowledge completely unrelated to pension actuarial work such as (1) knowledge of rate making for both life and casualty companies, (2) establishment of equitable, non-forfeiture value of a wide variety of insurance plans, (3) distribution of dividends under many types of policies and insurance coverages and (4) development of appropriate contract provisions for different types of life, health, disability and annuity policies. It is unnecessary and unrealistic to require pension actuaries to have a knowledge of this type which is completely unrelated to the pension field.

(*c*) One of the earliest criticisms of the private pension system was the fact that small employers could not afford the high cost of administration of pension plans which at that time were largely handled by highly paid specialists. This resulted in the development of:

1. Standardized, master and prototype plans.
2. Common trust funds for the investment of plan assets, and
3. A new profession of pension actuaries who are capable of handling all aspects of pension plans (excluding legal services) for their clients.

ASPA members are a part of this new profession which has brought competent, economical service into the pension plan field to small and medium size groups.

Recent statistics show that the average pension plan approved by IRS during 1972 involved slightly less than 25 plan participants. ASPA members are now responsible for providing complete service for approximately 20% of all of the pension plans established in the United States. It would be a gross injustice for this professional group to be denied the right to perform future computations on the pension plans they have established and currently administer.

(*d*) As previously mentioned under the "Funding Requirements" section of this report, most pension actuaries utilize standard published actuarial tables in performing pension plan calculations for small and medium size plans. It is, in fact, impractical to attempt to develop special actuarial tables for all but the largest of plans. The application of standard published actuarial tables (used almost exclusively in small and medium size plans) does not require the services of an "actuary," as that term is generally recognized.

(2) We strongly object to the recognition of membership in a private organization such as the American Academy of Actuaries (hereinafter referred to as the Academy) as automatically qualifying an individual to certify to pension calculations required under the proposed Bills for the following reasons:

(*a*) During the hearings and investigations which have been conducted with respect to the Private Pension System, the names of dozens of plans have been published where abuses were found and where pension plan participants had lost their benefits. A careful search of the D-2 reports on file with the Department of Labor revealed that in every instance (where a D-2 report could be located for these companies) the actuary was a member of the American Academy of Actuaries. We submit that the facts conclusively prove that certification of pension reports by a member of the American Academy of Actuaries has neither caused nor prevented plan abuses and loss of benefits by covered employees.

(*b*) The Academy is made up of members of:

1. Casualty Actuarial Society.
2. Fraternal Actuarial Association.
3. Conference of Actuaries in Public Practice.
4. Society of Actuaries.
5. Canadian Institute of Actuaries.

Many of the current members of the Academy did not have to take a single examination to obtain their membership status. At the present time, there are approximately 2,800 active members of the Academy. An additional 320 of the total membership are either retired or do not indicate any business connection. A large percentage of the active members of the Academy work in fields completely unrelated to the pension field and have never performed an actuarial evaluation of a pension plan. More than 60% of the active members of the Academy are employed by insurance companies. Only a small percentage of the actuaries employed by insurance companies work-primarily with pension plans. In fact, only a small percent of all life insurance companies have pension departments. Approximately 30% of the Academy members are classified as "consulting actuaries and insurance brokers." A large percentage of this group also work in specialty lines other than pensions. We respectfully submit that there is absolutely no logical reason to give this small group a monopoly in pension plan certification simply because they belong to an unlicensed private organization. We further submit that there is no reason to disenfranchise the members of ASPA and other pension actuaries who have helped to build the Private Pension System into the strong, viable force that it is today.

PORTABILITY

The provisions dealing with Portability of vested pension benefits are practically identical in S. 4 and H.R. 462 except the provisions of S. 4 are on a voluntary basis and the provisions of H.R. 462 would make Portability mandatory. Basically, the provisions of both Bills provide, in effect, that the present value of vested assets applicable to a severed participant shall be transferred to a Special Fund to be managed by an agency of the federal government. These funds will be invested ". . . in interest bearing accounts in any bank which are insured by the Federal Deposit Insurance Corporation or savings and loan association in which accounts are insured by the Federal Savings and Loan Insurance Corporation." The assets accumulated in this Special Fund for the participant will be paid out at the request of the participant to purchase credits of an equal value under another pension plan to which the employee transfers or upon his request used at age 65 to purchase for him a single premium annuity contract from a qualified insurance company. S-1179 encourages Portability by providing for a tax-fee transfer of vested pension benefits from one plan to another on a voluntary basis.

While the provisions of S. 1179 are a step in the right direction and are sound, we believe additional flexibility is needed.

In addition to the provision of S. 1179 and as an alternative to the provisions of S. 4 and H.R. 462, we propose:

(1) That plan administrators continue to have the right, on a voluntary basis, to purchase single premium deferred annuity contracts which are sufficient to pay severed participants the amount of their vested retirement income benefits at their retirement age.

(2) That Congress authorize "Restricted Savings Certificate" to be issued by banks insured by the Federal Deposit Insurance Corporation or by savings and loan associations insured by the Federal Savings and Loan Insurance Corporation. These certificates could be purchased on a voluntary basis by Plan Administrators for severed participants by paying over to the bank or savings and loan association an amount equal to the present value of the participant's vested benefits. The "Restricted Savings Certificate" would be issued directly to the severed participant and could be used by the participant only to have the assets transferred to a successor plan or to buy an annuity for his benefit at age 65. This would eliminate the need for a special government agency to administer the program and would allow the participant to select the qualified bank or savings and loan association of his choice.

We oppose the provisions of S. 4 dealing with Portability because this Bill would create a needless governmental agency without accomplishing anything which could not be accomplished either (a) through the direct transfer of assets from one plan to another, or (b) purchase of a single premium deferred annuity contract, or (c) purchase of a "Restricted Savings Certificate," as stipulated above.

In addition to the objections to S. 4 as stated above, we further oppose the mandatory aspects of H.R. 462. We oppose any program for Portability being made mandatory, for the following reasons:

(1) If any portion of the vested liabilities of a plan were unfunded at the time a participant severed, the severed participant would, in effect, be given preferential treatment by having his vested assets transferred in their entirety to the governmental agency. We see no reason for giving such preferential treatment to severed employees. If a large group of employees severed at one time, such transfers could deplete the assets of a plan to such an extent that it would be impossible for the plan to fulfill its obligations to retirees or other plan beneficiaries.

(2) The transfer of assets may require forced liquidation of plan assets at a time when the market value of such assets is depressed. This would be particularly true if a large group of employees terminated at one time.

(3) The transfer of the present value of vested liabilities for severed participants could frustrate and defeat an attempt to keep the ratio of assets to vested liabilities in a plan in accordance with the requirements of Section 302(a) of H.R. 2. For example, if the ratio of assets to vested liabilities at a given time was equal to 50% and 25% of the employees severed, the ratio of assets to vested liabilities would automatically drop to 25% (assuming the present value of vested liabilities of all plan participants were equal.) The provisions of Section 302(a), in effect, require that the ratio of assets to vested liabilities increase at the minimum rate of 4% per year over a 25 year period. Under the above circumstances, contributions in the next succeeding year would have to be sufficient to bring the ratio of assets to vested liabilities back to the minimum required schedule. In other words, the unfunded portion of the vested liabilities applicable to the severed participants would have to be made up by contributions each year. This could prove to be an insurmountable burden on many plans, thus forcing them to terminate.

Senator NELSON. Our next witness is Mr. S. C. DuRose, Commissioner of Insurance, State of Wisconsin.

STATEMENT OF S. C. DuROSE, COMMISSIONER OF INSURANCE, STATE OF WISCONSIN

Mr. DuROSE. Senator, I am Stanley C. DuRose. I am also insurance commissioner, as you noted, of the State of Wisconsin and I might mention that I have been in the insurance department there for 25 years. I have been commissioner since October 1969.

Through those 25 years I have developed a great sensitivity to the problems of the consumer in attempting to work on resolution of those problems. In Wisconsin we have had a pension and welfare fund disclosure act and fiduciary responsibility act since 1957. We have been one of the few States that have been in business, so to speak, administering the type of thing that is being referred to in much of the Federal legislation but in the area of fiduciary responsibility.

I appear today both as commissioner and as a spokesman for the National Association of Insurance Commissioners, and the scope of my remarks is basically limited to fiduciary responsibility regulations as opposed to funding, vesting, and portability. In general, it is my opinion that these are more properly, not necessarily so, but more properly issues for the Federal Government but I think that in respect to fiduciary responsibility regulation, the Federal law, if there is to be one, needs to have in it a provision for allowing States to assist in the enforcement of fiduciary responsibility regulation or requirements, or whatever.

In Wisconsin we have got some 7,200 plans registered. About 90 percent of those plans are intrastate. There is no employee that participates in a plan that is not a State resident. To some extent it is sort of like mutual insurance companies that you are familiar with. We have an examining staff. We examine these funds and the examination process, examination report, is much like mutual examination.

A great preponderance of the funds are small funds, 90 percent of it in the State. Of those I think approximately half have 100 or less employees participating. So that there is this great bulk of plans that we have that are largely an intrastate issue, in my opinion.

Senator NELSON. What is the total number of people covered by these private pension plans in the State?

Mr. DUROSE. I do not have a table with me on that but I believe that it is somewhere in the area of 800,000 and that number of employees would break down, again from memory, possibly 200,000 in the smaller plans.

I can provide you with tables that are current on those types of numbers.

[Mr. DuRose subsequently submitted the following:]

STATE OF WISCONSIN,
OFFICE OF THE COMMISSIONER OF INSURANCE,
Madison, Wis., May 31, 1973.

Senator GAYLORD NELSON,
Chairman, Subcommittee on Private Pension Plans, Senate Finance Committee, Washington, D.C.

DEAR SENATOR NELSON: During my May 23 appearance before your committee, you requested that I prepare and submit information on the number of Wisconsin employes covered by the various classifications of funds included in Exhibit B of my statement.

The following table summarizes participant totals reported by the 1,650 Wisconsin funds and 493 out-of-state funds shown in Exhibit B of my prepared statement.

	Number of covered employes		
	Employed in Wisconsin	Employed outside Wisconsin	Total
Fund located in Wisconsin	684,994	138,021	823,015
Fund located outside Wisconsin	222,930	10,262,817	10,485,747
Total	907,924	10,400,838	11,308,762

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Detail on the participants covered by the types and sizes of Wisconsin funds is shown on the attached table.

It should be noted that these tabulations are made from 1972 fund annual statement filings made with my office. Such filings are required from any fund covering more than 25 Wisconsin employes. Data on the 4,969 funds registered with my office on December 31, 1972 but covering fewer than 26 Wisconsin employes is not included in the above or attached tables. About 45,000 additional Wisconsin employes are covered by these funds.

These tabulations point out the great number of employes covered by smaller funds which required continuing surveillance by a governmental agency. Effective consumer protection is needed for participants in these smaller funds.

Federal enactment of a pre-emption provision will eliminate protection now provided under our Wisconsin law, and prohibit other states from establishing fiduciary standard regulation for smaller funds to replace the federal proposed solution of permitting a fund participant to engage an attorney and initiate suit in federal court to resolve his question with this fund.

Sincerely,

S. C. DuRose,
Commissioner of Insurance.

STATE OF WISCONSIN, OFFICE OF THE COMMISSIONER OF INSURANCE

[Employee welfare funds with situs in Wisconsin covering 26 or more Wisconsin participants; number of funds and participants classified by type of fund and number of participants]

Total employees	Number of funds	Participants		
		Wisconsin	Out of State	Total
Pension:				
26 to 100	317	16,759	449	17,208
101 to 200	116	15,401	532	15,933
201 to 300	70	16,197	717	16,914
301 to 400	42	14,068	586	14,754
401 to 500	31	13,015	748	13,763
501 or more	127	259,133	78,480	337,613
Total	703	334,573	81,512	416,085
Profit sharing and savings:				
26 to 100	511	24,964	855	25,819
101 to 200	97	12,341	983	13,324
201 to 300	28	6,142	826	6,968
301 to 400	15	5,021	421	5,442
401 to 500	42	52,086	15,528	67,614
501 or more	26	22,576	13,833	36,409
Total	719	123,130	32,446	155,576
Health and welfare:				
26 to 100	25	1,510	10	1,520
101 to 200	27	3,557	88	3,645
201 to 300	14	3,225	231	3,456
301 to 400	12	3,752	298	4,050
401 to 500	10	4,097	28	4,125
501 or more	78	143,613	13,131	156,744
Total	166	159,754	13,786	173,540
Other subgroup life and vacation:				
26 to 100	12	841		841
101 to 200	14	2,111	9	2,120
201 to 300	6	1,523	33	1,556
301 to 400	2	754		754
401 to 500	7	2,899	218	3,117
501 or more	21	59,409	10,017	69,426
Total	62	67,537	10,277	77,814
Total all funds	1,650	684,994	138,021	823,015

Mr. DuRose. I have attached to my report breaking down by classification the number of funds intrastate as opposed to those that have a domicile outside of Wisconsin with employees in Wisconsin where

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subjects are reporting restrictions. There are some very interesting numbers. I think this aspect of the small fund operating only in one State has really been overlooked in the past in the various hearings because people come down here and they are talking about Caterpillar Tractor or talking about General Motors. We have hundreds of thousands of employees where you have some very sophisticated personnel management activity and administration and you get into the small shop with 50 or 100 employees and it is not that way at all.

Now, another aspect that we have found is the employee with a grievance. He hesitates to go and talk to his employer in a small shop, or a lot of times he hesitates to go to the union leader or the shop steward because if he asks a question as to whether or not his plan is being properly administered or asks a question that might reflect on the management, then he fears that he is going to lose his job or he is going to fall into disfavor with the union, and for that reason it is my opinion that you need some local level agency to look into these grievances and to resolve them.

Senator NELSON. Would you simply reserve State inspection, surveillance, as you say, to solely intrastate plans?

Mr. DuROSE. Yes. I think that is a convenient line of demarcation. As an example—or you might even set a line of demarcation, say, of a thousand employees. You could say plans with a thousand employees or less are subject to State fiduciary responsibility administration or those with more would be subject to Federal. There are a number of ways that you could carve out different areas of responsibility and I think that these types of things need to be focused on.

All of the pending Federal legislation would preempt completely State authority and State activity so that we woud be out of business in Wisconsin. Our people in Wisconsin would not get the protection and the activity that we are doing now and there would be no viable Federal substitute. They would have to either try and get the Secretary of Labor to do something or they would have to get an attorney and go into Federal court and I think that is a nonsolution for our people out in Wisconsin.

Senator NELSON. Do you see any problems of duplication?

Mr. DuROSE. No, because, you see, I think the duplication issue is one largely in an interstate corporation or interstate employer or interstate union but if you keep this strictly on an intrastate basis, then there is no—there really is no duplication and particularly if you properly draft the Federal legislation, as I have suggested, and I have attached to my statement a proposed text for S. 4, that the Secretary of Labor, whatever Federal agency would be involved, should have authority to assign to a State, if the State would be desirous of entering into this responsibility, the Secretary of Labor could assign authority to the State insurance commission for a certain specified block of funds, whether it be by size, number of employees, whether it be intrastate versus interstate. You could have a specific agreement as to which plans that State agency would have jurisdiction over. You could eliminate by drafting this matter of duplication and if you only have an intrastate fund, the duplication would only be dual rather than multiple, the State of Wisconsin and, say, IRS, or whatever, which is what we have got right now—our forms track for these Department of Labor forms, D-1's and D-2's and that sort of thing.

The thing is that the employers in Wisconsin, the labor people in Wisconsin, the plan beneficiaries all agree we are doing a great job and this is something that is good and desirable and it bothers me that all of a sudden this would be removed from the picture.

Senator NELSON. What responsibilities do your inspectors have now? It is just fiduciary?

Mr. DUROSE. Basically, fiduciary and actuarial status. We can examine into the actuarial status of a plan. We can use certified public accountants under the authority of our statute to provide examination reports. We have a department of about seven men that administer these 7,000 plans that are registered with us.

Senator NELSON. 7,000?

Mr. DUROSE. Yes.

Senator NELSON. How often are these plans examined?

Mr. DUROSE. We have the plans on about a 7-year cycle of examination, as far as one-the-scene visits, but annually the plans that are more than 25 employees file an annual financial statement and that is subject to an office audit. So we can detect from that audit parties in interest, investment, and things that would raise questions that would precipitate correspondence or an examination. So that we actually look over—there are about, as I recall, 2,500 that file annual statements. So we look over that number of financial statements each year and satisfy ourselves as to whether there is any problem indicated, and we do find problems and follow up on them.

Senator NELSON. Go ahead.

Mr. DUROSE. So there is that type of activity that we are involved with which we think would be most unfortunate if we were to—the Federal act would—as I say, this is to stop and then there is no viable substitute.

There are just four or five points I might just make as far as to summarize this. We think that as far as Federal regulation of disclosure, fiduciary responsibility, it should be supplemented by State regulation because there are too many funds for proper surveillance by the Federal Government, that most problems of fiduciary standard regulations are in the smaller funds, that you need some aggressive action to adequately cope with these problems of disclosure, fiduciary responsibility, and that the reports alone just are not adequate, that consumer protection needs to be afforded at the level of the consumer, and that the Federal—the solution of hiring an attorney and going into Federal court is a nonsolution for protecting the consumers.

That basically summarizes what I have to say, Senator.

Senator NELSON. Thank you very much for your presentation. We appreciate your taking the time to testify.

[The prepared statement of Mr. DuRose follows:]

PREPARED STATEMENT OF STANLEY DUROSE, JR., COMMISSIONER OF INSURANCE OF THE STATE OF WISCONSIN

My name is Stanley C. DuRose, Jr., and I am the Commissioner of Insurance of the State of Wisconsin. I have been Commissioner since October 1, 1969. Between 1948 and 1969 I was a civil service employe of the Wisconsin Insurance Department, serving as Deputy Commissioner from 1965 until being appointed Commissioner. In addition to the State of Wisconsin, I also appear on behalf of the National Association of Insurance Commissioners (NAIC). I serve as Chairman of the NAIC Subcommittee on Regulation of Employee Pension and Welfare Plans.

With this background of almost 25 years in insurance regulation, it is not difficult to understand why I have developed a concern for the protection needed by Mr. Average Person, now commonly referred to as a consumer. I am of the opinion that he frequently needs help in understanding his insurance coverage and resolving insurance problems he doesn't understand. I hold the same view when he faces the same difficulties with his welfare or pension plans and benefits. Because of our experience with the Wisconsin employe welfare fund law, we have developed some opinions as to what protection is needed. I vigorously disagree with the concept contained in all pending federal legislation that all state interest and activity in the area of the regulation of disclosure and fiduciary responsibility be abolished and that all responsibility and authority be pre-empted to the faceless federal monolith. It is essential that federal regulation be supplemented by state regulation because:

(1) The number of funds is too great for proper surveillance to be provided by any one federal government agency.

(2) Most problems in fiduciary standard regulation come from funds with the smaller number of participants.

(3) Affirmative and aggressive action is required to adequately regulate disclosure and fiduciary standards. Disclosure reports alone are not adequate.

(4) Effective consumer protection needs to be provided at the level of the consumer.

Our Wisconsin law was passed in 1957, at the time when many states were considering or passing employe welfare and pension fund regulation. The bill originally introduced provided for fiduciary standard regulation, including examination powers, over Taft-Hartley type funds only—like New York's present law. As a matter of fact, I believe the original bill draft came from the New York legislative draft file.

During legislative consideration of the bill, labor spokesman complained that employer established funds should also be subject to the proposed law. Their view was adopted and our law applies to any fund that is operated under a trust agreement.

Any employe welfare or pension fund covering one or more Wisconsin employes is required to register with my office. Any fund covering 26 or more Wisconsin employes is required to file an annual statement and provide us with copies of the trust agreement, plan, employe booklet, labor agreement, or other document under which the fund operates.

Exhibit A attached to this statement consists of a table showing the classification of the 7,204 funds registered with my office as of December 31, 1972. On that date we had 2,235 funds covering more than 25 Wisconsin employes and 4,969 funds covering less than 26 Wisconsin employes.

We "office audit" all annual statement filings and conduct examinations at regular intervals of all funds covering 26 or more Wisconsin employes which are located in Wisconsin. Where unusual circumstances exist, we examine funds with less than 26 Wisconsin employes, and in a few instances—one of them being the Barbers Pension Fund in Indianapolis—we examine funds located outside Wisconsin. Since 1957 we have conducted about 1,700 fund examinations and reported thereon to fund trustees and participants. To a large extent, our examinations are accomplished with the assistance of the certified public accounting firm and, if a pension fund, the actuary regularly servicing the fund. We have developed audit programs for the different types of funds and an actuarial report form, all with the assistance of advisory committees from the professions involved.

Our law contains some specific prohibitions, but the primary thrust is to require trustees to be responsible fiduciaries. Trustees are identified as those parties having overall management of fund affairs.

In Wisconsin we became aware early in our experience of administering our law that many people do not view employe welfare and pension trusts as trusts requiring trustees to conform to the high fiduciary standards of conduct. I must acknowledge that we have a great number of very sincere trustees conducting fund affairs in a most proper manner. But there are exceptions. Quite frequently, those trustees not following proper fiduciary standards are those that by education and profession should be aware of trustee responsibility. I cannot avoid a conclusion that there will always be some union and employer officials who will refuse to accept the fact that employe welfare and pension funds are trusts and that they must be administered as such. So additional laws are needed to protect fund participants and to require trust surveillance by some governmental agency.

Let me give you some examples.

We are right now involved in action against three individual trustees responsible for a profit sharing retirement fund covering 20 employees. About $250,000 of the total fund assets of $400,000 represent unsecured loans to the employer establishing the fund. As originally written, these notes carried the personal endorsement of company officials, but this endorsement was eliminated in recent note renewals. The employer is now bankrupt. Of particular interest is the fact that the three individual trustees are knowledgeable and responsible people. Two are practicing attorneys and they all are men of stature in their community. In their representations to my office they do not acknowledge that as trustees of the profit sharing retirement fund they were wearing hats different than those worn as officers of the employer.

As another example, let me cite a problem with a jointly-administered Taft-Hartley type fund providing health and welfare benefits to around 25 building trade union employes. The employer and union trustees, although designated trustees by the trust agreement, never became involved with the fund, with the exception of the one trustee also serving as union business agent. He operated the entire program and, because of his unfamiliarity with accounting and office procedures, all union finances and affairs were completely commingled with those of the fund. Our examiners are assisting in the reconstruction of the fund records.

These two examples are not unique. Our experience indicates that many fund trustees do not recognize that they serve as fiduciaries and must operate the trust in accordance with fiduciary standards.

It also has to be acknowledged that state action in this field has not been very impressive. In the 1950's, various states were considering legislation and a few, like New York, California, Massachusetts, Connecticut, Washington, and Wisconsin, did pass laws of various kinds on the subject. With the passage of the federal disclosure act in 1958 state interest disappeared. The states were told that although trusts had been primarily the responsibility of state government, the federal government had taken over those state responsibilities.

In my opinion, the 1958 federal law could well have been supported by fund officials not wanting controls. The federal disclosure act is completely ineffective, except as a paper shuffling experiment.

But state interest in employe welfare and pension funds has increased recently. In my state, as a result of plant closings with resulting pension benefit disappointments, the 1971 legislature appointed a legislative council study committee. This study committee drafted a bill now before the 1973 session proposing increased state regulation of fiduciary standards and also proposing state funding and vesting standards.

Because of our Wisconsin law and legislative counsel study, I have become aware that California, Connecticut, Illinois, New Hampshire, New Jersey, New York and Pennsylvania also have legislation under consideration.

I should point out that at this time I am not an advocate of the states adopting vesting, funding, portability and reinsurance standards.

I am directly involved in encouraging states to enact fiduciary standard regulation of employe welfare and pension funds. I serve as Chairman of a National Association of Insurance Commissioners Subcommittee drafting a proposed model act for consideration by state legislatures interested in this area. It is my hope that a model act will be adopted by the NAIC this June during our meeting here in Washington.

The proposal before the committee would establish state jurisdiction where federal law permits. The model act would require funds to operate in accordance with fiduciary standards; require an annual disclosure to each participant of his benefit status in the fund; and vest regulatory authority over funds with the Commissioner of Insurance. Fund registration and annual statement filings would be required and the Commissioner would have the authority to conduct examinations of the funds. The proposed act would establish regulatory authority and procedures very similar to that now in effect in Wisconsin.

Broadly, the proposed model act is aimed at providing understandable disclosure to fund participants and establishing regulatory authority and procedures which minimize filing and cost burdens to properly operated funds. It is my view that private pension funds should be encouraged—not discouraged. The proposed act is consistent with that view. The adoption of a model act by the NAIC will tend to promote the development of a uniform pattern of regulation by the states, and hopefully fill a void that now exists.

One major problem I have had in my efforts against federal preemption of disclosure and fiduciary standard regulation is that the people drafting the legislation seem not to be listening.

First of all, the vesting, funding, portability, and reinsurance questions have been getting most of the publicity. Plant closings have attracted public and legislative interest to the subject. Although I might disagree with many of the proposed solutions, I do not disagree with the proposition that pension fund rules on vesting, funding, portability, etc. must be established on a national level. But, this being true, it is also equally true that fiduciary standard regulation must involve the states if it is to be effective.

Everytime I have appeared before Congressional hearings, and, for that matter, before business and labor groups, they cite programs like the Caterpillar Tractor Co. Pension Plan coverage perhaps 40,000 employees, the Garment Workers Fund covering 400,000 members, or a General Motors Pension Fund covering about as many. Then they say, how can states deal with funds like these? But I am not too worried about the Caterpillar Tractor, Garment Workers, or General Motors funds and their adherence to fiduciary standards. They have highly sophisticated administration, and such giant multi-state programs could appropriately be administered by the federal government.

The programs I am worried about—the funds needing surveillance—are much smaller funds, generally intra-state funds covering employes in only a single state. Exhibit B attached to this statement shows the number of funds filing annual statements with my office during 1972 classified by location (Wisconsin and out-of-state) and also type of fund and number of participants covered. This table clearly indicates that fiduciary standard regulation concerns a great number of smaller funds. There were 886 of these funds (865 Wisconsin funds and 21 foreign funds) with more than 25 but fewer than 101 participants.

S. 4 will have the federal government taking over exclusive responsibility for fiduciary standard regulation for all of these funds.

Our experience indicates that inadequate administration and conflict of interest questions are almost common in funds with the smaller number of participants. There are several significant reasons for this. First, a smaller employer is likely to adopt a profit sharing retirement plan as the pension funding arrangement. Rather than a corporate trustee, employer officials frequently serve as individual trustees and their employer interests frequently over-ride their responsibilities as trustees, which they view as a secondary consideration. This condition applies equally to profit sharing funds covering a few hundred employes as well as smaller numbers of employes.

In 1972, 161 profit sharing retirement funds located in Wisconsin covering between 26 and 100 participants were operated by individual trustees. Of this total, 21% had invested trust monies in party-in-interest investments. It should be noted that because of our auditing and examination efforts, party-in-interest investments should be much less frequent in Wisconsin than in other States.

Another circumstance tending to create an abnormal number of fiduciary standard problems in the smaller funds is the fact that many of these programs are sold by insurance agents, investment brokers, or others. Their interest is to make the sale and not in establishing proper trust administering procedures and providing the continuing service needed.

Another problem area in funds covering a small number of employes is the tendency of small funds to be established and operated for the convenience and tax saving of the owner-employer. Government surveillance over these small funds cannot be effective by relying solely on an annual disclosure report completed by fund trustees.

Perhaps because of my many years of experience in both insurance and pension and welfare fund regulation, it is my personal belief that effective regulation also requires a review and audit of annual reports supplemented by field examinations. As an example, I do not believe I can accept every insurance company annual financial statement received in my office as proof that the company is conforming to minimum standards of solvency and methods and practices. It is essential that we review and audit annual statements and also obtain additional information by correspondence and field examinations. In my opinion not less than the same type of activity is necessary to properly enforce employe welfare and pension fund fiduciary standards.

It is my view that the federal government will not provide the supervision required over these smaller funds. According to our calculations, based on the number of trusts filed with our office, the federal government would be responsible for seeing to it that somewhere between 85,000 and 100,000 trusts were being operated in accordance with the fiduciary standards provided by S. 4. Certainly the record of administration by the federal government under the 1958 disclosure act would not inspire confidence as to how this new, and much more complex task would be handled.

I want to emphasize again that participants in the larger funds are at present generally well taken care of. Recently in my state the retired participants of a large employer became exercised over a unilateral change in their group life coverage. They knew where to go for information and within a short time started legal action to attempt to reverse the insurance reduction. They had no trouble banding together with a class action and were led by one of their own retirees—formerly legal counsel for the employer involved.

But such opportunity is not available to an employee of a small employer or member of a small union. As a matter of fact, he is afraid to make any inquiry to his employer or union for fear of losing his job or friendly union status.

It is a non-solution to provide that such a person should engage an attorney and start action in a federal court to correct a wrong. But this is the solution provided in all federal legislation to date. Consider the following special cases in which my office brought about correction of the wrong.

A retired individual has $900 coming from an employer profit sharing retirement fund, but the trustee who is also a company officer won't pay because the fund is all invested in real estate used by the employer;

Building trade union members vacation money distribution from a jointly-administered trust was being withheld by the union business agent because of a disagreement over union affairs between those members and the union office;

Trustees in a jointly-administered fund covering about 200 union members ignored the failure of one employer to make the monthly contributions on his employes required by a collective bargaining agreement but continued to purchase insurance coverage for the employes involved;

In the same fund, more than a reasonable amount of money is paid the union every month as compensation for administrative services needed by the fund but grossly inadequate services are provided;

The federal proposal of hiring a lawyer and initiating action in federal court also is no solution to the man who terminated his employment and received the correct first year distirbution from fund trustees of his profit sharing retirement fund but never received the other nine payments. The total amount due him was around $370.00;

The federal proposed solution might have solved the problem of two participants in a profit sharing retirement fund who terminated their employment with amounts payable from the fund of $12,000 and $23,000. They could have engaged a lawyer and started action when fund trustees refused to pay their termination benefits. The trustees refused because the two individuals now worked for a competitor—but the plan and trust authorize no such trustee discretion. The amount here was sufficient so the terminated participants could have hired a lawyer—but they did not and my office got the matter corrected. We have had many similar complaints where the benefit is too small to permit the engagement of an attorney.

An attorney initiating federal court action would also be a nonsolution in a complaint we had from an employe who was employed at various times by many subsidiary companies. A cumulative record of his contributions had not been maintained so he needed help in forcing the companies to compute his total contributions. The total paid him, after this effort, was about $2,600.

S. 4, as amended by the Committee on Labor and Public Welfare and reported to the Senate April 18, 1973, contains language indicating that the administration of the fiduciary standards and other bill provision can be a joint federal and state venture. Section 101(e) states:

"In order to avoid unnecessary expenses and duplication of functions among Government agencies, the Secretary may make such arrangements or agreements for cooperation or mutual assistance in the performance of his functions under this Act and the functions of any agency, Federal or State, as he may find to be practicable and consistent with law. The Secretary may utilize on a reimbursable basis the facilities or services of any department, agency, or establishment of the United States, or of any State, including services of any of its employees, with the lawful consent of such department, agency, or establishment; and each department, agency, or establishment of the United States is authorized and directed to cooperate with the Secretary, and to the extent permitted by law, to provide such information and facilities as the Secretary may request for his assistance in the performance of his functions under this Act."

It is my opinion that the arrangement described in this section is not workable. If a state agency is to provide the surveillance needed over a particular assigned classification of funds, that state official must have some authority over such funds. The authority granted the Secretary of Labor in S. 4 must be transferable by the Secretary to a state official or the state official must be able to have such authority by state law.

As an example, when a fund participant writes to my office describing a fund problem, I need some authority over that fund to determine if the trustees have acted properly. I now have that authority under Chapter 211, Wisconsin Statutes. If S. 4 is enacted, section 609 will repeal our Wisconsin law for all funds covering 26 or more participants. We will have no choice other than refer fund participants to the U.S. Secretary of Labor in Washington. As I have noted earlier in this statement, I question whether the U.S. Labor Department can, or intends to, attempt to resolve complaints or inquiries from individual fund participants. My concern is reinforced by the statement in the explanatory material prepared by the Treasury Department to accompany the President's Pension Reform Program. That explanation says, "Neither of these bills [i.e. Retirement Benefits Tax Act and Employee Benefits Protection Act] would require any significant expenditure of tax dollars since the Federal Government will play principally the role of watchdog over the new standards."

All of my contacts with the federal agencies and Congressional committees have confirmed my view that the consumer grievance and complaint aspect of fund regulation has been overlooked in the plans for federal fiduciary standard regulation. To me it is elementary that a governmental agency must investigate a complaint from a trust beneficiary on the treatment he has received from trustees. I do not believe the federal government should take over responsibility for enforcement of trust fiduciary standards, abdicate responsibility for investigation of complaints from participants, and then by law prevent the states from affording consumer protection activity.

As noted earlier, S. 4, like the other bills, solves this problem by authorizing the trust beneficiary to hire a lawyer and sue in federal court. I question both the equity and effectiveness of this remedy.

The complaint resolving activity provided by my office is a necessary function in the regulation of the disclosure and fiduciary standards of employe welfare and pension funds. It is as valuable a service to fund trustees and managers as it is to fund participants. It also is an essential part of our fund regulatory activities. Frequently we first become aware of fund mismanagement or improper administration through a complaint from an individual participant in a fund.

I believe that total federal pre-emption of fiduciary standard regulation will, in effect, result in ineffective, or non-regulation, particularly as respects the smaller funds where regulation is needed most.

I do not advocate dual regulation. I think it is desirable for the federal government to establish standards and to determine whether the regulatory activities of any given state are adequate to enforce those standards. In such event, responsibility for regulation of a clearly defined classification of funds, located in that state, could be assigned to that state agency by the federal regulatory agency. Thus fund trustees could report to and be regulated by either the federal or state agency, but not both. In general, those funds covering a small number of employes, and/or primarily covering employes in one state, would be regulated by that state, if adequate regulation was provided by that state.

I respectfully ask that your committee give consideration to amending S. 4 in the following respects:

(1) Add a new subsection (f) to Section 101 of the bill similar to that attached as Exhibit C to this statement. This is intended to authorize the Secre-

tary to assign fiduciary standard regulation on a specific defined area of funds to a state meeting the regulatory standards established by federal law.

(2) Insert the following new language between "title" and "the" in the third line of Section 609(a) of the bill, "and state regulatory enactments approved under section 101(f)".

It is intended that the proposed model act under consideration by the National Association of Insurance Commissioners would track with such regulatory requirements as are in S. 4. If Congress permits assignment of part of the enforcement responsibility to qualifying states, the NAIC model bill would be ready for enactment by those states electing to provide such service to its citizens.

In closing, I want to state that I appear before this committee as a public employe concerned with the need for a reasonable measure of consumer protection for fund participants. In this protection endeavor, cooperative state and federal efforts are urgently needed. It is important to keep in sharp focus the fact that in Wisconsin the employers, the union leaders, the fund trustees, and the employes all agree that the job we have been doing needs to be done and further they are most statisfied with the results over the past 16 years. I ask that, when you consider the federal style of consumer protection as compared to the effectiveness of state activity at a local level, you consider my experience with the Barbers Pension Fund in Indianapolis.

In 1970 we became aware that this fund was an unsound venture. About 60,000 barber union members had been contributing to this pension program since 1966. Benefit payments were to begin in January, 1971. We were convinced that the fund would completely run out of money before 1986. I asked the Wisconsin Attorney General to join, as an "Amicus Curiae", in a class action lawsuit in U.S. District Court in Indianapolis brought by a dissident group of members, I wanted to either stop this program which was headed for bankruptcy or have it amended so that it would be actuarially sound. The program was not only actuarially unsound, but the investment practices were at best irresponsible.

I, together with members of my staff, and an Assistant Attorney General of the State of Wisconsin, spent many weeks in Indianapolis over a two year period, participating in court hearings and conferences to bring about a resolution of the Barbers Pension Plan matter. No other governmental agency appeared on the scene to assist in the project. The court in rendering its decisions was most gracious in acknowledging the efforts of the State of Wisconsin.

I am not knowledgeable in the powers the Labor Department feels it has under the present federal disclosure laws, but in my opinion some effort should have been made by that agency to help the barber union members straighten out their pension fund. The federal Department of Justice did take action in Chicago against certain individuals for fund investment practices. But no federal agency, to my knowledge, took any action to resolve the pension fund problem.

With this background, it was interesting to me to read the recently released 1972 Report to Congress by the U.S. Department of Labor on their administration of the Welfare and Pension Plans Disclosure Act. Five pages of this report are devoted to describing welfare and pension plan problems and legal action taken to correct the wrongs. Of these five pages, two are used to describe the Barbers Union Pension Fund and how the matter was resolved in the U.S. District Court by appointment of a receiver, referendum by members, and planned distribution of the fund. Everyone reading this report will conclude that the U.S. Labor Department assisted in bringing all this about. That is everybody but me and those people directly involved in the court action.

This is the kind of governmental regulation and assistance that the people don't need.

My interest is in providing needed protection to participants in these trusts. And I feel that the present federal legislative proposals, with the federal preemption of fiduciary standard regulation, can be enthusiastically supported by those employers and unions who favor ineffective control.

I wish to thank you for this opportunity to appear before you. If I can be of any assistance in providing information we have available from our Wisconsin regulatory experience, please let me know.

STATE OF WISCONSIN, OFFICE OF THE COMMISSIONER OF INSURANCE

CLASSIFICATION OF REGISTERED EMPLOYEE WELFARE AND PENSION FUNDS, DEC. 31, 1972

	Total	Wisconsin	Out of State [1]
All funds registered:			
Pension funds	3,428	2,880	548
Profit-sharing funds	3,174	3,023	151
Health and welfare funds	309	182	127
Group life insurance funds	61	17	44
Supplemental unemployment benefit funds	43	17	26
Vacation, savings, and other funds	189	132	57
Total	7,204	6,251	953
Funds covering more than 25 Wisconsin employees:			
Pension funds	1,036	730	306
Profit-sharing funds	714	654	60
Health and welfare funds	252	172	80
Group life insurance funds	41	16	25
Supplemental unemployment benefit funds	35	17	18
Vacation, savings, and other funds	157	118	39
Total	2,235	1,707	528
Funds covering less than 26 Wisconsin employees:			
Pension funds	2,392	2,150	242
Profit-sharing funds	2,460	2,369	91
Health and welfare funds	57	10	47
Group life insurance funds	20	1	19
Supplemental unemployment benefit funds	8		8
Vacation, savings, and other funds	32	14	18
Total	4,969	4,544	425

[1] Principal office of fund located outside Wisconsin.

EXHIBIT B

STATE OF WISCONSIN, OFFICE OF THE COMMISSIONER OF INSURANCE

EMPLOYEE WELFARE FUNDS FILING ANNUAL STATEMENTS—1972, NUMBER OF FUNDS CLASSIFIED BY LOCATION, NUMBER OF PARTICIPANTS, AND TYPE OF BENEFITS

	Pension	Profit sharing and savings	Health and welfare	Other—SUB group life and vacation	Total
WISCONSIN FUNDS					
Total employees:					
26 to 100	317	511	25	12	865
101 to 200	116	97	27	14	254
201 to 300	70	28	14	6	118
301 to 400	42	15	12	2	71
401 to 500	31	42	10	7	90
501 or more	127	26	78	21	252
Total Wisconsin funds	703	719	166	62	1,650
FOREIGN FUNDS					
Total employees:					
26 to 100	11	2	7	1	21
101 to 200	3	1	3	1	8
201 to 300	6	1	1		8
301 to 400	5	5	1		11
401 to 500	6	4	2	1	13
501 or more	262	78	55	37	432
Total foreign funds	293	91	69	40	493

[1] A fund classified as located in Wisconsin is: (1) A jointly administered or association type fund with its situs in Wisconsin, (2) a fund established by an employer with his main office or operations in Wisconsin, or (3) a fund established by an out-of-state employer which covers only employees located in Wisconsin.

Note: This tabulation excludes certain funds reported on exhibit A because of incomplete or delinquent annual statement filings or newly established funds not required to file annual statements in 1972.

BEST AVAILABLE COPY

EXHIBIT C

SUGGESTED LANGUAGE FOR NEW SECTION 101(f) TO S.4 TO PERMIT STATES TO REGULATE EMPLOYE WELFARE AND PENSION PLANS AND FUNDS

(f)(1) Any State which, at any time, by state statute and regulations assumes responsibility for development and enforcement of employe benefit plan disclosure, fiduciary standards, examination or audit programs and other regulations reasonably as effective as those in sections of this Act may submit for the Secretary's approval such State regulatory enactment, together with such other information as the Secretary may require.

(2) The Secretary shall approve the State regulatory enactment or any modification thereof, if such enactment in his judgment—

(*a*) designates a State agency or agencies as the agency or agencies responsible for administering the disclosure requirements and plan and fund regulations throughout the State,

(*b*) provides for the development and enforcement of employe benefit plan requirements for disclosure and regulation reasonably as effective as that provided in this Act,

(*c*) limits state jurisdiction to those plans or funds covering only, or substantially only, employes in that state and such other plans or funds as may be specifically designated by the Secretary,

(*d*) contains satisfactory assurances that such agency or agencies have or will have the legal authority and qualified personnel necessary for the enforcement of such enactment,

(*e*) gives satisfactory assurances that such State will devote adequate funds to the administration and enforcement of such enactment, but nothing in this Act shall prevent such state or agency thereof from making reasonable charges for the administration of the program,

(*f*) provides that the State agency will make such reports to the Secretary in such form and containing such information, as the Secretary shall from time to time require.

(3) If the Secretary rejects a state regulatory enactment submitted under subsection (b), he shall afford the State submitting the same due notice and opportunity for a hearing before so doing.

(4) The Secretary shall, on the basis of reports submitted by the State agency and his own inspections make a continuing evaluation of the manner in which each State having a state regulatory enactment approved under this section is carrying out each enactment. Whenever the Secretary finds, after affording due notice and opportunity for a hearing, that in the administration of the State regulatory enactment there is a failure to comply substantially with any provision of such enactment, he shall notify the State agency of his withdrawal of approval of such enactment and upon receipt of such notice such enactment shall cease to be in effect, but the State may retain jurisdiction in any litigation commenced before the withdrawal of such approval.

(5) The State may obtain a review of a decision of the Secretary withdrawing approval of or rejecting its enactment by the United States court of appeals for the circuit in which the State is located by filing in such court within thirty days following receipt of notice of such decision a petition to modify or set aside in whole or in part the action of the Secretary. A copy of such petition shall forthwith be served upon the Secretary, and thereupon the Secretary shall certify and file in the court the record upon which the decision complained of was issued as provided in section 2112 of title 28, United States Code. Unless the court finds that the Secretary's decision in rejecting a state regulatory enactment or withdrawing his approval of such enactment is not supported by substantial exidence the court shall affirm the Secretary's decision. The judgment of the court shall be subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28, United States Code.

Senator NELSON. Our next witness is Mr. Eldon Nyhart, president, Howard E. Nyhart Co. of Indianapolis.

STATEMENT OF ELDON H. NYHART, PRESIDENT, HOWARD E. NYHART CO. OF INDIANAPOLIS

Mr. NYHART. Thank you, Senator. The full text of my comments is here. I would like to have them introduced in the record.

Senator NELSON. They will be printed in full in the record.

Mr. NYHART. I would like to devote the time allotted to me to a graphic representation of the problems in connection with vesting which I think might be helpful to the committee members.

There is much confusion about what vesting is and if I might, an individual who participates in a pension plan can be displayed as a dot on this graph based on attained age running from 15 to 65 and age of hire running from 15 to 65. Everybody, every participant in a pension plan, can be displayed as a dot on this graph.

Now, you will notice—and we find from our experience, that plans do have vesting—most plans have early retirement provisions, age 55 and above, after completion of at least 10 years of service. So this area in most pension plans already provides for 100 percent vesting, and I wanted to make that clear.

Now, let us take the various proposals. Based upon age and service, S. 4 provides partial vesting for the light blue group and 100 percent vesting for the darker blue. They would be 100 percent vested, partially vested there. If they are in the white area they would have no vesting at all in the event of termination of employment.

Let us take S. 1179. This based on the vesting schedule provided and the participation requirements would have 100 percent vesting here, partial vesting here for this age group if they fell within this display.

Let us take S. 1631. It would provide partial vesting for anyone here, based on attained age, and age of hire, and would have 100 percent vesting in the event of termination for this dark group.

Now, how does this cost out? The cost of vesting in the event of termination of employment is highest based upon attained age and age of hire the smaller the box becomes. In other words, providing 100 percent vesting for this group down in here is much lower in cost than if we get to the high hire ages and the longer service.

So the problem is primarily this group here. This group is the one that costs the most to provide 100 percent vesting and it also is the group that probably needs vesting because of inability to get back into the work force. So let us see the solution to these various vesting schedules.

Here is S. 4. It provides 100 percent vesting down here where it costs very little but also this is not the problem area. The problem area is where these little boxes get smaller, and here S. 4 does not provide any vesting at all under the law as it now stands and only partial vesting among this group here.

Let us take S. 1631. This does a better job. It provides partial vesting for this group up here and 100 percent vesting. It also provides vesting down here, but you see it covers this critical area right here. Likewise, it would cost more.

Now, let us take S. 1179. It does a pretty good job by providing partial vesting for this small box critical area. If you remember that there is already in most plans 100 percent vesting down here, it really provides 100 percent vesting in a group here that really is not very costly and really is not much of a problem and it does provide partial vesting for this group here.

Now, we have provided the so-called rule of 50 at 10 percent a year which is in our proposal. It provides 100 percent vesting here and it provides partial vesting for this critical group. You see how these differ. This is our proposal compiled to 1631. This is 1631. It provides a partial vesting for more of the group but not as much—and 100 percent vesting for this group here. It does a pretty good job. In other words, 1631 is a pretty good pattern.

Here is 1179. You see, it also provides a pretty good coverage here and it would cover—it would provide 100 percent vesting for a group down here that is not very critical.

Here is S. 4. You see, S. 4 really does not do as good a job as the other proposals because it provides 100 percent vesting down in here where the boxes are big and the cost is not very much. However, it does not get into the critical area up here. In other words, you see, S. 4 does not get at the real problem. It provides 100 percent vesting down here where the boxes are big. In most plans there is already 100 percent vesting here but it provides very modest vesting here and provides vesting over in here where the cost is rather low. In other words, expressed as the problem area for this group, a dot here is a participant. Where we are really getting at the problem is in these small box areas and S. 4 does not really do the job.

Again, to just review, here is S. 4, leaving out the problem cost areas. Here is 1631. It does a pretty good job, at least in the partial vesting and 100 percent vesting up in here.

Here is 1179, partial vesting, only 100 percent vesting in here. It covers a good group of people but only partially vests them. And this is our proposal. We think it is a partial—it covers partial vesting. It covers a few more people, 100 percent vesting only among the group that is pretty well covered in most plans now, and partial vesting for a fair number of the work force.

Mr. Chairman, I wanted to bring this today to—it is an attempt to graphically—it requires practically a three-dimensional approach but we have developed it to try to help focus in on just what the various vesting schedules mean and what they amount to and try to visually present what the costs are. Remember again, to summarize, everybody can be displayed on this area on these various vesting schedules, partially and 100 percent. The sr aller the box, the higher the cost.

Senator NELSON. Does that plan take into consideration prior service?

Mr. NYHART. Yes, it does. We had to make certain assumptions, yes. This takes into consideration prior service.

Senator NELSON. You fund the prior service?

Mr. NYHART. In our recommendations we feel that the minimum funding required now by IRS is sufficient, which is interest on the past service liability. We think that is adequate. We believe in reinsurance. We thnk if you are going to have any pension reform legislation and require vesting, you have to have reinsurance to reinsure the unfunded vested liabilities in the event of plan termination.

Senator NELSON. Well, thank you very much for your presentation. We appreciate your taking the time to come.

[The prepared statement of Mr. Nyhart follows:]

Prepared Statement of Eldon H. Nyhart, President, Howard E. Nyhart Co. of Indianapolis

Mr. Chairman and Members of the Committee, the operation of the private pension system in the United States is increasingly becoming a subject of criticism by public-minded individuals. There is no doubt that this country's private pension system must be improved and strengthened to overcome the valid criticism it has received.

It would seem that the criticism of the private pension system is usually a result of one or more of the following:

1. Employees do not understand their benefits.
2. For any of several reasons, employees lose benefits to which they should be entitled.
3. Too many employees are not covered by private plans.

Any pension reform legislation can and should correct these defects without the expense of significant additional involvement by agencies of the Federal Government. At the same time, it should treat all private plans alike as nearly as possible.

All private plans must be treated alike if we are to have effective reform, avoid the cumbersome administrative complications which could discourage the growth of private pensions, and avoid discriminatory loopholes in the law. Exceptions cannot be made for union plans, small employer plans, self-employed, plans administered by tax-exempt organizations, and most important of all, no exception can be made for plans already in existence on the effective date of the legislation.

1. Broader Coverage

Plans should be required to provide broader coverage through minimum standards for participation. Each employee who has completed three years of service and is at least twenty-five years old should be eligible to participate. Such employees have established the permanent nature of their employment and should no longer be excluded from a pension plan. Of course, more liberal requirements could be adopted either unilaterally by the employer or though collective bargaining. Pension credit can easily be given for early years of employment before meeting the eligibility requirements, but the employer should not be required to keep pension records for very short-term employees.

Additionally, coverage should be extended to employees hired at older ages. Many pension plans exclude employees hired after age fifty-five, or age sixty, or some other higher age in order to keep down the employer's cost of providing pension benefits. A maximum age limit for participation should not be allowed, however, employers should have an adequate period of time to fund benefits for older employees, such as ten years of participation before an employee could receive full benefits. An employee retiring with less than ten years of participation could be entitled to a proportionately smaller benefit.

2. Vesting

Restricted employee participation requirements when combined with some minimum vesting provision would add immensely to benefit security and would surely encourage mobility, especially among that segment of work force near retirement.

A well designed vesting schedule would provide earlier vesting for employees who are hired at older ages so that pensions can be earned by that portion of the labor force. Gradual vesting is necessary to allow time for the employer to adequately fund the benefit. It is important to the employer, to the employee, and to the soundness of the entire system to encourage full funding of vesting benefits and, therefore, the requirements must be designed such that full funding of vested benefits can be accomplished under normal funding techniques.

To accomplish all of these objectives, pension plans should be required to provide that at least 10% of the full-acrued benefit of an employee be vested when his age plus his participation (after enactment of legislation) equals fifty. An additional 10% of the accrued benefits should become vested with each additional year of participation.

It should be stressed that the vesting percentage recommended be applied to the full accrued benefit and not just that portion accrued after legislation becomes effective. Little, if any retirement income security is provided the present working generation by vesting only benefits earned after the effective date of the legislation.

Even moıe important, this concept of gradual vesting provides the employer ten years of an employee's participation to fully fund his vested benefit. Under normal funding techniques this gives the employer a reasonable period to fully fund all vested benefits and also to fund full normal retirement benefits for employees hired at older ages.

The cost of vesting in pension plans is of considerable concern to everyone involved in the private pension system. This question has been thoroughly analyzed by Howard Winklevoss, Assistant Professor of Insurance at the Wharton School of the University of Pennsylvania in his publication "Analysis of the Cost of Vesting in Pension Plans" prepared for the United States Department of Labor in 1972. Mr. Winklevoss analyzed three vesting provisions and concluded that the difference in cost among them was not significant. The expected cost to add vesting (where none existed) in a maturing labor force with medium turnover under the three schedules analyzed would increase pension costs 14% to 20%. The added cost of vesting provisions recommended herein would likely be in the range of 10% to 13%. Certainly the true added cost of the recommended vesting is considerably less than that for the typical plan which now has some vesting. It can be expected that the aggregate actual additional cost to require the vesting described above would be in the range of 5% to 10% with wide variances among individual plans.

Participation and vesting requirements could easily be enforced by the Department of the Treasury as a part of the procedures currently in operation for qualification of plans for favorable tax treatment under the Internal Revenue Code. Such prior qualification of plans has proven in the past to be an excellent method to assure compliance with pension policy.

3. REINSURANCE OF UNFUNDED VESTED LIABILITIES

There has been much publicity concerning employees losing their pensions because of inadequate funds upon plan termination. To help remedy this problem each pension fund should be required to reinsure, through a Federal agency, that portion of value of the legally required vested benefits in excess of the pension fund assets which can reasonably be expected to be available upon plan termination. In case of full or partial plan termination, the reinsuring agency would make up any such deficiency in fund assets. This would guarantee that employees would not lose any legally required vested benefit either upon termination of employment or termination of the plan for any reason.

4. FIDUCIARY RESPONSIBILITY

Pension benefits should not be jeopardized by the mismanagement of funds, nor by the decline in value of the employer's securities. Although most fiduciaries accept their responsibilities conscientiously it would certainly be worthwhile to have legislation requiring fiduciaries to act as reasonably prudent men. For pension plans, fund investment in the employer's securities should be restricted and transactions involving conflicts of interest should be prohibited. Rules similar to the recommendations in the Report of the President's Commission on Financial Structure and Regulation pertaining to Trust Departments and Pension Funds are appropriate here. That Commission recommended a "federal prudent man investment rule."

5. DISCLOSURE

Disclosure should be made in two directions—to the employee and to the Department of Labor.

Employees are entitled to be informed of their benefits so they can adequately prepare for retirement. Specifically, the administrator of each plan should be required to:

Give each new participant a written summary of the plan.

Give all participants a summary each time the plan is amended.

Give each participant an annual written statement of estimated normal retirement benefits and his present vested benefits.

Give each terminating participant a written statement of benefits due.

The information currently required by the Department of Labor under the Welfare and Pension Plan Disclosure Act should be altered so that the Department can determine if plans are complying with the requirements of reinsurance, fiduciary responsibility, fund transactions and communication to participants.

6. EMPLOYEE CONTRIBUTIONS

Participation in private plans could be made more meaningful through the encouragement of greater individual savings toward retirement. By encouraging greater employee contributions to pension plans through favorable tax treatment, more individuals would be inclined to put aside some of their current income for retirement. A tax credit equal to 25% of an individual's own contribution to a qualified plan should be allowed. A practical limit to contributions to which such a credit would apply would seem to be 16% of compensation because that is generally the maximum total mandatory and voluntary employee contributions allowed presently under qualified pension plans.

If pension reform legislation incorporates only the provisions outlined above, the pension reform needed to achieve the public goals will have been accomplished. These goals will have been met in a manner that provides the maximum benefit to employees with the least amount of additional administrative involvement. The pension system would remain flexible and the increased cost of providing benefits would be kept at a minimum. There would be no need to consider other elaborate provisions that could have detrimental effects on the system. For example, reinsurance of unfunded vested liabilities would preclude the need for any minimum funding requirement; likewise, a minimum vesting requirement eliminates any reasons for having portable benefits.

In short, good pension legislation can solve the real problems and encourage growth in a sound private pension system in this country.

Senator NELSON. Our next witness is Mr. Leon Shapiro, National Marine Engineers Beneficial Association, AFL–CIO, accompanied by Mr. Robert Leaf, president, Benefit Services of New York City.

STATEMENT OF LEON SHAPIRO, NATIONAL MARINE ENGINEERS BENEFICIAL ASSOCIATION, AFL–CIO, ACCOMPANIED BY ROBERT LEAF, PRESIDENT, BENEFIT SERVICES OF NEW YORK CITY, AND BRIAN JONES, ASSOCIATE ACTUARY, PENSION AND WELFARE PLAN

Mr. SHAPIRO. Mr. Chairman, if I may, I also have with me Brian Jones, who is an associate actuary for the pension and welfare plan.

We have had the opportunity to examine various of the legislative proposals which have been made in the area of private pensions. We sympathize a great deal with many of the objectives and we do have some reservations with respect to certain of the concepts proposed. We can live with the idea of vesting and funding standards. In fact, we have already provided generous vesting and a fast funding schedule for our MEBA plan.

We do point out, however, in our prepared testimony that the funding standards can be a problem for new plans. We have serious reservations about the disclosure requirements of some of the bills. We think they will be expensive, time consuming, and unproductive. All they will do is waste money which could be better spent on benefits.

We think that the proposed insurance of unfunded liabilities is not practical, especially in those bills which do not distinguish between single and multiemployer plans and those bills which do distinguish between single and multiemployer plans. It is important that a definition of multiemployer plans be clearly established in order to avoid the creation of loopholes for those single employer plans who wish to avoid being designated as such.

We think that the proposal for portability can be deceptive and may be harmful. It achieves really nothing which the vesting standards do not and it also allows the terminating employees to take assets out of the plans, perhaps to the detriment of the long service employee who remains and the pensioners who are already out on pension.

Additionally, we are of the opinion that if there is to be any pension legislation, it should begin in relation to those organizations that have pension benefits at all for their employees. It seems unfair that all current legislation is directed at those groups which have been willing to provide pension benefits for their employees with no regard whatsoever to those other groups who have not been so profitable.

Basically, Mr. Chairman, our pension plan which emanated out of a collective bargaining agreement in 1955 was a plan that we had hoped to streamline and we think it is a plan that has met the requirements to answer the problems that have arisen out of other plans. We think that the multiemployer program at present with the records indicate that less than one-tenth of the total employees in multiemployer plans have experienced any termination of their plans.

We think that the provisions that have been provided for in a plan such as ours on termination are sufficient unto themselves. Our present program which is multiemployer covers the industry so that the vesting and the practical aspects of portability are already applicable to our people. They can work for any company within our union and receive the same benefits that they receive if they stayed with one company for the entire length of their career. The one thing that we really do not want to see is because of the many bad problems that have emanated from single employer plans it created almost an emotional aura in the country and we think that the law should be written to cover the problems and should be written in a sensible, levelheaded way in which those plans which already have provided the needed requirements spelled out in the bills such as multiemployer plans with sound funding vesting should be excluded.

Senator NELSON. You are saying they should be excluded from all provisions of proposed pension legislation or just from the reinsurance plan?

Mr. SHAPIRO. We think the ultimate, of course, is exclusive from all, but vesting and funding is something that we can live with.

Mr. LEAF. I would just like to comment, Mr. Chairman, on the point that Mr. Shapiro brought out regarding the termination of plans that are multiemployer. The study done by the Department of Labor and Treasury Department in 1972 on pension plan terminations points out that most of these terminations are not due to failures of the plan. In fact, I can quote from the study. They say that when multiemployer pension plans terminate it is usually because the union and the employers desire to consolidate various pension plans on which they are parties in order to achieve economy of administration. So the statistics, as low as they are, at two-tenths of 1 percent, are far from an indication of inadequacy on the part of multiemployer plans.

Senator NELSON. The figure you gave us is 1——

Mr. SHAPIRO. It is two-tenths of 1 percent.

Senator NELSON. And you are saying some of those terminations were not failures of the plan but consolidations?

Mr. SHAPIRO. That is right, sir. I am saying that according to the study done by the Department of Labor and Department of the Treasury, not some but the vast majority of those terminations were not failures. They were mergers of the plan and then they would show up because the study was geared to show a termination every time a plan stopped existence they did not really differentiate between terminations due to failure and terminations due to merger.

Senator NELSON. Is there not a somewhat different problem if it is a multiemployer made up of a whole lot of small employers in the building construction trades as contrasted with large employers in the shipping business?

Mr. LEAF. Generally, Mr. Chairman, if the multiemployer definition which Mr. Shapiro requests be made very specific, it if is—if it provides certain safeguards, for example, industrywide, industrywide representation, regardless of the industry, the terminations have been very, very low. The termination figures in the Treasury study include terminations of all multiemployer plans even though small building trades and what we would like to avoid if there is going to be a differentiation between single and multiemployer plans is the opportunity for a single employer plan to merge with another single employer plan and call itself a multiemployer plan and then get the favor ble treatment that would be given under the law to a multiemployer plan, therefore, creating a loophole. We would strongly suggest that kind of situation be avoided.

Senator NELSON. Well, you say there has been a termination of two-tenths of 1 percent of the multiemployer plans. How many of them did in fact involve an involuntary termination with insufficient funds to pay the vested accrued obligations?

Mr. SHAPIRO. The statistics were not clear on that, sir, except for the point that it was a very small portion of those terminations were due to failures.

Senator NELSON. What is the objection to having an insurance program to cover the termination? If it is such a small percentage, it would obviously, I suppose, require a small amount of money to cover it.

Mr. SHAPIRO. Well, providing the amount of the insurance premium were geared to the rate of failures, we would really have no basic objection to insurance. It does, however, offer another problem. When an insurance provision is put into a plan that really does not need it, safeguards have to be written into the law to prevent the plan from assuming assumptions which might normally be unsound.

For example, instead of investing the money in a conservative portfolio of fixed income and equities which would support an interest assumption of 4 or 5 percent, the fund, to go to extremes, might invest in building more funds which yield 18 percent and base their benefits on an 18 percent assumption, and the failure of that fund would then be guaranteed just as well as the failure of the fund with the more conservative. So if there is going to be insurance we feel there should be, one, a separate premium established for multiemployer funds which will be based on the actual failure rate of these funds, and two, there should be some safeguards put into the law which will prevent abuse on the part of any fund, the kinds of abuse I mentioned in assuming unrealistic assumptions which might increase the probability of failure, which might tempt them to fail because they are insured.

Senator NELSON. Under the present multiemployer fund arrangements, do you have reinsurance provisions? That is to say, do you guarantee every vested pension right if some company goes out of business or there is involuntary termination, or bankruptcy? What happens to the pension under the multiemployer plan such as the Marine Engineers have?

Mr. JONES. When one employer goes out of business that does not mean that the plan goes out of business. The credits that that particular employees' members have accrued remain perfectly valid. The employees generally move into another company in the same industry. That company continues to contribute for them and their credits remain perfectly valid. They come up to retirement with perhaps a history of working for four or five different companies. Possibly one of those may have gone out of business in the meantime but that would have no effect.

Senator NELSON. What you are saying is that you already have a voluntary reinsurance or termination insurance program within the pension plan that your employees are under.

Mr. JONES. Built into the structure of a multiemployer plan, yes, sir.

Could I make one other small point about the question with reference to insurance? Another problem with insurance is that if you institute an insurance program, a single employer or a multiemployer fund which is funding very quickly, for instance, the MBBA fund which now has only 20 years' funding under its funding schedule, there may be an incentive to slack up on the funding schedule to the minimum, the 30, 40 years that have been discussed. This would mean that instead of a plan properly funding its own benefits it would be kind of leaning back and relying on the Government to bail them out if there is trouble.

Senator NELSON. But you would not object to some—did I understand you right—some termination insurance if it were specifically tailored to a particular fund and the experience rating and—well, experience rating of that fund?

Mr. JONES. Well, if the——

Senator NELSON. And the liabilities, et cetera?

Mr. JONES. If the experience rating were very specific and took into account all of these factors, then presumably at some point it would no longer be objectionable but it would be extremely complex at that point.

Senator NELSON. So it is your position that there is no need for any reinsurance at least for the multiemployer plan under which the Marine Engineers Beneficial Association operates?

Mr. SHAPIRO. That is correct, Mr. Chairman.

Senator NELSON. Just one more question. I did not quite understand the problem raised by provisions for portability in the plans. Are you taking the position that vesting itself satisfies all the requirements, all the benefits needed and portability necessary?

Mr. JONES. Yes. We are saying not only that, we would go further and say portability would create a distortion, and I would like to illustrate that by pointing out that the person that that portability provision takes care of is the first one to leave the plan which very often may be the youngest employee, assuming that he is vested, he has maybe 15 years of service. He terminates. At that point he takes assets out to the detriment of the people who remain.

Senator NELSON. That is the point I do not understand. Even if the assets remain in there, they are his and it is an obligation against the fund.

Mr. JONES. Yes, but if he takes the assets with him, then he has complete priority on those assets. For instance, in a hypothetical plan which has just three employees, and this could be three large groups of employees, so it is equally true of a large plan, if A has 15 years of service and the present value of his benefit is $10,000, B has 20 years of service and his vested benefit is worth $15,000, and C is drawing a pension and his annuity is worth $5,000, then if there is $12,000 in the fund at this point, that would leave an $18,000 unfunded vested liability. So the vested liability at that point would be 40 percent funded.

Now, let us assume that A terminates. Under the portability program, $10,000 would be transferred to the portability program, so some central agency, to fund his vested benefits and that would leave the plan with only $2,000 in the till against a $25,000 vested liability. So at this point it would only be 8 percent funded and the benefits of the other employees would be much less secure. And to take it even further, if B were to leave, then he would be attempting to draw $15,000 out of this plan and there would at that point be only $12,000 in.

Senator NELSON. This is on the assumption that nobody else took his place, for one thing, right? And, two, I do not know how you would have a vested retirement fund of $5,000 based on the amount of money you have named. You could not produce that much.

Mr. JONES. Excuse me? No. I am just talking about hypothetical values. The value which it would take to go to an insurance company and purchase this man's benefits or to—the amount that would be required to transfer into the central portability agency in order to guarantee a man's benefits, and I am saying that if the vested liabilities of the total plan are only as in my hypothetical 40 percent covered, are not completely funded, then if you allow the man who is lowest on the priority ladder to take out his liability, take with him the full assets corresponding to that liability, you leave very little or maybe no assets to cover the liabilities of the people who remain.

Senator NELSON. I guess—I am not an actuary. I would have to take a longer, harder look at that. If that is based upon the assumption that you have 10,000 employees that one-third of them are going to—9,000 employees, one-third of them are going to immediately leave and are in the lowest seniority and take all their money with them, is that right?

Mr. JONES. Yes. My hypothesis was a very small single employer plan but if this were a larger plan and there was contraction in the industry and people with the least seniority moved out into a different industry and then the portability program required that they be able to take out of that plan assets to match their liabilities, then they would be geting the first crack at those assets and they might even exhaust the assets, leaving nothing for the people who are already on pension or who may have much more seniority.

Senator NELSON. Have you ever applied that to an actual situation, say, the coal industry, or the railroad industry which—I do not have the exact figures in mind any more, but which over a period of 20 years dropped their employment by about 50 percent from 1940 to 1960? Would that have happened?

Mr. JONES. I certainly have not analyzed a particular industry but I would think that in an industry such as the type you mentioned, if you had a combination of generous vesting and a portability program which allowed everyone who left with a vested benefit to take assets out of that plan, then I think you may very well find that there would be a number of plans, both single, particularly single employers, possibly even multiemployers that would be forced under by that sort of provision.

Mr. LEAF. What you might be doing is starting a run on the bank because the best way for the man to guarantee that he would receive all of the assets that have been accrued on his behalf would be to quit. As soon as he quit he would have top priority over other employees who remained.

Senator NELSON. On the other hand, if the industry is contracting fairly rapidly, 10, 15, 20 years, and all the money remains in there, there are not going to be enough people paying into the fund to pay out the retirement benefits anyway.

Mr. LEAF. Well, that is where the funding schedule domes in, sir. That is where the funding has to be structured in such a way that there will be enough money coming into the fund.

Senator NELSON. But you could not very well do that. The funding schedule was all right, as I understand it, in the Studebaker plan but they terminated without adequate funds. If they had stayed in business 30 years, according to the testimony, their funding schedule would have been fine. But they did not stay in business that long and, therefore, they could not pay the benefits. So if you have a contracting industry which reduces employees by 50 percent in a 15-year period, then all those accumulated obligations are going to have to be paid for by the employer and the employee and what is left of the industry and that fund itself probably is not viable.

Mr. JONES. That is true, sir, but then the Studebaker situation, as I understand it, what happened is that the retirees did receive their benefits. People who were close to retirement received partial payment and the ones who were furthest from retirement received nothing.

Now, under the portability program our objection is that the short service people—comparatively short service people who might be entitled to vesting, let us say 10, 15 years, they could bail out when they see a problem, take assets with them, and the net result would be that the pensioners who do not have that sort of option perhaps would then be the people who are getting 30 cents on the dollar. So there would be an inversion of the priorities.

Senator NELSON. So in any event, your position is that all vested rights should remain in whatever fund they have accumulated in and that the employee at retirement age will draw whatever accumulated benefits he has in that fund based upon the contributions at the time he retired plus the accumulation of whatever interest, and so forth. Is that what you are saying?

Mr. JONES. That is correct.

Senator NELSON. So he may be drawing from three, four, five employers in his lifetime.

Mr. JONES. Possibly. Plus there is also the serious problem that we did not discuss, that I could just mention briefly, and that is that each plan has different actuarial assumptions. Each actuary has a different idea of what the vesting benefit is worth and this would involve great complications when a man transfers from one plan to another.

Senator NELSON. OK. Thank you very much for your testimony. We appreciate your taking the time to come.

[Mr. Shapiro's prepared statement follows:]

PREPARED STATEMENT OF LEON SHAPIRO, DISTRICT 1—PACIFIC COAST DISTRICT, SECRETARY-TREASURER, NATIONAL MARINE ENGINEERS BENEFICIAL ASSOCIATION, AFL–CIO

Mr. Chairman and members of the subcommittee, my name is Leon Shapiro, representing the National Marine Engineers Beneficial Association, AFL–CIO. MEBA is a labor organization representing marine engineers aboard American flag vessels. MEBA is composed of two (2) affiliated districts—District No. 1—Pacific Coast District, MEBA and District 2. I would like to submit this Statement expressing our views on S. 4 and S. 1179.

The affiliated districts of MEBA participate in three (3) major pension plans and three (3) major welfare plans. These Plans are established pursuant to our collective bargaining agreements with employers in the maritime industry. They are multi-employer Plans and all employers under contract with various affiliates of the Union contribute to these pension and welfare Plans.

Marine engineers who are members of our affiliated districts work for various employers in the maritime industry. Employment is generally obtained through hiring halls and an engineer may work for a number of different employers over a period of time. A marine engineer earns pension credits by employment with an employer in the maritime industry.

I wish to state at the outset that we support the principle of protecting the pension entitlement of American workers. I only wish that many more American workers were protected by pension and welfare plans so that, upon retirement, they would be able to receive pension benefits in addition to Social Security.

I am familiar with the tragic stories of pension default that have been uncovered and publicized by various Senate and House Committees over the past years. No one with any feeling or sensitivity for the problems of the older members of our society can help but be affected by the injustices perpetrated upon employees who have given a lifetime of service to a particular employer and then found that they were either not eligible for a pension or that their pension payments, after being received for a short period, were no longer available. There is no question in my mind but that these abuses and these tragic examples of the inability of private pension plans to fully protect older employees need correcting and need action by the Congress of the United States.

However, I would like to emphasize that the many examples of the forfeiture of pension entitlement and the many instances in which an employee was deprived of pension benefits arise exclusively under single employer pension plans. These situations have not occurred under multi-employer pension plans.

Under the multi-employer pension plan the risk of an employer's failure to continue in business is substantially reduced because that risk is spread over the number of employers in the industry. If an employee is adversely affected by an employer's going out of business, he may secure employment in the same occupation or at the same trade with another employer engaged in the same form of business. More importantly, an employee's credits are protected by the continuation of the employee benefit plan which is maintained by other employers in the same industry.

I need not detail for you the adversities which have beset the American Merchant Marine over the past few years. In our industry we have seen a number of shipowners who have been forced into bankruptcy or out of business. Yet no marine engineer has suffered a deprivation of pension benefits because the multi-employer pension plans have protected the pension credits of adversely affected marine engineers.

Thus, it is my view that your attention should be primarily directed toward single employer pension plans. The abuses in the pension field and the tragic circumstances leading to the loss of pension benefits for individuals have occurred in the curcumstances of single employer pension plans. I frankly see no need to impose burdens, financial and otherwise, on multi-employer pension plans for the purpose of correcting abuses arising from single employer pension plans.

The most important factor in the administration and operation of any pension or welfare plan is its cost. In any multi-employer plan increasing the cost of the operation and administration of the plan results either in the necessity of increased employer contributions or in the reduction of the level of pension or welfare benefits. It is my general view that the proposed legislation creates substantial additional administrative and operational costs for our pension and welfare plans which will have the obvious result of further burdening the employers in this industry and requiring increased contributions in order to maintain the present level of benefits.

This result is created by both the procedural and substantive aspects of S. 4 and S. 1179. Not only does the proposed legislation increase the cost of administration of our pension and welfare plans, but also the provisions of this legislation will undoubtedly result in increased costs to employers because of the requirements for funding, portability, termination insurance, etc. Such an increase in costs can only result in adversely affecting the purposes and objective of the welfare and pension programs established by the employers in the maritime industry and MEBA.

I shall attempt to analyze some of the increased costs which are bound to result from certain provisions of S. 4 and S. 1179. Section 104 of S. 4 concerns the annual report required to be filed by any employee benefit plan. The report referred to in Section 104 goes beyond the reporting requirements presently contained in the Welfare and Pension Plan Disclosure Act. I believe that the reporting requirements of Section 104 are unnecessarily burdensome to employee benefit plans and will clearly result in increased costs to such plans.

For example, Section 104(b)(2) of S. 4 requires the report to include a schedule of all investments of the fund as of the end of the fiscal year. I am not aware of what purpose such reporting will serve and whether a detailing of the investments of any fund is essential information that need be provided to the Secretary of Labor.

Similarly the requirement of 104(b)(4) that each receipt and disbursement of the fund be reported is undoubtedly burdensome to any employee benefit fund. The present provisions of the Welfare and Pension Plan Disclosure Act permit an interested party to review books and records of any plan and ascertain such disbursements and receipts. I question the wisdom of imposing upon employee benefit plans the necessity of making such a detailed report. Moreover, the requirement of Section 104(e) requiring detailed reporting by a pension plan of facts concerning its fund, the number of participants, its reserves and liabilities and a copy of its most recent actuarial report is of questionable value.

I have substantial doubt as to the purpose of the kind of reporing required by S. 4. Welfare and pension funds have been required for some ten years to file an annual Form D-2 with the Secretary of Labor. Our welfare and pension plans have annually complied with this requirement. Yet I know of no use that has ever been made of these reports or no purpose that they have ever served other than to occupy space in the warehouse rented for this purpose by the Secretary of Labor.

I do not believe that the reporting requirements of the present Act should be increased. Those requirements have been sufficient to permit the Secretary of Labor to make investigations where it was felt deficiencies in the operation of a welfare or pension plan existed. Those reports are of course available to beneficiaries. Increasing the detailed information necessary in these reporting requirements will add substantial costs to the operation of an employee benefit plan without a resulting increase in the benefits gained therefrom.

A similar comment could be made about the requirements of Section 105 of S. 4 dealing with the requirement that an employee benefit plan publish the plan description and annual report. It is stated in Section 105(b)(2) that the Administrator of the plan is required to make available copies of the latest collective bargaining agreement for examination by a participant or beneficiary. In many instances administrators do not have copies of such collective bargaining agreements. I would point out that Title I of the Labor-Management Reporting and Disclosure Act of 1959, 29 U.S.C. 414, entitles every employee affected by a collective bargaining agreement to receive a copy of such agreement from the labor organization involved.

I am also concerned about the provisions of Section 106 of S. 4 because I believe it represents an open invitation to litigants to use the courts in an effort to force an employee benefit plan to provide benefits. Obviously an increased amount of litigation will result in an increase in administrative costs to any employee benefit plan. We are afraid that the provisions of Section 106 will invite attorneys to take advantage of disappointed claimants and to begin frivolous law suits in the hope of obtaining an award of counsel fees or a settlement which will include counsel fees. I am concerned that participants who feel themselves unjustly treated will create unnecessary litigation, which will only result in increasing the legal expenses of employee benefit plans.

It should be noted, in passing, that S. 4 exempts from its coverage employee benefit plans administered by the Federal Government or by an agency or instrumentality of the Federal Government. I have serious question as to the necessity for such an exclusion which is contained in Section 101(b) of S. 4.

The exemption of an employee benefit plan administered by the Federal Government from the coverage of S. 4 would mean that employees of the Federal Government of any agency thereof would not enjoy the benefits and protections the legislation is intended to accomplish. MEBA, for example, represents marine engineers who are employed by the Military Sealift Command (MSC) and who are covered by a pension plan administered by the Federal Government. If some of these marine engineers leave employment with MSC and obtain employment as a marine engineer under our collective bargaining agreements there is no reason why they should lose their pension credits with the Federal Government and not receive the benefit of the portability provisions of S. 4.

I suggest that the Federal Government should get its own house in order in regard to pension coverage before attempting to impose upon established multiemployer plans those conditions which it does not itself observe. Why should employees of the Federal Government who leave such service and obtain employment in private industry be deprived of the benefits which this legislation seeks to effect?

I believe that there is no basis for the exclusion of pension plans administered by the Federal Government from the provisions of this legislation. Employees covered by such plans should certainly be entitled to the same pension protection as employees in private industry.

S. 4 contains provisions for vesting, funding, portability and plan termination insurance. I suggest that the Committee should give serious consideration to the effect of these provisions and requirements upon multi-employer plans as distinguished from single employer plans.

The Department of the Treasury and the Department of Labor issued in February of 1973 an Interim Report entitled "Study of Pension Plan Terminations, 1972". This Study shows that in 1971 7.5 million workers were covered by multi-employer pension plans, roughly one-third of the 23 million workers in private pension plans. Multi-employer pension plans, however, comprised in 1971 about one-tenth of the private pension plans on file with the Department of Labor under the Welfare and Pension Plan Disclosure Act.[1]

The National Marine Engineers Beneficial Association has affiliates who are parties to three major and substantial pension plans, the MEBA Pension Plan, the MEBA Pension Fund (covering West Coast employers and employees), and the District 2 MEBA Pension Plan. Reciprocal agreements exist between these three Plans under which a marine engineer who is employed under any of the three Plans will receive reciprocal pension credit for such employment and, when he achieves sufficient overall credit to earn a pension, his pension payments will be shared by all three Plans.

Experience has shown that there is very little movement among marine engineers to employment outside of their chosen occupation. A marine engineer who studies to receive his license and spends five years or so in the industry will make such employment his life's work. We think that this is true of our industry and certainly is true in the building and construction industry where a large number of multi-employer plans exist. For these employees, in our industry and elsewhere, the multi-employer fund structure provides a degree of security of pension rights at least equal to that offered in the Bills before this Committee.

Thus, I believe that the concept of portability is impracticable in our industry and in other industries covered by multi-employer pension plans. Because of reciprocal agreements between our pension plans, the portability requirements of the proposed statute accomplish nothing except a distortion in allocation of assets and an unnecessary expense. This same protection to employees can better be accomplished by mandatory vesting standards.

The vesting requirements of the proposed statute have no serious effect upon the MEBA pension plans. We have 15 year vesting and many of our plan participants are fully vested.

I believe that the provisions of these bills on funding should be considered with a view toward their effect on multi-employer plans. They are written upon the

[1] Study of Pension Plan Terminations, 1972, p. 68.

assumption that a level of benefits is established and then the plan is funded. This is simply not the way collectively bargained multi-employer plans are established.

When the MEBA pension plan was established, the parties did not decide on a $100 per month and then hire an actuary to figure out how big the shipowner's bill should be. A contribution of $1 per day was negotiated, and the question was how big a benefit this could buy. The trustees decided that the first priority was to provide an adequate benefit to the older employees retiring in the early years and, therefore, they adopted "interest only" funding. Of course, as the plan matured, benefits were increased, the funding was improved and the plan grew. Nevertheless, the fact remains that had higher funding been legally required at the outset, the early retirees might only have received perhaps $80 per month instead of the $100 per month they actually got.

Finally, S.4 attempts to provide what is referred to as Plan Termination Insurance. I think that such Plan Termination Insurance is unnecessary in multi-employer plans.

The Study of Pension Plan Terminations, 1972, issued by the Department of the Treasury and the Department of Labor points out that in the years from 1965 through 1971 only one-half of 1% of all multi-employer pension plans terminate in any given year and that such terminations involve less than 2/10ths of 1% of the participants covered by all such plans.[2] The Study further points out that these terminations generally result either from the merger of a pension plan into another plan or from the voluntary desire of the participants to cease contributions to the plan. The Study of Pension Plan Terminations states:

"When multiemployer pension plans terminate, it is usually because the union and the employers desire to consolidate various pension plans to which they are parties in order to achieve economy in administration and to provide uniform benefits." [3]

Thus it is clear from the Study undertaken by the Department of the Treasury and the Department of Labor that the termination of multi-employer pension plans has not resulted in a loss of benefits or pension rights to employees. Such terminations may well have increased the pension entitlement of covered employees. But the important fact which is established by this Study is that multi-employer plans do not create or engender the risk of loss of pension benefits which are entailed for single employer plans when the employer involved ceases operations or goes out of business.

The imposition of Plan Termination Insurance upon multi-employer pension plans is unjustified by the experiences under such plans. The Study by the Department of the Treasury and the Department of Labor shows conclusively that when a multi-employer pension plan terminates, employees are not adversely affected. This is for the obvious reason that such employees, if their employer goes not of business, still have a right to benefits which is supported by the assets of the fund and by the future contributions of the remaining Employers. Thus, employees covered by multi-employer pension plans do not lose pension credits by the loss of employment, but retain their pension credits and coverage. The incidence of the termination of multi-employer pension plans, is, according to the Department of the Treasury and the Department of Labor, practically nil.

Yet S. 4 would require multi-employer pension plans to assume the same insurance requirements and costs as are imposed upon single employer pension plans where the risk of going out of business is far greater. Elementary principles of insurance indicate that where there are different risks, different premiums are paid. A man aged 30 pays a far lower life insurance premium than a man aged 60, for straight life insurance. Fire insurance costs differ depending upon the structure and the degree of fire protection for the insured building. Automobile insurance premiums differ depending upon the location, amount of driving, etc. of the insured. But S. 4 would impose the same insurance requirements on multi-employer plans and on single employer plans.

The evidence is clear that employees covered by multi-employer pension plans maintain their pension credits even if a particular employer ceases business operations. The very nature of a multi-employer pension plan creates a basis for protecting the employee's pension credits and permits him to continue to earn pension credits by continued employment in the industry. None of this is true for a single employer pension plan and it is my belief that this Committee

[2] Study of Pension Plan Terminations, 1972, p. 73.
[3] Study, p. 78.

should concern itself in the proposed legislation only with single employer plans.

I believe that the failures in the private pension system stem from single employer plans. The need for legislation in the pension field concerns single employer plans and not multi-employer plans. Yet the proposed legislation is universal in application and will raise the costs of multi-employer plans as much as, and perhaps more than, it will raise the costs of single employer pension plans.

I request this Committee not to correct the injustices and the tragedies to employees covered by pension plans at the expense of the seven and one-half million workers covered by multi-employer plans. Moreover, I think it necessary to emphasize that there are some 30 million workers in this country who enter retirement with no pension coverage except that provided by Social Security benefits.

Every pension plan must be tailored to meet the needs of those employees covered by it. The needs of our industry differ from the needs of other industries and our multi-employer pension plans may provide different coverages and benefits than those prevalent in other industries. I ask this Committee to give the same consideration to this legislation. Enact a pension law to meet the real problems in the pension field and do not penalize those sound and well administered multi-employer pension plans which have been serving their industries and the workers whom they benefit.

Senator NELSON. The committee is in recess, subject to the call of the Chair.

[Whereupon, at 1:25 p.m., the committee was recessed, subject to the call of the Chair.]

Appendix A

Department of the Treasury Responses to Questions Submitted by Senator Gaylord Nelson, Chairman of the Subcommittee on Private Pension Plans

I. *Question:*

The Administration's proposed rules on vesting and funding apply across the board for all qualified plans.

(A) Does this mean that in order to be a qualified plan a Government plan such as, for example, the Federal Civil Service Retirement would have to have the current liabilities fully funded and also make payments into the fund equal to 5 percent of unfunded vested liabilities attributable to past service?

(B) Is it correct that the Federal Civil Service plan is not funded to this extent? If it is not, does this mean that if the Administration bill is enacted the Federal Civil Service Retirement System will no longer be a qualified plan?

(C) Is it correct that the vesting rules contained in S. 1631 apply uniformly to both private and governmental plans?

(D) Has the Rule of 50 been tested against the rules of the Federal Civil Service Retirement System?

(E) For example, if you had someone who was 46 years old who had 4 years of service, under the Rule of 50 the plan must provide for vesting in order to be a qualified plan. However, under the Federal Civil Service Retirement plan, if a person terminates his service without having been in Government service for 5 years, he forfeits the amount put up for him by the Government. Doesn't this mean in the example I have described, that vesting has not yet occurred in the case of this 46-year-old individual who has had 4 years of service under the regular rules? Doesn't this mean that under your rules the Federal Civil Service plan would not be a qualified plan?

Answer:

As presently constituted, the Federal Civil Service Retirement System would not meet the proposed Rule of 50 vesting standard. If the Administration's proposal is adopted, the Civil Service Retirement System would either have to be amended prior to the effective date of S. 1631 or an exception in the law would have to be provided to allow it to continue as a qualified plan. It is, of course, important that the Civil Service system retain its qualified status since there are certain tax benefits which would be lost by government employees if the plan became nonqualified. For example, an estate tax exclusion under section 2039(c) of the Code is available only to qualified plans. In addition, contributions to nonqualified plans are taxable to employees unless they are subject to substantial risk of forfeiture.

Under S. 1631 as originally introduced, the Federal Civil Service Retirement System also would have had to meet the proposed new minimum funding standard. However, under the technical revisions we are proposing, governmental plans would be exempt from the new minimum funding standard.

II. *Question:*

(A) May I have your comments on this argument? Some people argue that the Rule of 50 for vesting discriminates against workers approaching the age of 50 because pension costs to cover such workers may be higher than pension costs to cover younger persons and that this will discourage the hiring of persons nearing the age of 50.

(B) On the other hand, others have suggested that the Rule of 50 discriminates against those considerably younger than 50 because it provides less pension coverage for them than for older persons even though they may have worked the same period of time. May I have your comments on this suggestion?

Answer:

(A) It has been suggested that the proposed Rule of 50 minimum vesting standard would increase the cost of hiring older workers and lead to discrimination against older workers. It is true that, under the Rule of 50, older employees will vest more quickly than younger employees, and this taken alone will tend to increase the relative cost of vesting for older employees. However, there is a countervailing factor which reduces the cost of vesting for older workers. Vesting results in a cost only when an employee leaves. Older employees are much less likely to leave than younger employees. Taking this factor into account, although the Rule of 50 would result in higher *vesting* for older workers, it would not necessarily result in higher vesting *costs* for older workers.

In fact, chart 4 of Secretary Shultz' testimony on May 22 to your Subcommittee shows that, for a plan promising $100 annually for each year of service, on the assumptions used, the additional cost of the Rule of 50 imposes with respect to an individual age 55 (at hire and initial participation) is only $15 per year, while the cost for an individual age 35 is $30 per year. In this case, the differential cost between hiring an older worker and a younger worker is actually *reduced* by the Rule of 50.

The relationship between pension costs for older workers and pension costs for younger workers is determined by many different factors, and it is impossible to make meaningful estimates of the precise cost relationship that apply to all cases. However, after studying this question in depth, we have concluded that the Rule of 50 would not result in discrimination against older workers. The possible incentive for age discrimination in hiring that is currently provided by the differential costs under existing benefit formulas and assumptions would not be modified significantly by the imposition of the Rule of 50 as a minimum vesting standard.

(B) It has been suggested that the Rule of 50 discriminates against younger workers because it provides them less pension protection than older workers. It is true, of course, that the Rule of 50 provides less pension protection for younger workers than for older workers for the same period of time worked. The Rule of 50 is intended to concentrate the benefits of vesting on those who need it the most—older workers. Younger workers who stay in the work force will ultimately benefit from the Rule of 50 as they become older workers. The general judgment that loss of benefits by unvested workers terminated near retirement age is particularly undesirable is illustrated by the heightened dismay which is felt when workers in their 60's are terminated with no pensions.

III. *Question:*

The Joint Committee on Internal Revenue Taxation staff pamphlet of the various pension proposals contains, on page 9, a table comparing costs of the vesting rules provided under S. 4 and under the Rule of 50 recommended by the Treasury Department. In terms of cost as a percent of payroll, that table shows that the S. 4 funding requirements have a cost which ranges up to 1.4 percent of payroll. The Rule of 50 is shown as having a cost which ranges up to 7/10th of one percent of payroll. I understand, however, that if S. 4 did not provide for the vesting of past service, its cost would range up to 6/10ths of one percent of payroll. In other words, if you leave out of account vesting for past service, the cost of these vesting rules may actually be slightly below the cost of the Administration vesting rules.

(A) Since in most respects the vesting rules under S. 4 provide for earlier vesting than the Administration proposal, why would one want to substitute the Administration rules if there is no significant difference in cost?

(B) Isn't the real difference in cost simply a question of whether you cover service rendered prior to the date of enactment of the bill?

(C) Isn't this fundamentally an issue which can be faced separately from the issue of when vesting in the future generally is to begin?

Answer:

(A) The vesting standard of S. 4 does not provide for earlier vesting than the Administration proposal "in most respects." Compared with the Administration proposal, S. 4 provides earlier initial vesting and about the same age of full vesting for younger workers, but later initial and full vesting for older workers. For example, a worker hired at age 30 will reach first vesting at 39 and full vesting at 46 under S. 4, while he will reach first vesting at 42 and full vesting at 47 under S. 1631. A worker hired at 50, on the other hand, will reach first vesting at 59 and 100% vesting at 66 under S. 4, but will reach initial vesting at 53 and full vesting at 58 under S. 1631.

(B) The Rule of 50 and 8–15 year vesting will have roughly the same cost when fully phased-in, and the main difference in cost between S. 1631 and S. 4 arises from the fact that the vesting standard of S. 4 applies to benefits previously accrued.

(C) Yes.

IV. *Question:*

The Administration proposal's requirement for the funding of past service is at an annual rate of 5 percent of the remaining unfunded balance. Senator Bentsen's bill and S. 4 provide for funding over a 30-year period, which for the most part is a longer period for funding of these past service liabilities. However, both S. 4 and Senator Bentsen's bill require the funding of *all* accrued liabilities, while the Administration's proposal deals only with liabilities which have vested. Could you explain the logic of overlooking the funding of liabilities which have accrued even though they may not yet have become vested?

Answer:

The reason that the Administration's proposal requires funding of only liabilities presently vested is that the most pressing protection needed for workers is with respect to such benefits. Forfeitable benefits can be lost by an employee if he terminates his employment. He does not rely on receiving such benefits and employers need not necessarily be required to fund them. A requirement to fund all liabilities may lead to overfunding since only vested liabilities are ever paid.

As we understand it, neither S. 4 nor Senator Bentsen's bill would require the funding of *all* accrued liabilities, since in computing accrued liabilities turn-over assumptions would be used to limit funding to those accrued liabilities which it is expected will ultimately be vested. If the assumed turn-over rates are too small, overfunding will result. In funding liabilities now vested, no turn-over assumptions are used.

V. *Question:*

As I understand your testimony, the Administration is not prepared to offer any termination insurance proposal at this time in part because of unresolved technical problems of such a proposal. I have been informed that the Treasury Department drafted this year a bill containing a termination insurance plan. It is my belief that some members of the Senate Finance Committee and many members of the Senate favor some form of termination insurance and will, in all likelihood, vote for such a plan. So that the Subcommittee on Private Pensions may have the benefits of Treasury's work in the area, may I request a copy of the draft bill and any accompanying technical material?

Answer:

I understand that copies of a preliminary draft of a termination insurance bill, prepared by the Treasury staff, and a preliminary draft of a termination insurance bill, prepared by the Department of Labor staff, have been made available to your Subcommittee staff.

The background of the draft bills and the reasons for the Treasury Department's reluctance to propose termination insurance legislation are discussed in the attached statement which Deputy Assistant Secretary John H. Hall presented to the General Subcommittee on Labor of the House Committee on Education and Labor on June 13, 1973.

[EDITOR'S NOTE: The statement referred to follows:]

STATEMENT OF HON. JOHN H. HALL, DEPUTY ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY

Mr. Chairman and members of this subcommittee, I am pleased to be with you today to discuss proposals for a government-sponsored system of insuring pension plan benefits against losses on plan termination.

As you know, the Administration is not recommending a plan of termination insurance at this time. We are sympathetic to the idea of termination insurance. We have done quite a good deal of work in attempting to frame a reasonable program, and are cotninuing to study the area in hopes of developing a workable program. However, as President Nixon stated on April 11, 1973:

> "No insurance plan has yet been devised which is neither on the one hand so permissive as to make the Government liable for any agreement reached between employees and employers, nor on the other hand so intrusive as to entail Government regulation of business practices and collective bargaining on a scale out of keeping with our free enterprise system."

This morning I would like to discuss with you some of the specific problems which underlie that conclusion.

First, a bit of history:

In December of 1971, President Nixon directed the Departments of Labor and Treasury to undertake a study to determine the extent of benefit losses arising from pension plan terminations. It was the purpose of the study to obtain information needed to determine what Federal policy should be on funding, the nature of the employer's liability, and termination insurance. To do this, it was necessary to determine both the extent of the problem of termination-connected benefit losses, what kind of insurance program would best correct the problem, and what new problems if any would be created in the course of solving the termination problem.

An Interim Report on this study was completed and released in February of this year. This study found in general that while individuals suffer significant losses on plan terminations, each representing serious hardship to those affected, these losses are small in relationship to the total benefits paid under the private retirement system. Specifically, during the first seven months of 1972, 3,100 employees lost $11 million of vested benefits as a result of termination of underfunded plans. This is a small fraction of the $10 billion of benefits paid out in 1972. This is also a small fraction of the benefits lost through termination of employment without full vesting.

In connection with this study, the Administration exerted considerable effort in analyzing the insurance systems which have been proposed and in attempting to devise the optimum program.

If we could be confident that the existence of the termination insurance program would not affect people's behavior in any way, the idea would be an excellent one. Because benefit losses from terminations are few, they could be insured against at a relatively small cost, and with relatively few administrative difficulties. As we studied the possibilities, however, it became readily apparent that there is an inherent instability in the situation. The existence of the insurance program itself could lead to a variety of abuses and in fact increase the number of plan terminations, creating constantly rising costs for what would at the outset appear to be an inexpensive program. Let me illustrate this.

Under current law: it is to the advantage of unions and employees generally to see that plans are properly funded. An underfunded plan endangers the ultimate receipt of retirement benefits. With full termination insurance in effect, it is to the union's interest to have the barest minimum funding the law permits, with the employer dollars thus saved applied to increase other forms of compensation. However, with minimum funding, benefit losses would increase, and the insurance program could become very expensive.

Without termination insurance, an employer is less tempted to cause trust assets to be invested in risky securities in hopes of getting a better yield. With termination insurance, his employees have little to lose from such investment policies because, if the investments become worthless, the insurance system will pay their pensions. Here again, the existence of the insurance program could increase benefit losses.

Under present law, where there is no termination insurance, benefit increases are not lightly granted, particularly in declining industries where the plan's ability to make payment is problematical. If such increases are to be insured, however, the increased pensions will be paid even if the plan is underfunded and the employer is bankrupt. If worst comes to worst, the insurance will always take care of the unfunded benefits. With termination insurance, in fact, it would be ~~possible—if you~~ don't have proper safeguards—for an employer in a declining industry to substitute an unfunded promise of benefit increases (at the potential expense of the insurance fund) for a wage increase he would otherwise have to make.

Again, to keep highly-paid people from receiving large amounts from the insurance fund, some limit on the size of benefit insured seems desirable. But then, in the absence of regulations saying who gets paid first out of the fund, plans could respond to such limits on termination insurance by providing that *uninsured* benefits would be paid first with available trust funds. The insurance fund would then be left to pick up the balance.

As a result of these and other potential abuses, we concluded that abuse-prevention controls would be absolutely required for a sound termination insurance plan. Some form of maximum insured benefit would be needed to keep stockholder-employees from lining their own pockets at the fund's expense. Some form of residual employer liability would be needed to prevent the premature or unnecessary termination at the insurance fund's expense of an underfunded plan. For instance, a new employer taking over the assets and employees of a predecessor could look at the predecessor's underfunded plan and rather than funding it in order to keep his employees content, could just terminate it and let the insurance fund pick up the check. Some restriction on benefit increases or limitation on the insurance of such increases would be required to preclude a large benefit increase as a parting pre-bankruptcy gift at the insurance fund's expense by stockholders of an organization facing imminent insolvency, to the employees—and perhaps to themselves. It would be necessary to have some form of prescribed order of priority for use of available trust funds on termination. Otherwise the available funds could be used first to pay the uninsured benefits, leaving the insurance fund holding the bag, and so forth. Actuarial assumptions would have to be controlled in order to avoid underfunding, and investment policy would have to be controlled in order to minimize investment losses.

In order to determine what kind of abuse controls could be devised, the staffs at Treasury and Labor, with assistance from Commerce and the OMB, went ahead and prepared discussion drafts. Because no decision had been reached on which Department could best administer such a program, the Department of Labor staff drafted a statute designed for administration by their department: the Treasury staff prepared a statute designed for Treasury administration. Having done this, we then stepped back and looked at what we had done.

We had bills which would not have eliminated all benefit losses. To prevent abuses, it was deemed necessary to exclude coverage of benefits beyond $500 per month, to exclude coverage of benefits under new plans for several years, to exclude coverage of benefit increases for several years, and to exclude coverage of non-vested benefits. On the other hand, the bills would very significantly encroach upon the present flexibility of establishing plans. We had regulated the order of priority of payments: we had imposed a residual liability on the employer which he never bargained for when he established the plan and which might adversely affect his financial statements; to protect the fund, we had authorized an outside agency to come in and terminate a plan which appeared to the agency to be endangered; and we had created a system of regulations which would apply to all defined benefit plans although only a small minority are in jeopardy of termination. In fact, it appeared possible that the regulatory and other costs of the system to protect the insurance fund might actually outweigh the benefit payments themselves.

The result of our investigations both into the scope of the problem and into the possibilities of termination insurance, led us finally to the reluctant conclusion that we could not justify the best termination insurance program we could devise, in the teeth of the great problems which would be created either by a program *without* adequate abuse controls on the one hand, or one *with* adequate abuse controls on the other.

We are only too well aware of the painful impact of termination losses on those who are affected. But we had to conclude reluctantly that the adverse impact of the kind of program we are talking about on the whole system of voluntary pension coverage might, in the aggregate, deprive more employees of benefits because their employers decided not to set up plans, than the number of employees who would receive insurance benefits.

We are still working on the problems, and we are open-minded, and hopeful that we may yet be able to devise a workable solution which steers between the Scylla of under-protection against abuse and the Charybdis of over-regulation. To date, the best status we could come up with seem to us to impose social costs which outweigh their social benefits.

Now, in the light of our consideration of this problem, perhaps it would be helpful if I covered more specifically some of the issues our staffs sought to deal with in preparing our study-drafts of termination insurance legislation.

DIVERSITY OF PLANS

In attempting to design a feasible pension plan termination insurance program, we found that there are many types of pension plans, with significantly differing characteristics. We initially concluded that termination insurance is inappropriate for about half of the retirement plans in the country. Such plans consist of money purchase pension plans, profit-sharing plans and stock bonus plans. Under such plans the employee recognizes that he is entitled to no more than the balance in his account, and makes his plans accordingly. Moreover, since the employee stands to gain by market gain, it is only fair that he should suffer any market loss.

Thus, the termination insurance concept makes sense only when applied to a defined benefit pension plan. However, even among defined benefit pension plans, there are wide variations. We quickly despaired of devising a separate system for each type of defined benefit pension plan. Nevertheless, we found it useful to make a distinction between two broad groups of plans—single-employer plans and multi-employer plans.

Single-employer plans may cover only employees in a single plant or office, or may cover substantially all of a company's employees and plants throughout the country. These plans may or may not be collectively bargained. Most single-employer plans call for a specific benefit amount payable at retirement, but do not specify a required employer contribution. They are generally administered by the employer, and the employer generally has the right to terminate the plan at any time with no further liability for pension contributions.

Multi-employer plans have significantly different characteristics. They generally require a specific employer contribution. They generally are administered by a joint employer-employee board of trustees which has the authority to set benefits. The employer's obligation is generally limited to making the specified contribution, and a participating employer cannot terminate the plan although he may withdraw from it. The withdrawal of any employer does not necessarily terminate the plan.

Because of these differences, it is difficult to draft one insurance program which applies to both types of plans. It has been suggested that multi-employer plans do not need the protection of termination insurance. However, significant losses have been incurred in multi-employer plans. Multi-employer plans do have a special problem because, from the employers' point of view, the plans are not defined benefit plans at all; they are somewhat like money purchase plans, since in general the employers have agreed upon a specific contribution rate, but have not agreed on a specific benefit level. Thus, one approach that might be followed is to treat single-employer plans and multi-employer plans separately under a termination insurance program, with different funding and employer liability requirements and, perhaps, even with separate risk pools.

Of course, devising separate provisions for different types of plans creates problems. Initially, there is a significant definitional problem, since some single-employer plans have many characteristics which are more commonly found in multi-employer plans, and vice versa. Furthermore, separate provisions create administrative complexity. Nevertheless, if termination insurance is adopted, some distinction must be drawn between single-employer plans and multi-employer plans.

INSURED TERMINATION

A significant problem exists in deciding when an insurance system should step in to take over a plan. If the system takes over too early, losses can be created which would not otherwise exist. This is because the employer might have made significant contributions to the plan in the future. If the system takes over too late, losses can be incurred because payment of non-insured benefits may have depleted the fund, or because assets have been poorly managed.

There is an additional problem of coordinating a termination for insurance purposes, which may trigger an insurance payment, with a termination for the purpose of causing 100% vesting under the plan as required by the Internal Revenue Code. We have felt that these two "terminations" should occur at the same time to the extent possible. However, we have yet to develop a comprehensive definition which solves both problems. For instance, suppose an employer switches from a pension plan to a profit-sharing plan. Is that a plan termination?

Some proposals limit the types of terminations permitted or insured against. These provisions provide abuse control, but result in both over-regulation and under-protection against benefit losses.

EMPLOYER LIABILITY

At present, under most pension plans, the employer has no obligation to make further payments into a terminated pension plan, although many employers make such payments in order to maintain employee good-will. Under an insurance system, if there is no employer obligation to make payments, employers will tend to skimp on their funding requirements and to terminate their plans if the value of the fund assets drops significantly since they know their obligation will be met by the insurance system. Unfortunately, however, imposing a liability upon employers in such cases is unfair to employers with existing plans—particularly multi-employer plans—and may force an employer into bankruptcy, or adversely affect its credit rating or its ability to meet its day-to-day expenses.

In such a case, the termination insurance concept creates a situation which is worse than that which exists under the present system. If we are not careful, termination insurance, rather than increase retirement security, will jeopardize jobs by adding to the problems of marginal employers.

As an attempt to solve this problem, we considered a concept whereby an employer would be liable in the event of an insurance loss, but with liability limited to 25% of taxable income over the 20 years following termination. We excluded from liability multi-employers except in the case of a dominant employer.

This solution has its own problems. Employers can hold down profits by paying large salaries; 25% of taxable income may exceed the available cash; a subsequent reorganization of the business may substantially reduce (or increase) taxable income; raising fresh capital could be hampered, and so on. However, at present this solution appears to be preferable to other proposals we have seen.

INSURANCE LIMIT

To be truly effective, an insurance system would have to insure all vested benefits without limitation. However, such a system without any controls would be highly susceptible to abuse. As controls against abuse are built into an insurance system, the degree of coverage decreases and the degree of governmental interference increases.

We concluded that, for effective abuse control, new plans should not be insured at all for a short period, such as 3 years, and should not become fully insured for a longer period, *e.g.*, 10 years. Benefit increases would be treated as a new plan for this purpose. We further concluded that large pensions should not be fully insured and that insurance should be limited to vested benefits. However, we were uncomfortable with these conclusions because the result is inadequate coverage. We never did figure out just how far we might wish to go in insuring benefits which are not pure retirement benefits—such as death benefits or widow's allowances.

In general it would seem that, under termination insurance, plans would have to be amended to provide that insured benefits are paid first, in order to prevent the assets of the plan from being depleted. However, previously retired employees have a special status which suggest that they should be paid first even though they receive more than the insured limits. We found ourselves led to imposing a requirement that the assets of a terminated plan must be applied in a specific order required by statute until all insured losses are paid.

Unfortunately, the termination insurance concept forces us to impose requirements in these areas—thereby greatly reducing the flexibility of the private pension system.

FINANCING

One of the basic decisions which must be made in developing a termination insurance proposal is the means of financing the insurance payments. The simplest means of financing is out of general revenues. This would have the obvious advantage of no additional collection cost. The amount of estimated annual benefit losses, in the area of $20 million to $40 million, is small enough to make this means of financing feasible. However, financing out of general revenues can be criticized because substantially less than one-half of the work force is covered by defined benefit pension plans, and this half is already receiving significant benefits through the tax system. It seems a little unfair to require the rest of the work force to contribute to the security of those who are already favored.

If financing is to be by means of a premium, a premium base must be chosen. Our first thought was that the premium should vary with the risk of loss. However, we soon realized that the risk varies with so many factors—such as the degree of funding, the composition of the portfolio, and the financial strength of the employer—that a completely risk-related premium would be practically impossible to administer. Moreover, a completely risk-related premium would put such a burden on a failing plan as to cause it to be terminated. Nevertheless, we felt that the premium should bear some relation to risk.

There are three basic alternative premium bases which we considered—contributions, number of participants, and unfunded vested liabilities. The base of contributions and the base of the number of participants have the advantage of simplicity, and since the premium should be quite small, it should not matter too much if the premium burden is not completely equitable. The contributions base is probably more risk-related than the number of participants base, since under a contributions base a rich plan will pay a higher premium than a meager plan covering the same number of participants. However, the contribution base has an unfortunate effect in that, while higher contributions would reduce the risk, they would also increase the premiums.

The base of unfunded vested liabilities may be the fairest of the three bases. However, it suffers from being the most difficult to compute. In fact, the cost of calculating the base may very well exceed the premium cost itself. In broad terms, unfunded vested liabilities relate to the insured risk. However, even plans which do not have unfunded vested liability still have significant risk of becoming underfunded due for example to a decline in portfolio values. Yet, under this base there would be no premium.

The means of assessing the premium is another problem. Most termination insurance proposals simply impose a liability for the premium, and leave it to the administering agency to sue upon default. Some proposals cancel the insurance in the event of default. We have considered a concept whereby the premium is imposed as an excise tax, which would be collected by the Internal Revenue Service under normal tax procedures. An amount equivalent to the tax collected would then be paid into the insurance fund.

Of course, part of the insurance payments can be financed by employer liability, if employer liability is imposed. However, it is expected that collections from employer liability would be relatively small.

The financing of the administrative expenses is another problem. Some termination insurance proposals impose a flat charge on each insured plan equivalent to its pro rata share of administrative costs. We anticipate that the administrative costs of such a plan will be very substantial, perhaps even as high as the benefit losses. It does not seem equitable to have a plan covering 100 participants pay the same administrative charge as a plan covering 100,000 participants.

ADMINISTERING AGENCY

The selection of an administering agency is a difficult one. Any choice will involve the establishment of a large bureaucracy to solve a relatively small problem in the context of the entire private pension system. We tend to think that the administering agency should be either the Treasury Department or the Labor Department because both departments have significant responsibilities regarding private pension plans. However, no final decision on this matter was ever reached.

The basic problem which creates the desire for termination insurance is that employees do not always receive the benefits they expect. In large part that problem can be alleviated through minimum funding requirements and through adequate disclosure. We must continue to work on the termination insurance problem, because it is an important one. But we must recognize that there are many other areas of pension reform where action is clearly called for because we know what we do will result in a better pension system. We should act in those other areas now—before tackling the difficult termination insurance problem.

The establishment of a government-sponsored termination insurance program would be a very significant step, and should not be taken lightly. We feel that, on balance, the step is too large to be taken at this time, when we know so little of the consequences. There is a significant danger that an ill-advised insurance system could cause greater social costs than benefits by restricting pension coverage, limiting benefit improvements, delaying earlier vesting, and precipitating employer bankruptcies.

I hope that you have found this discussion helpful. I will be glad to respond to any questions which you may have.

VI. *Question:*

The Administration recommends that the amount which self-employed individuals can set aside for retirement pension be increased from 10 percent of salary to 15 percent and from a maximum of $2,500 a year to a maximum of $7,500 a year.

(A) Coul'l you give me a distribution by adjusted gross income class as to the income levels where you expect the revenue losses from this proposal would occur?

(B) Isn't it true that only those with relatively high income levels could afford to set aside as additional savings the $5,000 additional amount which you permit under this provision?

(C) Also, doesn't the fact that it is a deduction mean that it is more useful to those in the higher tax brackets?

Answer:

(A) As Secretary Shultz stated in his testimony before your Subcommittee on May 22, we estimate that this proposal would involve a maximum revenue cost of $70 million in the first year of operation, rising to $140 million in subsequent years. However, because this proopsal may forestall incorporations and the establishment by such corporations of plans with deductible contributions in excess of $7,500 per year, this estimate is unreliable. except as an outside revenue loss figure. In fact, there may well be revenue gain. Because there may in fact be such a gain, it is not possible to predict with any accuracy the new benefit levels which will be established in practice in response to the proposed change, and because we do not have adequate data on the number of salary levels of nonprofessional employees who will receive better pensions under the proposed change, it is not possible to furnish a meaningful breakdown by income class of the revenue effects.

(B) You asked whether it was true that only those with relatively high income levels could afford to set aside as additional savings the $5,000 additional amount permitted under this provision. Under the proposal, the additional amount allowed to be set aside could, of course, only reach the $5,000 maximum if the income was at least $50,000. However, those individuals could make the additional contribution only if they made correspondingly higher contributions for their employees, since, in geenral, self-employed individuals may not contribute for themselves at a higher rate than for their employees.

(C) You also asked whether the fact that the amount contributed by self-employed individuals is allowed as a deduction means that the tax deferral is more useful to those in higher tax brackets. This, of course, is true. The basic nature of pensions makes a deduction much more appropriate than a credit. The principle underlying the special tax treatment accorded pension plans is that individuals should be allowed to set aside a portion of their income with a tax deferral during their working years in order to provide for their retirement. The portion to be set aside should be enough so that the empolyee will be able to maintain substantially the same standard of living during retirement (with his pension, social security benefits and savings) as he maintained prior to retirement. Tax is paid on the income during retirement. Following this principle, the amount to be set aside should be a percentage of income rather than a flat dollar amount. Since tax must ultimately be paid, the deferral should be reflected by a deduction rather than a credit. The subsequent inclusion correlates properly with a deduction but not a credit.

This general principle is followed under retirement plans for employees. However, under retirement plans for self-employed individuals, there is a flat dollar limit on the amount which may be deferred. The effect of this flat dollar limit is to make the deferral advantage much lower for high income individuals as a percentage of income than for low income individuals. The Administration proposal, because of the potential revenue loss, would not eliminate this limitation. However, it would increase the limitation in order to lessen the discrimination under present law between the employed and the self-employed and reduce existing artificial advantages to incorporations which are inducing wholesale formation of professional corporations with attendant revenue losses.

VII. *Question:*

Before December of last year, an employee by means of a "salary reduction agreement" could agree to a salary reduction and then have the employer contribute the amount of the reduction to a qualified plan without current taxation to the employee. On December 6, 1972, the IRS issued a proposed regulation (Proposed Treas. Reg., 37 Fed. Reg. 25938) providing that the individual would be charged with immediate constructive receipt of any compensation he elects to defer by using a salary reduction agreement.

(A) Isn't the salary reduction agreement achieving the same purpose as tax deductible contributions to personal retirement plans, proposed by S. 1631?

(B) It seems that the Administration is asking Congress to qualify direct employee before—tax contributions, while the Treasury proposes to prohibit indirect before-tax contributions. Please explain the logic of the Treasury position on these two items.

Answer:

Both S. 1631 and salary reduction agreements provide tax deductions for contributions to personal retirement plans. The chief difference between the two is that S. 1631 contains limitations which are not present in salary reduction agreements and which serve important objectives:

Wide coverage. Our existing pension system is designed to promote coverage of all employees. Employers and high-paid executives are not permitted to provide pensions for themselves with government assistance without also providing pensions for employees generally. If our system had permitted everyone to provide for himself individually, we would have nothing like the 50 percent coverage of the work force which we have today. Insofar as salary reducing plans are a device to permit optional participation by employees at their own expense, they depart from the basic approach of the present statutory scheme. A system used only by the provident will leave the improvident as potential social charges.

On the other hand, some limited system of permitting individuals to provide for themselves is required. There is a $4 billion revenue loss associated with the tax benefits provided under the present pension system. While taxpayers generally bear the revenue loss, only half of the work force (and a lesser fraction of the total population) receive the benefits. Equity requires that the remaining one-half of the work force be given an opportunity to share in pension benefits and the Administration believes that goal can be achieved only if otherwise uncovered individuals may elect benefits on their individual initiative. Thus, the problem is to permit optional individual participation, but to do so in a way (1) that is targeted on those who do not now have benefits and (2) that does not undercut existing employer plans. If the benefits under optional plans are as favorable as those under employer plans, we will destroy the incentive to provide coverage for all employees.

To that end S. 1631 provides limitations on individual deductions. In general, those limitations permit deductions which are more liberal than salary reduction plans in the case of lower income individuals and more restrictive in the case of higher income individuals. Under salary reduction plans (where a 6 percent of income ceiling is customary), a person earning $100,000 can deduct up to $6,000 per year, but a person earning $10,000 can deduct no more than $600. This sharply contrasts with the Administration's proposal under which both a person earning $100,000 and a person earning $10,000 can deduct a maximum of $1,500.

Revenue loss. A major potential revenue loss is associated with salary reduction plans. Some revenue loss is inevitable if we are to extend pension benefits to those persons who do not now have them. But in considering whether the revenue loss is reasonable, account must be taken of the fact that salary reduction plans do not serve the desirable objective of providing coverage for all employees within a unit. Since the deductions accomplish a more limited social purpose it is appropriate that they be more limited in amount. Even more seriously, however, salary reduction plans require the acceptance of the legal theory that an employee may avoid tax on his salary simply by saying "don't pay it to me directly, but pay it to someone else who will invest it for me and pay me later." The implications of such a theory are enormous and might, for example, be urged in an attempt to alter the long-standing tax treatment of pension contributions by civil service employees. The potential revenue loss to the government under such a theory is great, perhaps in excess of $5 to $6 billion in the first year (when employees would seek refunds for a number or prior years) and $2 billion a year subsequently. These amounts are so major that Congress should focus specifically on the salary reduction plan issue.

VIII. *Question:*

In 1969, Congress imposed the same kind of limitations on retirement plans of 5 percent shareholders who availed themselves of the subchapter S partnership-type treatment as applies in the case of the self-employed. At that time, the Finance Committee also proposed a similar type of limitation on professional corporations, but the Treasury Department opposed this on the floor of the Senate.

(A) Have you reconsidered your position in this regard?

(B) What would the Department's position now be as to imposing the same limitations as those applicable to the self-employed in any case where 5-percent shareholders are covered by a pension plan (except perhaps where they account for only a very small portion of the total number of covered employees)?

Answer:

(A) We feel that it is unwise to base a limitation on the maximum amount of contributions to a pension plan on the basis of whether or not a corporation engages in "professional" activities. We see little relation between the business activities of the corporation and the kind of pension its employees should receive.

(B) A proposal that imposes the same limitations as those applicable to the self-employed in any case where 5% shareholders are covered by a pension plan discriminates against small business. In practice the limitations would be applied to all employees if some 5% shareholders are participating. As a consequence, employees of widely-held corporations would receive greater pension benefits than employees of closely-held corporations. In fact, in numerous cases, the response would be not to set up a plan at all and leave small-business employees without any pension.

The proposal also prevents administrative problems. The Subchapter S limitation under current law already is very difficult to administer. The proposal would be much more difficult because it would apply to more corporations and because corporations in general are not limited to one class of stock and 10 shareholders as are Subchapter S corporations.

IX. *Question:*

The figures on vesting given on page six of your testimony before the Subcommittee and Table B accompanying the Treasury Department's fact sheet raises questions of consistency with other data, specifically the survey by the Pension Task Force of the Senate Labor and Public Welfare Committee and reports of the Bureau of Labor Statistics.

Please indicate the basis for your figures and explain specifically the relatively high rate of vesting among younger workers and relatively low rate of vesting among older workers contained in your figures in view of the early retirement provisions provided by most pension plans.

Answer:

The studies by the Pension Task Force of the Senate Labor and Public Welfare Committee and of the Bureau of Labor Statistics are directed to the question of how many participants are in pension plans with no vesting and how many are in pension plans with vesting (by categories of vesting provisions). While this is useful information, it does not indicate how many participants in plans with vesting *are vested.* A plan may have a liberal vesting requirement but have a high percentage of participants who are not vested. Moreover, it is important to have information on the extent of vesting among participants by age groups.

To fill this data gap, Treasury, Labor, and HEW jointly contracted with the Census Bureau for a special survey of workers in the labor force in the Spring of 1972. The special survey was, in effect, an add-on to the regular Census *Current Population Survey* dealing with labor force characteristics. The survey covered about 29,000 interviews which was a representative sample of the U.S. work force as a whole. At this date, there is no final report on the results of the special study. The delay is attributable to checking the consistency and validity of the data and time needed for analysis. However, because data were needed to make pension decisions early in 1973, the Treasury made estimates based on preliminary tabulations from the special survey, and these are the figures shown in the Secretary's testimony.

The special survey tabulations used to obtain Treasury estimates of the extent of vesting among private pension plan participants were obtained using the following criteria:

1. Only full-time workers were included.
2. Only those in private employment were included. Excluded were government workers, self-employed, unpaid family workers, and those not employed.

3. Plan participation was based on the answer to the question: "Excluding Social Security, Railroad Retirement, and Veterans' Pensions, are you covered in your present full-time job by a pension or profit-sharing plan providing retirement benefits?"

4. Vesting status was based on the question: "If you should change to a job not covered by this plan, would you still be eligible to receive the plan's benefits at retirement age?"

Evaluation of the survey is now underway. A final report will be issued shortly and will focus on the vesting data and their limitations.

We have no reason to believe that the effect of early retirement provisions is not reflected in the data.

X. Question:

Both S. 4 and Senator Bentsen's bill provide for plan termination insurance. The Administration's proposal does not.

(A) I recognize that in terms of total plans only a very small percentage of plans are terminated, but is there not a real hardship in the case of those plans where termination does occur?

(B) Isn't it highly unfair to an employee who has spent most of his working life building up rights to a vested pension to suddenly find that he is to receive nothing or a very small percentage of what he thought he was entitled to?

(C) If plan terminations are at a very low level, is it now also true that premiums required to fund insurance to cover these plan terminations can also be very low?

Answer:

The Administration's difficulty with termination insurance should not be interpreted as reflecting an insensitivity to the real hardships which result in the few cases of plan termination. However, it is somewhat of an oversimplification to assume that premiums required to fund insurance to cover plan terminations will be low. In general, to prevent abuse of an insurance system (and presumably to keep premium costs down) it will be necessary to closely regulate pension plans and their vesting provisions. However, such a program runs the risk of incurring large administrative expenses which must be borne by the system. On the other hand, a loosely regulated system will not cost much to administer but would require high premiums to insure against the termination of insufficiently funded plans. The problems in a termination insurance program which we encountered are more fully discussed in our reply to question V.

XI. Question:

Mr. Harold Swartz, a former Assistant Commissioner (Technical) of the Internal Revenue Service, testified before the Subcommittee that the IRS expends annually more than 400 man-years of field office staff time on pension matters and has more than 50 pension specialists and actuaries in its National Office, in Washington. Please comment on Mr. Swartz' statement and also provide the Subcommittee with information of the extent of IRS personnel experience and knowledge as to the problems of vesting, funding, termination, and qualification of private pension plans.

Answer:

Described below is the staffing, experience and knowledge of personnel in the various branches and divisions of the Service with regard to problems of vesting, funding, termination, and qualification of private pension plans.

1. *Audit Division* (*Compliance*).—The Audit Division expends annually more than 400 man-years of field office staff resources on pension plan matters.

These pension specialists issue advance determinations as to the qualification of pension and profit-sharing plans and examine plans in operation to ensure that the plans continue to qualify and that the tax deduction claimed is correct. Through training and experience these specialists become expert in all aspects of the law, regulations, and rulings relating to pension plans. A comprehensive training course of seven weeks, given in two phases, is required of Revenue Agents newly assigned to this activity.

2. *Pension Trust Branch* (*Technical*).—As of June 1, 1973, the Pension Trust Branch has a total of 58 employees on its professional staff consisting mainly of attorneys and accountants, some of whom have both disciplines. Almost half of this staff has prior Service experience although not necessarily in the

pension trust area. The Branch Chief has a shade under 30 years pension trust experience, the two Section Chiefs approximately 20 years experience, and each of the six Group Supervisors a minimum of 10 years experience. Below the supervisory levels, the average range of experience drops off sharply. Only one employee has had any relevant pension trust experience prior to coming with the Service.

Each professional employee is given intensive training, both on-job and classroom, extending over a two-year period during which time actual cases are assigned depending on his progress. This training and case assignment covers all termination.

3. *Actuarial Branch (Technical).*—The Actuarial Branch currently employs four actuaries who work full-time in the pension trust area. Three of these are Fellows of the Society of Actuaries and all had experience in pension plan design and administration before coming to the Service. They are full familiar with all the factors involved in pension plan operation, such as vesting, funding, termination, and qualification in general. The average Service experience of the four actuaries is approximately three years. Prior to Service employment their experience ran from three to 20 years with consulting firms or insurance companies. In addition, the Branch Chief has some 20 years Service pension trust experience.

Each actuary is given similar training to that furnished employees of the Pension Trust Branch, but the on-job and case assignments are primarily with regard to actuarial matters.

4. *Legislation and Regulations (Chief Counsel).*—The Legislation and Regulations Division of the Office of the Chief Counsel for the Internal Revenue Service is responsible for the preparation of draft legislation and regulations relating to the Internal Revenue Code. Branch 4 of that Division has assigned 5 attorneys, including a Branch Chief and Assistant Branch Chief, to matters relating to qualified plans. Both the Branch Chief and Assistant Branch Chief are Certified Public Accountants as well as attorneys and both had prepared materials relating to qualified plans prior to government service, as had one of the other attorneys. Although matters relating to qualified plans are assigned exclusively to these 5 attorneys, none of these attorneys works exclusively on these matters.

XII. *Question:*

I understand that one problem with present administration of the tax law is that the failure of an employer to comply with the rules—for example, as to prohibited transactions—many result in the pension trust losing its exempt status. This tends to penalize the employees who are generally innocent of any wrongdoing. Thus, the IRS is reluctant to use this sanction. Are there any other sanctions which would make the IRS administration more effective?

Answer:

As you note in your question, the existing sanctions in the tax laws are unsatisfactory in that they generally penalize those innocent of wrongdoing for the wrongful actions of others. In addition, they fail to discourage violations of the rules since parties who administer or control pension plans are not subject to penalties. In order to correct this deficiency in the law, S. 1631 would impose excise taxes on the amount involved in a prohibited transaction. These taxes would be paid by any party in interest (e.g. the trustee, the employer, officers of the employer, and other persons having a close relationship to the trust or employer) who are participants in the transaction. An initial tax would be imposed at the rate of 5% of the amount involved in the prohibited transaction. An additional tax would be imposed at the rate of 200% if the transaction is not corrected within 90 days after notice of deficiency for such tax is mailed. An additional period for correction of the transaction may be allowed if reasonable and necessary to bring about correction of the prohibited transaction. These provisions are similar to taxes imposed by the Tax Reform Act of 1969 with respect to private foundations. The appeal in this approach toward prohibited transactions is that the pension trust and its beneficiaries are not deprived of the tax benefits available under the Code by reason of the wrongful actions of others.

XIII. *Question:*

On page 21 of your testimony before the Subcommittee, it is estimated that approximately 15 million individuals would benefit from the Administration's proposed employee tax deduction for voluntary retirement savings.

Would you provide an estimate of the number who would benefit because they are currently contributing to a retirement plan and the number who would be expected to benefit by setting aside additional amounts for retirement savings beyond their current savings?

Answer:

As indicated in the following table which compares first and fourth year effects of the employee deduction proposal, an estimated 15 million individuals would benefit in the first year and 16.1 million would benefit in the fourth year. The 15 million who would benefit in the first year are employees who are in employee contributory plans. The 1.1 million increase in the fourth year is attributable to individuals who would increase their retirement savings as a result of an independent voluntary plan. It is expected that this number would continue to increase in the future as more and more people become aware of the benefits of this provision and marketing procedures become more developed.

ESTIMATED COST OF RETIREMENT DEDUCTION FOR EMPLOYEES AND NUMBER BENEFITING[1]

Salary and wage class	1st-year effect[2]		4th-year effect	
	Number benefiting (thousands)	Revenue loss (millions)	Number benefiting (thousands)	Revenue loss (millions)
0 to $3,000	230	$1	240	$1
$3,000 to $5,000	1,640	13	1,670	27
$5,000 to $7,000	3,040	63	3,110	129
$7,000 to $10,000	4,410	133	4,610	278
$10,000 to $15,000	4,140	120	4,420	269
$15,000 to $20,000	1,330	42	1,580	126
$20,000 to $50,000	190	3	370	62
$50,000 to $100,000	([3])	([3])	50	30
$100,000 and over	([3])	([3])	10	8
Total	14,980	375	16,060	930

[1] Based on 1973 levels and social security tax provisions.

[2] Initial effect, before voluntary plans are set up. In the first year deductions are limited to 50 percent of employee contributions.

[3] Less than 500 employees or $500,000.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, July 1973.

XIV. *Question:*

The Administration has proposed a tax deduction for contributions to a personal retirement saving plan. Senator Bentsen's bill (S. 1179) contains a similar proposal except that a tax credit would be given.

(A) Please comment on Senator Bentsen's proposal and provide an estimate of revenue loss resulting from the tax credit approach.

(B) If there is substantial difference in the cost of the credit compared to the deduction approach, please provide an explanation for the difference in revenue loss.

Answer:

The tax credit approach contained in the Bentsen bill although more costly than the Administration's proposal, would, in general, have the same impact upon various income groups as would the Administration's proposal. In some instances, a credit would give a greater benefit to a taxpayer than would a deduction where it exceeds his highest marginal rate.

The table below shows the initial *full-year* revenue effect of the Administration's deduction proposal and Senator Bentsen's credit proposal. The distribution of the revenue loss by income class is shown for each. In order to have a $750 million revenue loss—equivalent to the Administration's proposal—the credit in the Bentsen bill would have to be reduced to 19 percent. The overall cost differential would probably be maintained in later years.

COMPARISON OF ADMINISTRATION PROPOSAL AND SENATOR BENTSEN PROPOSAL: INITIAL EFFECT OF PROVISIONS FOR EMPLOYEES

Salary and wage class	Revenue loss	
	Administration proposal [1]	Bentsen proposal [2]
0 to $3,000	$1,000,000	$2,000,000
$3,000 to $5,000	26,000,000	48,000,000
$5,000 to $7,000	127,000,000	201,000,000
$7,000 to $10,000	266,000,000	347,000,000
$10,000 to $15,000	240,000,000	288,000,000
$15,000 to $20,000	85,000,000	90,000,000
$20,000 to $50,000	5,000,000	4,000,000
$50,000 to $100,000	(3)	(3)
$100,000 and over	(3)	(3)
Total	750,000,000	980,000,000

[1] Represents the full first-year effect if allowable deduction were not cut in half.
[2] Allowance of 25-percent tax credit in lieu of exclusion for employee contributions to retirement plans.
[3] Less than $500,000.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, July 1973.

We disagree with the tax credit approach. As Secretary Shultz pointed out in his testimony, it is desirable for the tax situation of an employee who establishes an individual retirement account (or who makes a contribution to an employer-financed plan) to be substantially similar to the tax situation of an employee covered under an employer-financed plan. When an employee is covered under an employer-financed plan, the amounts contributed by the employer to the plan on his behalf are excluded from his income. The provision for a deduction for employee contributions achieves substantial similarity with the exclusion approach, but the provision for a tax credit is radically different.

Moreover, as stated in the answer to question VI, the basic idea behind special tax treatment for pension plans is that individuals should be allowed to set aside a portion of their income in their working years to be received in their retirement years. The provision for a tax credit is inconsistent with this general principle.

XV. *Question:*

In 1969, Congress added a provision to the tax law providing that in the case of lump-sum distributions most of the amounts received with respect to future contributions would be treated as ordinary income but be subject to 7-year averaging. I am told, however, that the provision turned out to be quite complicated. In view of this, would you think it appropriate for the Committee to reconsider this provision with the idea of simplifying the ordinary income treatment and the averaging provisions that we enact in 1969?

Answer:

As you point out, the existing tax treatment of lump sum distributions from qualified plans is unsatisfactory because it is overly complicated. The complications are of two kinds:

(1) First, it is very difficult to determine how much, if any, of a lump sum distribution is subject to capital gains tax, and how much is subject to ordinary income tax.

(2) Second, it is very difficult to compute the tax on the ordinary income portion.

Proposed regulations have been issued on both types of computations and a new set of proposed regulations was recently issued on the second category computations.

We agree that it would be appropriate for the Committee to reconsider this provision with the idea of simplifying the provisions enacted in 1969.

Appendix B

Department of the Treasury Material Relating to S. 1631

(a) Proposed technical revisions to S. 1631

(b) Technical explanation and section by section analysis of S. 1631 as proposed to be revised

(c) Revised general explanation of S. 1631 as proposed to be revised

PROPOSED TECHNICAL REVISIONS OF S. 1631 (93D CONG.)

Page 2

1. On line 4, after "provision" insert ", the reference is to a section or other provision".
2. On line 11, after "paragraph," insert "except in the case of a plan established and maintained by the United States, a state or political subdivision thereof, or a corporation which is an instrumentality of the United States, a state or political subdivision thereof,".
3. On line 20, after "interest" insert "for such year".

Page 4

1. On line 2, strike out "or" and insert in lieu thereof "including".
2. On line 7, strike out "greater" and insert in lieu thereof "less".

Page 5

On line 2 strike out "or" and insert in lieu thereof "including".

Page 6

1. On line 11, strike out "earnings during the 12" and insert in lieu thereof "average covered earnings during the 60".
2. On line 15, strike out "or" and insert in lieu thereof "including,".

Page 7

On line 23, strike out "gains" and insert in lieu thereof "expenses, gains,".

Page 8

1. On line 5, after "such contributions" insert "(less withdrawals)".
2. On line 6, after "employer" insert "(less withdrawals)".

Page 9

On line 4, strike out "insert" and insert in lieu thereof "interest".

Page 11

On line 19, after "plan" insert "year".

Page 12

On line 25, strike out "to" and insert in lieu thereof "in".

Page 13

1. On line 3, strike out "and".
2. Strike out line 18 and insert in lieu thereof " '(3) The plan benefits—".

Page 14

1. On line 8, after "year" insert "and does not include any employee who is included in a unit of employees covered by an agreement which the Secretary or his delegate finds to be a collective bargaining agreement, if such agreement does not provide that such employee is to be included in the plan".
2. On line 19, after "(10)," insert "of" and after "(6), and" insert "of".

Page 15

On line 25, strike out "and (c)" and insert in lieu thereof ", (c), and (h)".

Page 18

1. On line 20, strike out "tion with respect" and insert in lieu thereof "tion for a taxable year with respect".
2. On line 22, after "years" insert "before the end of such year".

Page 19

1. On line 22, strike out the quotation mark.
2. After line 22, insert the following:

" '(g) Regulations.—The Secretary or his delegate is authorized to prescribe such forms and regulations as may be necessary to carry out the purposes of this section, including forms on which employers may be required to furnish needful information to employees. Such forms shall be furnished to employees at such time as the Secretary or his delegate may by regulations prescribe.

" '(h) Special Limitation for 1973.—For taxable years ending before January 1, 1974, the amount allowable as a deduction under subsection (a) shall not exceed 50 percent of the limitation determined under subsection (b).' "

Page 21

1. On line 8, strike out "in" and insert in lieu thereof "by".
2. On line 9, strike out "trust by, or in the custody of,".
3. On line 12, strike out "or have".
4. On line 13, strike out "custody of".

Page 22

On line 9, strike out "spouse)" and insert in lieu thereof "spouse),".

Page 23

1. Strike out lines 1 through 4 and insert in lieu thereof the following: "constituting a qualified individual retirement account if such arrangement would, except for the fact that it is not a trust, constitute a qualified individual retirement account under this subsection. Paragraph (6) shall not apply if distribution".

2. Strike out lines 9 through 16 and insert in lieu thereof the following:

" '(1) Excess contributions.—If all or a portion of the contributions paid by an individual during any taxable year to a qualified individual retirement account are not deductible under section 219 (other than by reason of section 219 (c)), under regulations prescribed by the Secretary or his delegate, such contributions or portion thereof shall be treated in the same manner as an excess contribution within the meaning of section 401(e)(1), and for this purpose, section 401(e) (2) and (3) shall apply as if such individual were an owner-employee."

Page 24

1. On line 4, strike out "or" at the end thereof.
2. On line 5, strike out "having custody of".

Page 25

1. Strike out lines 3 through 6.
2. On line 7, strike out "(4)" and insert in lieu thereof "(3)".
3. On line 23, after "219" insert "(other than by reason of section 219(c))".

Page 26

1. On line 1, after "distributed" insert "to him".

2. After line 2, insert the following:

" '(f) Special Rule.—Solely for the purpose of determining whether section 72 (p)(2)(C) applies to a contribution under subsection (a)(2) or to an amount paid or distributed under subsection (d)(2), the requirement of section 72 (p) (1) that the amount paid or distributed be received before age 59½ shall not apply.' "

3. Strike out line 3 and insert in lieu thereof the following:

"(g) Cross References.—

"(1) For excise tax on a qualified individual retirement account, see section 4960.

"(2) For additional tax on certain distributions from a qualified individual retirement account, see section 72(p)."

Page 27

On line 13, strike out "(B)" and insert in lieu thereof "(A)".

Page 29

On line 20, strike out "13" and insert in lieu thereof "31".

Page 33

1. Strike out lines 1 through 9.
2. On line 10, strike out "(5)" and insert in lieu thereof "(4)".
3. After line 25, insert the following:

"(5) Basis for assets held for qualified pension plan contracts.—Section 801(g)(7) (relating to basis of assets held for qualified pension plan contracts) is amended by striking out 'or (D)' and inserting in lieu thereof '(D), or (E)'."

Page 34

1. On line 19. strike out "after '72 (m)" and insert in lieu thereof "after '72 (n)".
2. Strike out lines 20 through 26.

Page 35

Strike out lines 1 through 26.

Page 36

1. Strike out lines 1 and 2.
2. On line 14, strike out "aply" and insert in lieu thereof "apply".
3. On line 20, strike out "Indivduals" and insert in lieu thereof "Individuals".

Page 37

1. On line 9, strike out "or 10 percent".
2. On line 10, strike out "or 15 percent".

Page 39

1. On line 7, strike out "within 60 days" and insert in lieu thereof "no later than the 60th day".
2. On line 8, after "him, such" insert "otherwise includible".

Page 40

1. On line 2, strike out "within 60 days" and insert in lieu thereof "no later than the 60th day".
2. On line 3, after "such" insert "otherwise includible".

Page 41

1. On line 23, strike out "payee" and insert in lieu thereof "employee".
2. On line 24, strike out "payee" and insert in lieu thereof "employee".

Page 42

1. On line 3, strike out "within 60 days" and insert in lieu thereof "no later than the 60th day".
2. On line 5, after "such" insert "otherwise includible".

Page 43

1. On line 1, strike out "within".
2. On line 2, strike out "60 days" and insert in lieu thereof "no later than the 60th day".
3. On line 3, strike out "him, such" and insert in lieu thereof "him, such otherwise includible".

Page 49

Strike out lines 10, 11, and 12 and insert in lieu thereof the following: "(iii) by striking out 'chapter 42 tax' in subsection (c) and inserting in lieu thereof 'chapter 42 or 44 tax'."

Page 52

1. On line 1, after "inserting" insert "in".
2. On line 7, strike out "therof" and insert in lieu thereof "thereof".
3. On line 20, strike out "and inserting" and insert in lieu thereof "and inserting".

Page 53

1. Strike out lines 8 through 11 and insert in lieu thereof the following: "(b) Amendment of Section 401 (a).—Section 401 (a) (relating to requirements for qualification) is amended—"(1) by striking out paragraph (3)(A) and inserting in lieu thereof:".
2. On line 19, strike out "which" and insert in lieu thereof "if such agreement".
3. On line 21, after "cluded" insert "in the plan".

Page 54

1. On line 3, strike out "or'." and insert in lieu thereof "or', and".
2. After line 3, insert the following:

"(2) by inserting after the second sentence of paragraph (5) the following new sentence: "'The determination of whether a plan is discriminatory within the meaning of paragraph (3) (B) or (4) shall be made without taking into account any employees who are included in a unit of employees covered by a collective bargaining agreement, if such agreement does not provide that such employees are to be included in the plan." '

Page 55

1. On line 17, strike out "in trust by, or in custody of," and insert in lieu thereof "by".
2. On line 20, strike out "or have custody of".

Page 56

1. After line 4, insert the following:
"(e) Employee Contributions of Owner-Employees.—Section 401(d)(4)(B) (relating to additional requirements for qualification of trusts and plans benefiting owner-employees) is amended by inserting 'in excess of contributions made by an owner-employee as an employee' after 'benefits'."
2. On line 5, strike out "(e)" and insert in lieu thereof "(f)".
3. On line 9, after "Accounts" insert "or Other Arrangements".
4. On line 10, after "account" insert "or an arrangement similar to a custodial account or similar to an annuity contract".
5. On line 12, after "account" insert "or arrangement".
6. On line 14, after "section;" insert "and".
7. On line 15, strike out "custodian is" and insert in lieu thereof "assets thereof are held by".
8. On line 18, strike out "have custody of" and insert in lieu thereof "hold".
9. On line 19, strike out "section; and" and insert in lieu thereof "section.".
10. Strike out lines 20 and 21.
11. On line 22, after "account" insert "or arrangement".
12. On line 24, strike out "custodian of such account" and insert in lieu thereof "person holding the assets of such account or arrangement".

Page 57

1. On line 1, strike out "(f)" and insert in lieu thereof "(g)".
2. On line 10, strike out "(g)" and insert in lieu thereof "(h)".

Page 60

On line 20, strike out "(h)" and insert in lieu thereof "(i)".

Page 61

Strike out lines 12 through 16, and insert in lieu thereof the following: " '(1) the amount of the contributions made on his behalf (reduced by any amount includible in gross income under section 1379(b)(1) with respect to such contributions) by the employer during the taxable year of the employer (including amounts deemed to be paid during such year under section 404(a)(6)) to or under a money purchase section 404(a)(6)) to or under a money purchase pension plan which satisfies the requirements of section 401(a), 404(a)(2), or 405(a) during such taxable year of the employer, over". '

Page 62

1. One line 20, strike out the quotation mark.
2. After line 20, insert the following:
" '(d) Limitations.—(1) Subsection (a) shall not apply for a taxable year of an employee if, at all times during the employee's taxable year referred to in subsection (a), under the money purchase pension plans maintained by the employer (considering all such plans as a single plan) the rate at which employer contributions are to be made with respect to employee compensation does not exceed 20 percent.
" '(2) Subsection (a) shall not apply to contributions made to or under a money purchase pension plan on behalf of an individual who is an employee within the meaning of section 401(c)(1) with respect to such plan.
" '(e) Regulations.—The Secretary or his delegate is authorized to prescribe such forms and regulations as may be necessary to carry out the purposes of this section, including forms on which employers may be required to furnish needful information to employees. Such forms shall be furnished to employees at such time as the Secretary or his delegate may by regulations prescribe.'
"(j) Penalty for Failure to Furnish Information.—Subchapter B of chapter 68 (relating to assessable penalties) is amended by inserting at the end thereof the following new section:

" 'SEC. 6690. REPORTS BY EMPLOYERS.

" '(a) Civil Penalty.—If any person who is required, by regulations prescribed under section 219(g) or 409(e), to furnish information to an employee fails to comply with such requirement at the time prescribed by such regulations, such person shall pay a penalty of $10 for each such failure, unless it is shown that such failure is due to reasonable cause.

" '(b) Deficiency Procedures Not to Apply.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by subsection (a).'

"(k) Net Operating Loss.—Section 172(d)(4) (relating to net operating loss modifications) is amended by—

"(1) striking out 'and' at the end of subparagraph (C),

"(2) striking out 'such individual.' in subparagraph (D) and inserting in lieu thereof 'such individual; and', and

"(3) by adding immediately after subparagraph (D) the following new subparagraph (E):

" '(E) any deductions allowed under section 219 shall not be treated as attributable to the trade or business of an individual'."

"(l) Retroactive Changes in Plan.—

"(1) Amendment of Section 401.—Section 401 (relating to qualified pension, etc., plans) is amended by striking out subsection (b) and inserting in lieu thereof:

" '(b) Certain Retroactive Changes in Plan.—A stock bonus, pension, profit-sharing, or annuity plan shall be considered as satisfying the requirements of subsection (a) for the period beginning with the date on which it was put into effect, or for the period beginning with the date on which there was put into effect any amendment which caused the plan to fail to satisfy such requirements, and ending with the time prescribed by law for filing the return of the employer for his taxable year in which such plan or amendment was put into effect (including extensions thereof) or such later time as the Secretary or his delegate may designate, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes for the whole of such period.'

"(2) Amendment of Section 1379.—Section 1379 (relating to certain qualified pension, etc., plans) is amended by striking out the last sentence of subsection (a) and inserting in lieu thereof:

" 'A plan shall be considered as satisfying the requirement of this subsection for the period beginning with the first day of a taxable year and ending with the time prescribed by law for filing the return of the employer for such taxable year (including extensions thereof) or such later time as the Secretary or his delegate may designate, if all the provisions of the plan which are necessary to satisfy this requirement are in effect by the end of such period and have been made effective for all purposes for the whole of such period.'."

3. On line 21, strike out "(i)" and insert in lieu thereof "(m)".

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1. Strike out lines 5, 6, and 7, and insert in lieu thereof the following:

"(2) Clerical amendments.—

"(A) The table of sections for part I of subchapter D of chapter 1 of subtitle A is amended by inserting at the end thereof the following new item: " 'Sec. 409. Inclusion of certain employer contributions in gross income.'

"(B) The table of sections for subchapter B of chapter 68 is amended—

"(i) by striking out the penultimate item and inserting in lieu thereof:

" 'Sec. 6688. Assessable penalties with respect to information required to be furnished under section 7654.'

"(ii) by inserting at the end thereof the following new item:

" 'Sec. 6690. Reports by employers.'

"(C) Subchapter B of chapter 68 is amended by striking out the heading of the section immediately preceding section 6689 and inserting in lieu thereof:

" 'SEC. 6688. ASSESSABLE PENALTIES WITH RESPECT TO INFORMATION REQUIRED TO BE FURNISHED UNDER SECTION 7654.' ".

2. On line 8, strike out "(j)" and insert in lieu thereof "(n)".

3. On line 9, strike out "(h)" and insert in lieu thereof "(i)".

4. On line 12, strike out "(h)" and insert in lieu thereof "(i)".

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Retirement Benefits Tax Act S. 1631 With Proposed Technical Revisions

TECHNICAL EXPLANATION AND SECTION BY SECTION ANALYSIS

Section 1. Short Title, Etc.

(a) *Short title.*—Section 1(a) of the bill provides that the bill may be cited as the "Retirement Benefits Tax Act".

(b) *Amendment of 1954 Code.*—Section 1 (b) of the bill provides that, except as otherwise expressly provided, whenever in the bill an amendment is expressed in terms of an amendment to a section or other provision, the reference is to a section or other provision of the Internal Revenue Code of 1954.

Section 2. Minimum Standards Relating to Funding, Eligibility, and Vesting.

(a) *In general.*—Section 2 (a) of the bill would amend section 401 (a) of the code (relating to requirements for qualification) by adding a minimum funding standard in paragraph (7), and by adding new paragraphs (11), (12), (13), and (14). Proposed paragraph (11) would impose limits upon the age and service conditions for participation in a qualified plan. Proposed paragraph (12) would require a qualified plan to include provisions according participants nonforfeitable rights under the plan prior to retirement, in accordance with the "rule of 50". Proposed paragraph (13) would provide a limited exception to the application of the rule of 50 under paragraph (12). Proposed paragraph (14) would provide special transitional rules for applying paragraphs (11) and (12).

Minimum funding standard—section 401(a)(7)

Section 401(a) of the code does not contain any explicit funding standard, although a funding standard has been developed administratively. The standard is used in determining whether, under section 401(a)(7), a complete discontinuance of contributions to a qualified pension plan has occurred. (Sec. 1.401-6(c) of the Income Tax Regulations.) A qualified plan is required to provide that if such a discontinuance occurs, the rights of participants under the plan, to the extent funded, become vested. (Sec. 1.401-6(c)(1) of the Income Tax Regulations.) Under the administrative standard, a suspension of contributions is not a complete discontinuance of contributions if the benefits under the plan are not affected at any time by the suspension and the unfunded past service cost at any time does not exceed the unfunded past service cost as of the date of establishment of the plan, plus any additional past service or supplemental costs added by amendment. An employer will generally satisfy the administrative funding standard, in the case of a defined benefit pension plan, by annual funding of the sum of normal cost and interest on unfunded past service costs.

Section 2(a)(1) of the bill would amend paragraph (7) of section 401(a) of the code to provide that for purposes of that paragraph, a complete discontinuance of contributions under a defined benefit pension plan occurs if the amount contributed to or under the plan for a plan year beginning after December 31, 1973, is less than the minimum-funding standard. This minimum funding standard would not apply to a plan maintained by the United States, a State or political subdivision thereof or a corporation which is an instrumentality of the United States, a State or political subdivision thereof.

For the first plan year beginning after December 31, 1973, the minimum funding standard is to be the sum of (i) the normal cost of the plan for such year plus interest for such year on the unfunded liability computed under the funding method used to determine normal costs, and (ii) 5 percent of the unfunded liability for nonforfeitable benefits under the plan (computed as the excess of the present value of the nonforfeitable benefits then accrued under the plan over the then fair market value of the assets). For this purpose, nonforfeitability of benefits is to be determined without regard to such contingencies as withdrawal of employee contributions, service with a competitor, or improper conduct.

For each subsequent plan year, the standard is increased by the total of the amounts determined under (i) and (ii) of the preceding paragraph with respect to the plan for each of the preceding plan years beginning after December 31, 1973, and reduced (but not below zero) by the total of the amounts contributed to or under the plan for each of the preceding plan years beginning after such date. Thus, amounts contributed for a plan year in excess of the standard reduce the standard for subsequent plan years.

The proposed minimum funding standard for any plan year is not to exceed the excess (if any) of the accrued liability, under the entry-age normal funding method (including the normal cost for the year), over the fair market value of the assets held under the plan. Thus, for example, if the fair market value of the assets held under the plan is greater than the accrued liability under the entry-age normal funding method, no contributions would be required under this provision because the plan is already fully funded.

For purposes of the minimum funding standard, liabilities under the plan and the assets held under the plan are to be determined as of the same date during the plan year and such date is to be used consistently from year to year. The fair market value of the assets held on such date is to be determined on the basis of a reasonable method applied consistently, such as on the basis of their average value during the year. Further, the actuarial assumptions used in determining liabilities under the plan are required to be reasonable in the aggregate.

As under present law, failure to satisfy the minimum funding standard would not be the only means of effecting a complete discontinuance of contributions.

As amended, paragraph (7) would also provide that the Secretary of the Treasury or his delegate may authorize the use of another minimum funding standard which results in a satisfactory rate of funding.

Eligibility requirements—proposed section 401 (a) (11)

Under section 401 (a) (3) of the code (relating to requirements for qualification), a qualified pension, profit-sharing, or stock bonus plan (or plans treated as a single plan for qualification purposes) must cover either (1) specified percentages of employees (generally, 70 percent of all employees or 80 percent of the eligible employees if 70 percent of all employees are eligible) or (2) such employees as qualify under a classification that does not discriminate in favor of officers, shareholders, supervisors, or highly compensated employees. Under the percentage coverage requirement, employees who have been employed for a minimum period prescribed by the plan (not in excess of 5 years) and certain part-time and seasonal employees may be excluded. These requirements, however, do not directly limit the restrictions on eligibility to participate which may be imposed by such a qualified plan. Under section 401 (a) (4) of the code, a plan may not discriminate in favor of shareholders, officers, supervisory employees, or highly compensated employees. For example, under present law, employees who, when they first otherwise become eligible to participate in a plan, are older than a specified age (generally an age close to normal retirement age) may be excluded if the prohibited discrimination does not result.

Proposed section 401 (a) (11 provides that a trust is not to constitute a qualified trust under section 401 of the code if the plan of which such trust is a part requires, as a condition of participation, that an employee (A) have a period of continuous service with the employer (including, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, a predecessor of the employer) in excess of 3 years, (B) have attained an age in excess of 30 years, or (C) have not attained an age which is less than the normal retirement age under the plan reduced by 5 years. For this purpose it is contemplated that regulations will provide a definition of "continuous service" which will be broader than the definition of "employment relationship" provided by § 1.421–7 (h) of the Income Tax Regulations. The Secretary of the Treasury or his delegate is, by regulation, to define the term "normal retirement age under the plan" for purposes of proposed section 401 (a) (11).

Accordingly, under subparagraphs (A) and (B) of proposed section 401(a) (11), a plan would be required to cover an employee who has completed 3 years of service and is at least 30 years old (if he meets all other conditions of participation) if any trust forming part of the plan is to constitute a qualified trust under section 401 of the code. Furthermore, for example, if the normal retirement age under the plan is age 65, the requirements of proposed section 401(a)(11) (C) would not be satisfied if, under the plan, employees who, when they would first otherwise become eligible to participate in the plan, are excluded because

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they have attained age 59 (because 59 is less than 65 reduced by 5). However, in such a case, the requirements would be satisfied if the plan required, as a condition of participation, that an employee have not attained age 60 years or an age greater than 60 years when he first becomes otherwise eligible to participate in the plan.

A plan would not be required to cover an employ who is younger than 30 years even if he has completed 3 or more years of service with the employer. However, a plan could, for example, permit coverage of employees younger than age 30 who have completed more than 3 years of service, or employees who have completed less than 3 years of service who are older than age 30. Similarly, a greater service requirement could be imposed with respect to an employee who, as of the time he is first otherwise eligible to participate, is older than normal retirement age reduced by 5 years.

Vesting requirements—proposed section 401(a)(12)

Section 401(a) of the code (relating to requirements for qualification) does not explicitly require that a qualified pension, profit-sharing, or stock bonus plan provide that a participant in the plan acquires a nonforfeitable right to his accrued benefit under the plan at any time before he becomes eligible to retire. However, section 401(d)(2)(A) of the code (relating to additional requirements for qualification of trusts and plans benefiting owner-employees) presently requires that a plan established by an unincorporated business in which an owner-employee participates must provide that each participant's rights to or derived from the contributions under the plan are nonforfeitable at the time the contributions are paid to or under the plan. In addition, under section 401(a)(4) of the code, the failure of a plan to provide for preretirement vesting is taken into account by the Internal Revenue Service in determining whether the plan satisfies the requirement that it not discriminate in favor of officers, shareholders, supervisory employees, or highly compensated employees. Furthermore, under section 401(a)(7) of the code, a qualified pension, profit-sharing, or stock bonus plan must provide that, upon its termination or upon a complete discontinuance of contributions under the plan, the rights of each employee in his accrued benefits, to the extent funded, or the amounts credited to his account, are nonforfeitable. Although the computation of benefits accrued by an employee is required for purposes of section 401(a)(7) of the code and for purposes of other code provisions, the code does not provide rules for the computation of accrued benefits.

Subparagraph (A) of proposed section 401(a)(12), provides that, except as provided by subparagraphs (B) and (C) of that paragraph (relating, respectively, to forfeitures due to voluntary withdrawal of employee contributions, and forfeitures required to prevent discrimination in favor of shareholders, officers, supervisory employees, or highly compensated employees) a trust is not to constitute a qualified trust under section 401(a) of the code unless the plan of which such trust is a part satisfies specified minimum vesting standards. Under the proposed standards, an employee's rights in his accrued benefit derived from his own contributions must be nonforfeitable (other than by reason of death). Furthermore, under a qualified plan at least 50 percent of his accrued benefit derived from employer contributions would be required to be nonforfeitable (other than by reason of death) no later than the later of (i) the close of the first plan year in which the sum of his age and the period of his active participation in the plan equals or exceeds 50 years, or (ii) the time he has completed 3 years of continuous service with the employer (including, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, service with a predecessor of the employer). For the purpose of (i), years of age and years of active participation are to be rounded separately to the nearest whole year and active participation would not include, for example, periods after employment ceases, or periods for which employee contributions required to be made under the plan are not made. Proposed section 401(a)(12).(A) would further require that an employee's rights in the remaining percentage of all of his accrued benefit derived from employer contributions become nonforfeitable (other than by reason of death) not less rapidly than ratably over the next succeeding 5 plan years following the close of the first plan year in which such employee satisfies the initial nonforfeitability requirement. More rapid vesting than that required under proposed section 401(a)(12) could be required under section 401(a)(4) if necessary to prevent discrimination in favor of officers, shareholders, supervisory employees, or highly compensated employees.

Under proposed paragraph (12)(A), if an employee's active participation of a plan year at age 30, and continued for a period of 15 consecutive plan years, his right to at least 50 percent of his accrued benefit derived from employer contributions would have to be nonforfeitable (other than by reason of death) no later than the close of the 10th plan year of participation and his right to all of his accrued benefit would have to be nonforfeitable (other than by reason of death) no later than the close of the 15th plan year of participation. Further, under proposed paragraph (12)(A) his right to any benefit accrued after such 15th year would have to be nonforfeitable (other than by reason of death). If, as of the close of the plan year in which the vesting standard becomes effective, participant A is age 40 and participant B is age 50, and each has participated in the plan for 10 years, A's right to at least 50 percent and B's right to 100 percent of the benefit accrued for such year would have to be nonforfeitable (other than by reason of death). (See effective date provided by sec. 2(d) of the bill and special transitional rules provided under sec. 401(a)(14) as proposed to be added l y sec. 2(a) of the bill.)

Subparagraph (B) of proposed section 401(a)(12) provides that a trust, which is a part of a plan to which employees are required to contribute as a condition of participation, is not to be disqualified under proposed paragraph (12) merely because an employee's right in his accrued benefit derived from employer contributions under the plan are forfeitable if, by reason of his separation from the service or termination of his active participaiton in the plan, he voluntarily withdraws all or a part of the amount contributed by him. If a plan provided that a terminating employee is required to withdraw his contributions to the plan under certain circumstances, his rights in his accrued benefit may not be forfeited because of such withdrawal. Moreover, proposed section 401(a)(12)(B) would not apply to a plan which merely permits an employee to make voluntary contributions to the plan (i.e., contributions that are not required to be made under the plan to receive a benefit (or an additional benefit) derived from employer contributions).

Subparagraph (C) of proposed section 401(a)(12) provides that proposed paragraph (12) is not to apply to contributions which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary of the Treasury or his delegate to preclude discrimination prohibited by paragraph (4) of section 401(a) (in favor of shareholders, officers, supervisory employees, or highly compensated employees), may not be used to provide benefits for designated employees in the event of early termination of the plan. However, except to the extent necessary to prevent the prohibited discrimination, the rights of such a designated employee must be nonforfeitable in accordance with provisions of the plan satisfying the rule of 50.

Many plans provide, for example, for the forfeiture of benefits by a participant who serves with a competitor or engages in improper conduct. To the extent provisions such as these render forfeitable those benefits which would be required to be nonforfeitable under proposed section 401(a)(12), such provisions would require amendment. Improper conduct may, nevertheless, continue to be deterred by provisions giving an employer lien rights against employee interests in a trust to recover liabilities to the employer if permitted under local law, e.g., recovery for embezzlement.

Subparagraph (D) of proposed section 401(a)(12) provides rules for determining the amount of an employee's accrued benefit (which are minimum amounts in the case of benefits under defined benefit pension plans), as of any applicable date, for purposes of proposed sections 401(a)(12) and 401(d)(2)(A) (relating to the vesting requirements of qualified plans benefiting owner-employees). Separate rules would apply for the determination of the minimum accrued benefit in the case of a defined benefit pension plan and for such determination in the case of other plans.

Clause (i) of proposed section 401(a)(12)(D) provides general rules for determining such accrued benefit on the basis of an annual benefit commencing at normal retirement age in the case of a defined benefit pension plan. (Subparagraph (F) of proposed sec. 401(a)(12) provides rules for the determination of a benefit other than an annual benefit commencing at normal retirement age.) The general rule provided by proposed clause (i) is that an employee's minimum accrued benefit, as of any applicable date prior to normal retirement age, is to be the product of (1) the annual benefit commencing at normal retirement age to which such employee would be entitled under the plan as in effect at such time, assuming that he continues to earn annually until normal retirement age the same rate of compensation as he earned at such time (based upon his average covered earnings during the 60 preceding months or, if shorter, the actual preceding period of employment), and (2) the following fraction: the numerator of the fraction is to be the total number of his years of service with the employer (including, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, service with a predecessor of the employer) performed as of such time and the denominator of such fraction is to be the total number of years of service he will have performed as of normal retirement age, assuming that he will continue to be employed by the employer until attaining such age. However, such denominator is not to be less than 15 nor more than 40. Notwithstanding the above rules, the fraction referred to in proposed clause (i) is to be deemed to be equal to one at normal retirement age and is never to exceed one. Thus, for example, if an employee's age is equal to or greater than normal retirement age, his annual benefit would be multiplied by one, and prior to normal retirement age the minimum accrued benefit of an employee with a level salary would accrue at a level rate, not to exceed 1/15th per year and not less than 1/40th per year. The minimum accrued benefit for an employee with 40 years of service would be equal to the annual benefit payable at normal retirement age based on assumed continuation of his present compensation to that age.

For example, employee A becomes an employee of X Corporation and a participant in its noncontributory plan at age 40 in 1976. The plan provides a pension at age 65, the normal retirement age, equal to 30 percent of the average compensation during the five years of service immediately preceding retirement. A participates in the plan for 10 years, earning average annual covered compensation in the last 60 months of $12,000. Under proposed section 401(a)(12)(D), at the end of the 10th year, his accrued benefit is not to be less than $1,440 per year beginning at age 65 (30 percent of $12,000 multiplied by 10/25). It is anticipated that regulations prescribed by the Secretary of Treasury or his delegate would provide special rules for determining an employee's accrued benefit derived from employer contributions under a defined benefit pension plan which is integrated with social security benefits.

The last sentence of proposed section 401(a)(12)(D) provides that, in the case of a defined benefit pension plan which permits voluntary employee contributions, the portion of an employee's accrued benefit derived from such contributions is to be treated as an accrued benefit derived from employee contributions under a plan other than a defined benefit pension plan. A separate account would be required to be maintained for voluntary contributions of each participant together with the income expenses, gains and losses thereon.

Clause (ii) of proposed section 401(a)(12)(D) provides that in the case of a plan other than a defined benefit pension plan (a profit-sharing, stock bonus, or money purchase pension plan (including a "target benefit" plan)) an employee's accrued benefit as of any applicable date is to be the balance of the account or accounts for such employee as of that time.

Subparagraph (E) of proposed section 401(a)(12) provides rules for determining an employee's accrued benefit derived from employer contributions (which would be subject to the applicable proposed vesting standards) and from employee contributions (which would be fully nonforfeitable, except in the case of death). The first sentence of proposed section 401(a)(12)(E) defines an employee's minimum accrued benefit derived from employer contributions as of a particular date as the excess of the employee's accrued benefit determined under proposed section 401(a)(12)(D) as of such date over the amount of the accrued benefit derived from his employee contributions as of such date. Thus, the amount of an employee's accrued benefit derived from employer contributions depends on the terms of the plan but does not depend upon the amount of employer contributions actually made and does not depend on the value of the assets in the fund.

With respect to a plan other than a defined benefit pension plan, the amount of the accrued benefit derived from employee contributions as of any date is to be the benefit attributable to the balance in his separate account consisting only of his contributions and the income, expenses, gains, and losses attributable thereto. However, if a separate account is not maintained with respect to an employee's contributions under such a plan, the amount of the accrued benefit derived from employee contributions is to be the amount which bears the same ratio to the employee's total accrued benefit as the total amount of the employee's contributions (less withdrawals) bears to the total amount of his contributions (less withdrawals) and the employer contributions (less withdrawals) made on his behalf. For this purpose, forfeitures credited to an employee's account are to be treated as employer contributions.

With respect to a defined benefit pension plan providing an annual benefit in the form of a single life annuity commencing at normal retirement age (proposed sec. 401(a)(12)(F) provides rules for other forms), the amount of the minimum accrued benefit derived from employee contributions as of any applicable date is to be the annual benefit equal to the employee's accumulated contributions multiplied by the appropriate conversion factor. For this purpose, the term "appropriate conversion factor" means the factor necessary to convert an amount equal to the accumulated contributions to a single life annuity commencing at normal retirement age.

Such factor is to be 10 percent for a normal retirement age of 65 years and is to be the same for men and women. For other normal retirement ages, such factor is to be determined in accordance with regulations prescribed by the Secretary of the Treasury or his delegate.

For purposes of proposed section 401(a)(12)(E) the term "accumulated contributions" means the total of: (i) all mandatory contributions made by the employee before the end of the last plan year referred to in clause (i) or (ii) of proposed section 401(a)(14)(A) (relating to transitional rules), together with interest (if any) credited thereon under the plan to the end of such plan year (to the extent such contributions and interest are nonforfeitable on the applicable date), and interest compounded annually thereafter at the rate of 5 percent per annum, to the date upon which the employee would attain normal retirement age, and (ii) all mandatory contributions made by the employee after the end of the last plan year referred to in clause (i) or (ii) of proposed section 401(a)(14)(A), together with interest on such contributions compounded annually at the rate of 5 percent per annum to the date upon which the employee would attain normal retirement age.

For purposes of subparagraph (E) of proposed section 401(a)(12), mandatory contributions made by an employee are the contributions that are required to be made under the plan to receive a benefit (or an additional benefit) derived from employer contributions. For example, if the benefit derived from employer contributions depends upon a specified level of employee contributions, employee contributions up to that level would be treated as mandatory contributions.

Proposed section 401(a)(12)(E) further provides that the accrued benefit derived from employee contributions is not to exceed the accrued benefit determined under subparagraph (D) of proposed section 401(a)(12). Thus, for example, if an employee's accrued benefit determined under subparagraph (D) equals $20,000, his accrued benefit derived from employee contributions is not to be greater than $20,000 even though such benefits determined under subparagraph (E) equal $25,000.

Subparagraph (F) of proposed section 401(a)(12) provides that, in the case of a defined benefit pension plan, if an employee's accrued benefit is to be determined as an amount other than an annual benefit commencing at normal retirement age, or if the amount of the accrued benefit derived from contributions made by an employee is to be determined with respect to a benefit other than an annual benefit in the form of single life annuity commencing at normal retirement age, the employee's minimum accrued benefit, or the amount of the minimum accrued benefit derived from contributions made by an employee, as the case may be, is to be the actuarial equivalent (determined in accordance with regulations prescribed by the Secretary of the Treasury or his delegate) of such benefit or such amount determined under subparagraph (D) or (E) of proposed section 401(a)(12).

It is contemplated that amendment of many existing plans would be required to conform them to the proposed rules relating to the required percentage of vesting and the definition of accrued benefit, in order to remain qualified. For instance, the United States civil service retirement system would have to be amended to conform to these rules.

Exception to vesting requirements—proposed section 401(a)(13)

Proposed section 401(a)(13) provides that a trust forming part of a defined benefit pension plan which is in existence on December 31, 1972, is not to be disqualified for any plan year merely because such plan provides that an employee's accrued benefit derived from employer contributions for any plan year is forfeitable if both of the following conditions are satisfied: (1) the sum of the periodic benefit payments to retired participants (or their beneficiaries) during the plan year exceeds the benefit accruals (determined in accordance with regulations prescribed by the Secretary or his delegate) by active participants during the plan year, and (2) as of the beginning of the plan year, the sum of the present values of accrued plan liabilities to active and retired participants under the plan exceeds the fair market value of plan assets. Such accrued benefits for an employee during such a plan year could remain forfeitable until the employee attains retirement age under the plan.

The present values of accrued plan liabilities are to be determined in accordance with actuarial assumptions which in the aggregate are reasonable. The fair market value of plan assets held at the beginning of the plan year is to be determined on the basis of a reasonable method applied consistently, such as on the basis of their average value during the preceding year.

Subparagraph (B) of proposed section 401(a)(13) provides that this exception is not to apply for any plan year beginning after December 31, 1972, if the plan is amended during such plan year to provide additional or increased benefits (for example, by lowering the retirement age or raising benefit levels). For this purpose, neither a reduction in eligibility requirements to comply with applicable law nor an increase in the rate of vesting would be deemed to result in additional or increased benefits. If the plan is so amended, the exception will also not apply to any succeeding plan year or to any plan year which begins after December 31, 1972, and which precedes the plan year in which the plan is amended by not more than 5 plan years.

Transitional rules—proposed section 401(a)(14)

Proposed section 401(a)(14)(A)(i) provides that proposed paragraphs (11) and (12) of section 401(a), relating to eligibility of participants and nonforfeitability of accrued benefits, respectively, are not to apply, in the case of a plan in existence on December 31, 1972, with respect to a plan year which begins before January 1, 1975. However, if later, in the case of a plan maintained pursuant to an agreement which the Secretary of the Treasury or his delegate finds to be a collective bargaining agreement between employee representatives and one or more employers, in effect on December 31, 1972, proposed paragraphs (11) and (12) of section 401(a) are not to apply to a plan year ending before the termination of the agreement. For purposes of determining the date on which such an agreement terminates, an extension agreed to after December 31, 1972, would be disregarded. Thus, in the case of such a collectively bargained plan, the proposed rules relating to nonforfeitability of accrued benefits would generally not apply to benefits accrued during plan years ending before the expiration of the collective bargaining agreement in effect on December 31, 1972.

Generally, subparagraph (B) of proposed section 401(a)((14) provides an exception to the application of the transitional rules under subparagraph (A) of proposed section 401(a)(14). Subparagraph (B) of proposed section 401(a)(14) provides that proposed section 401(a)(12), relating to nonforfeitability of accrued benefits, is to apply to all benefits accrued under the plan unless the conditions of nonforfeitability under the plan as in effect on December 31, 1972, remain in effect with respect to benefits accrued during plan years beginning before January 1, 1975 (or, if applicable, the appropriate later date in the case of a plan maintained pursuant to a collective bargaining agreement). For this purpose the conditions of nonforfeitability are to be deemed to remain in effect so long as such conditions are not amended to provide for the forfeiture of amounts which would not have been forfeited but for the amendment.

Subparagraph (B) of proposed section 401(a)(14) further provides that, in the case of a profit-sharing, stock bonus, or money purchase pension plan, proposed section 401(a)(12) is to apply to all benefits accrued under a plan unless separate accounts are maintained with respect to the benefits accrued during plan years beginning before January 1, 1975 (or, if applicable, the appropriate later date in the case of a plan maintained pursuant to a collective bargaining agreement).

(b) *Plans benefiting owner-employers.*—Section 2(b) of the bill would amend section 401 (d) of the code (relating to additional requirements for qualification of trusts and plans benefiting owner-employees). Paragraph (1) of section 2 (b) of the bill would revise the conditions for nonforfeitability of benefits under such a plan. Paragraph (2) of section 2 (b) of the bill would revise the service requirements for participation in a qualified plan benefiting an owner-employee.

Conditions for nonforfeitability of benefits—section 401 (d) (2) (A)

Section 401 (d) (2) (A) of the code provides that an employees' trust, in which an owner-employee (defined in sec. 401 (c) (3) of the code as a sole proprietor or a partner who owns more than 10 percent of the capital interest or the profits interest in a partnership) participates, constitutes a qualified trust under section 401, only if under the plan of which such trust is a part the rights of each participant in the plan to or derived from employer contributions are fully nonforfeitable at the time such contributions are made.

Paragraph (1) of section 2 (b) of the bill would amend section 401 (d) (2) (A) to provide minimum vesting standards which must be met if such a trust is to constitute a qualified trust under section 401. Under the proposed standards, an employee's rights in his accrued benefit derived from his own contributions (within the meaning of proposed sec. 401 (a) (12)) must be nonforfeitable (other than by reason of death). Furthermore, his rights in at least 50 percent of his accrued benefit derived from employer contributions (within the meaning of proposed sec. 401 (a) (12)) must be nonforfeitable (other than by reason of death) as of the close of the first plan year in which the sum of his age and the period of his participation in the plan equals or exceeds 35 years.

Proposed section 401 (d) (2) (A) would further require that an employee's rights in the remaining percentage of all of his accrued benefit derived from employer contributions become nonforfeitable (other than by reason of death) not less rapidly than ratably over the next succeeding 5 plan years following the close of the first plan year in which such employee satisfies the initial nonforfeitability requirement. As under present law, an employee's rights in employer contributions to a plan would not be required to be nonforfeitable to the extent that, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary of the Treasury or his delegate to preclude the discrimination prohibited by section 401 (a) (4) of the code, such contributions may not be used to provide benefits for designated employees in the event of early termination of the plan. Further, more rapid vesting could be required if necessary to prevent discrimination in favor of self-employed individuals, supervisory employees, or highly compensated employees.

Conditions for participation—section 401(d) (3)

Section 401 (d) (3) of the code provides that an employee's trust, in which an owner-employee as defined in sec. 401(c) (3)) participates, does not constitute a qualified trust under section 401 of the code unless the plan of which such trust is a part benefits each employee having a period of employment of 3 years or more. For this purpose, the term "employee" does not include any employee whose customary employment is for not more than 20 hours in any one week or is for not more than 5 months in any calendar year.

Section 2(b)(2) of the bill would amend section 401(d)(3) to provide that such a trust is not to constitute a qualified trust under section 401 unless the plan benefits each employee having a period of continuous service with the employer of 3 years or more who is younger than 30 years of age, each employee having a period of continuous service with the employer of 2 years or more who has attained the age of 30 years but is younger than 35 years of age, and each employee having a period of continuous service with the employer of 1 year or more whose age is 35 years or greater. Also, for this purpose, the term "employee" is not to include any employee who is included in a unit of employees covered by an agreement which the Secretary of the Treasury or his delegate finds to be a collective bargaining agreement, if such agreement does not provide that such employee is to be included in the plan. Under regulations to be prescribed by the Secretary of the Treasury or his delegate, the term "employer" would include a predecessor of an employer.

(c) *Conforming amendments.*—Section 2(c) of the bill would make conforming amendments to section 404(a) (2) of the code (relating to deduction for contributions of an employer to employees' annuity plan), section 405(a) (1) of the code (relating to qualified bond purchase plans), and section 805(d) (1) (C) of the code (relating to definition of pension plan reserves). Paragraphs (1) and (2) of section 2(c) would extend to employees' annuity plans and qualified bond purchase plans, respectively, that do not utilize trusts, the requirements that would be imposed upon plans utilizing trusts by subsections (a)(2) and (b) of section 2 of the bill. Paragraph (3) of section 2(c) would conform the definition of "pension plan reserves" in section 805(d) to reflect the new requirements described above.

(d) *Effective dates.*—Section 2(d) of the bill provides that generally, the amendments proposed to be made by section 2 of the bill are to become effective after the date of enactment of the bill. The amendment proposed to be made to section 401(d)(3) of the code (relating to eligibility conditions with respect to a plan providing benefits for an owner-employee) by section 2(b)(2) of the bill is not to apply for a plan year beginning before January 1, 1975, in the case of a trust or contract which is a part of a plan in existence on December 31, 1972.

Section 3. Deduction for Retirement Savings

(a) *In general.*—Section 3(a) of the bill would amend part VII of subchapter B of chapter 1 of the code (relating to additional itemized deductions for individuals) by redesignating section 219 (containing cross references) as section 220 and by inserting after section 218 a new section 219 which would allow individuals a limited deduction for certain amounts saved for retirement purposes. Section 3(e)(2) of the bill would amend section 62 of the code to provide that the deduction allowed by proposed section 219 is to be taken into account in computing adjusted gross income.

Deduction allowed—proposed section 219(a)

Under existing law, an individual (other than a self-employed individual) is not allowed any deduction for amounts which he saves for retirement purposes. On the other hand, a participant in a qualified pension, annuity, profit-sharing, stock bonus or bond purchase plan is allowed to exclude from his gross income amounts contributed by his employer on his behalf to the plan, even though his rights in such amounts may be nonforfeitable.

Proposed section 219(a) provides that, subject to the limitations imposed by proposed section 219 (b), (c), and (h), an individual (including a self-employed individual) is to be allowed a deduction for amounts paid in cash during his taxable year by him (1) to or under a qualified individual retirement account (as defined in sec. 408(a) of the code (as proposed to be added by sec. 3(b) of the bill)) which is exempt from tax under section 501(a) if the individual established such account, (2) to an exempt employees' trust described in section 401(a) of the code, for the benefit of the individual, (3) for the purchase of an annuity contract for the individual under a plan which meets the requirements of section 404(a)(2) of the code (relating to employee annuities), or (4) to or under a qualified bond purchase plan (described in sec. 405(a) of the code (relating to qualified bond purchase plans)), for his benefit. The requirement that the contribution paid by the individual be for his benefit has the effect of denying the deduction to an individual who contributes to an employees' trust in which he is not a participant.

Limitations on deduction—proposed section 219(b)

Paragraph (1) of proposed section 219(b) provides that the amount allowable as a deduction under proposed section 219(a) to an individual for any taxable year is not to exceed an amount equal to 20 percent of his earned income paid or accrued for such taxable year, or $1,500, whichever is the lesser. This limitation on the deductible amount is to apply to the sum of the amounts paid during such taxable year by such individual to or under all accounts, trusts, and plans described in proposed section 219(a). The general limitation computed under this paragraph is to be reduced under paragraphs (2) and (3) of proposed section 219(b).

Paragraph (2) of proposed section 219(b) provides that the amount of the limitation determined under proposed section 219(b)(1) for any taxable year is to be reduced by the amount (determined under regulations prescribed by the Secretary of the Treasury or his delegate) of contributions paid on behalf of the individual by his employer (including a sole proprietor or partnership treated as an employer under sec. 401(c)(4)) for the individual's taxable year to an exempt employees' trust which qualifies under section 401(a), for the purchase of an annuity contract under a qualified annuity plan which meets the requirements of section 404(a)(2) (including a plan described in sec. 805(d)(1)(C)), to or under a qualified bond purchase plan described in section 405(a), or for the purchase of an annuity contract described in section 403(b) of the code (relating to annuities purchased by a sec. 501(c)(3) organization or by a public school). This reduction is to be made even though the employee's rights under the plan are forfeitable in whole or in part.

Proposed section 219(b)(2) provides that under regulations prescribed by the Secretary of the Treasury or his delegate, the amount of any such contributions (other than for the purchase of an annuity contract described in section 403(b)) paid on behalf of an individual by his employer for his taxable year may, at the option of the individual, be considered to be 7 percent of his earned income paid or accrued for such taxable year which is attributable to the performance of personal services for such employer. This choice is to be available even where it may be readily demonstrated that the actual employer contributions on behalf of the taxpayer exceed 7 percent of such earned income. However, proposed section 219(b)(2) provides that the option to treat such employer contributions to such a trust or plan as not exceeding 7 percent is not to apply in the case of a contribution on behalf of an owner-employee within the meaning of section 401(c)(5) of the code. Thus, for example, a partner owning more than a 10 percent interest in the partnership would not have the option to treat partnership contributions made on his behalf to or under a plan maintained by the partnership as being equal to 7 percent of his earned income if they exceed that percentage.

Paragraph (3) of the proposed section 219(b) provides that, if an individual has earned income for the taxable year which is not subject to tax under the Self-Employment Contributions Act of 1954 (chapter 2 of the code), the Federal Insurance Contributions Act (chapter 21 of the code), or the Railroad Retirement Tax Act (chapter 22 of the code), the limitation on the deductible amount computed under paragraphs (1) and (2) is to be further reduced by an amount equal to the tax (or, if such individual has some earned income which is subject to any of such taxes, the increase in tax) that would have been imposed upon such income under section 3101 of the code (relating to rate of tax on employees under the Federal Insurance Contributions Act) for such taxable year if such income constituted wages (as defined in sec. 3121(a) of the code) received by such individual with respect to employment (as defined in sec. 3121(b) of the code).

Paragraph (4) of proposed section 219(b) provides that no deduction is to be allowed under proposed section 219 for a taxable year with respect to any payment described in section 219(a) which is made by an individual who has attained the age of 70½ years before the end of such year.

The application of proposed section 219(b) may be illustrated by the following example:

Example. A is employed solely by the United States and is participant in the Civil Service Retirement System. A's taxable year is the calendar year, and for 1975, his compensation is $10,000 and the amount of his contributions to the Civil Service Retirement System is $700. (It is assumed that the Civil Service Retirement System will be amended to conform to the requirements of the Retirement Benefits Tax Act for 1975.) The amount allowable as a deduction under proposed section 219(a) for 1975 is determined in the following manner:

1. A's contributions which may be taken into account under proposed section 219(a).	$700
2. The lesser of 20 percent of A's earned income (proposed sec. 219(b)(1)) for 1975 or $1,500	1,500
3. Employer contributions to Civil Service Retirement System (7 percent of $10,000 (proposed sec. 219(b)(2))	700
4. Tax that would be imposed for 1975 under section 3101 if compensation constituted wages (5.85 percent of $10,000 (proposed sec. 219(b)(3) reduction))	585
5. Sum of items (3) and (4)	1,285
6. Limitation under proposed section 219(b) (item (2) less item (5))	215
7. Amount allowable as a deduction under proposed section 219(a) (lesser of item (1) or item (6))	215

Recontributed amounts—proposed section 219(c)

Subsection (c) of proposed section 219 provides that no deduction is to be allowable under proposed section 219 with respect to a contribution described in section 72(p)(2)(C) (as proposed to be added by sec. 3(c)(9) of the bill), 402(a) (6) or (7) (as proposed to be added by sec. 5(a)(2) of the bill), or 403(a) (4) or (5) (as proposed to be added by sec. 5(b)(2) of the bill). Proposed sections 72(p)(2)(C), 402(a) (6) and (7), and 403(a) (4) and (5), provide "roll-over" rules under which certain distributions received from a qualified individual retirement account or a qualified trust or plan may be contributed within a specified period to another qualified account, trust, or plan and excluded from gross income for the taxable year in which the distribution is received. Thus, taxation of distributions "rolled-over" to another plan, trust, or account would generally be deferred until distributions commenced from the other plan, trust, or account. Proposed section 219(c) would deny any deduction under proposed section 219 for these "roll-over" contributions.

Married individuals—proposed section 219(d)

Subsection (d) of proposed section 219 provides special rules in the case of a married individual. The marital status of an individual is to be determined under the rules provided in section 153 of the code (relating to determination of marital status for purposes of personal exemptions). Proposed section 219(d) provides that in the case of a married individual, the limitation under proposed section 219(b)(1) is to be determined without regard to the earned income of his spouse and without regard to contributions described in proposed section 219(b)(2) paid on behalf of his spouse. For purposes of proposed section 219, the earned income of a married individual is to be determined without regard to community property laws of a State. Thus, for example, an individual could contribute his own earnings to a qualified account even though such earnings would be community property under State law.

Earned income defined—proposed section 219(e)

Subsection (e) of proposed section 219 defines the term "earned income" for purposes of proposed section 219 as any income which is earned income within the meaning of section 401(c)(2) of the code (defining earned income in the case of a self-employed individual) or of section 911(b) of the code (defining earned income in the case of a common-law employee).

Time contributions deemed made—proposed section 219(f)

Subsection (f) of proposed section 219 provides that for purposes of proposed sections 219 and 408, an individual is to be deemed to have made a payment during the taxable year if the payment is on account of such taxable year and is made no later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). This rule corresponds to the rule presently provided in section 404(a)(6) for a contribution by an accrual basis employer to a qualified plan. (Sec. 7(h)(4) of the bill would amend sec. 404(a)(6) to extend the rule to cash basis employers.)

Regulations—proposed section 219(g)

Subsection (g) of proposed section 219 provides that the Secretary of the Treasury or his delegate is to be authorized to prescribe such forms and regulations as may be necessary to carry out the purposes of proposed section 219 including forms on which employers may be required to furnish needful information to employees. Such forms are to be furnished to employees at such time as the Secretary of the Treasury or his delegate may by regulations prescribe.

Section 6690 (as proposed to be added by sec. 7(j) of the bill) would prescribe assessable civil penalties for an employer's failure to furnish information to his employees as required under this section.

Special limitation for 1973—proposed section 219(h)

Subsection (h) of proposed section 219 provides that for taxable years ending before January 1, 1974, the amount allowable as a deduction under proposed subsection (a) is not to exceed 50 percent of the limitation determined under proposed subsection (b). Thus, for example, if for a taxable year ending in 1973, the limitation under proposed subsection (b) for an individual is $215 (without regard to proposed sec. 219(h)), the maximum amount allowable as a deduction under proposed section 219 would be $107.50.

(b) *Individual retirement accounts.*—Section 8(b) of the bill would amend part I of subchapter D of chapter 1 of the code (relating to pension, etc., plans) by adding a new section 408. Proposed section 408 would provide rules for the establishment and maintainance of qualified individual retirement accounts which individuals could utilize for saving for retirement purposes, and would also provide rules for the taxation of distributions from qualified individual retirement accounts.

Requirements for qualification—proposed section 408(a)

Proposed section 408(a) provides that, if certain requirements are satisfied, a trust created or organized in the United States is to constitute a qualified individual retirement account. Proposed section 408(a) provides that, for purposes of the code, a custodial account, annuity contract, or other similar arrangement is to be treated as a trust constituting a qualified individual retirement account, if otherwise qualified. The requirements for qualification would be required to be set forth in a written governing instrument. It is contemplated that, in an appropriate case, a plan similar to a dividend reinvestment plan of a regulated investment company might constitute a "similar arrangement", even though no certificates are issued, provided there is an appropriate governing instrument for the plan.

Paragraph (1) of proposed section 408(a) provides that an individual retirement account is not to constitute a qualified individual retirement account unless its governing instrument provides that the account is maintained for the purpose of distributing the contributions to such account and the income derived from such contributions to the individual who established it or his beneficiaries. Distributions from the account could be in the form of money or property. The payment of an expense or obligation on behalf of or for the benefit of a beneficiary would be considered a distribution to such beneficiary. Such an account is to be considered to be maintained for the purpose of distributing the contributions thereto and the income therefrom to the individual who established it or his beneficiaries even though the assets of the account include policies which have life or disability insurance features if such features are incidental to the purpose of providing benefits in a manner which satisfies proposed sections 408(a) (5) and (6).

Paragraph (2) of proposed section 408(a) requires that the governing instrument of a qualified individual retirement account provide that except in the case of a "roll-over" contribution described in section 72(p)(2)(C) (as proposed to be added by sec. 3(c)(9) of the bill), section 402(a)(6) (as proposed to be added by sec. 5(a)(2) of the bill), or section 403(a)(4) (as proposed to be added by sec. 5(b)(2) of the bill), the amount of contributions to such account during any taxable year is not to exceed a specified amount. This specified amount is in excess of the limitation provided by proposed section 219(b) for such taxable year over the sum of the amounts paid by such individual during such year to a qualified pension, etc., plan for such individual's benefit, for the purchase of an annuity contract for the individual under a qualified annuity plan, or to or under a qualified bond purchase plan described in section 405(a), for his benefit. Paragraph (2) of proposed section 408(a) further requires that such instrument provide that contributions to the account may be made only by the individual who established the account. However, proposed section 408(b)(2) would permit certain community property of the individual and his spouse to be contributed.

Paragraph (3) of proposed section 408(a) requires that the governing instrument of a qualified individual retirement account provide that the assets of the account may not be comingled with other property except in a common trust fund. This requirement would not prohibit the assets from being held in a custodial account or invested in an annuity contract.

Paragraph (4) of proposed section 408(a) would require that the assets of a qualified individual retirement account be held by a bank (as defined in sec. 401(d)(1) of the code) or other person (including the issuer of an annuity contract) who demonstrates to the satisfaction of the Secretary of the Treasury or his delegate that the manner in which he will hold such assets will be consistent with the requirements of proposed section 408. It is contemplated that regulations prescribed under proposed section 408(a)(4) will provide that neither the transfer nor redemption of such assets may be effected without the consent of the holder of the assets.

Paragraph (5) of proposed section 408(a) requires that the governing instrument of a qualified individual retirement account provide that the entire interest (i.e., the contributions to such account and the income derived from such contributions) of the individual who established such account must be distributed to him if he is then alive not later than the last day of his taxable year in which he attains the age of 70½. Alternatively the instrument may provide that such interest will be distributed periodically, commencing no later than the last day of such taxable year, over the life of such individual or the lives of such individual and his spouse or over a period not extending beyond the life expectancy of such individual or the life expectancy of such individual and his spouse. The Secretary of the Treasury or his delegate would be given authority to prescribe regulations with respect to these alternative methods of distribution. If such individual's entire interest is to be distributed in the form of an annuity contract, the requirements of proposed section 408(a)(5) would be satisfied if the distribution of such contract is to take place on or before the last day of the taxable year in which such individual attains the age of 70½ and if such interest is to be paid over a period allowable under proposed section 408(a)(5). Paragraph (5) of proposed section 408(a) provides the same rule presently provided with respect to self-employed individuals under section 401(a)(9) of the code.

Paragraph (6) of proposed section 408(a) requires that the governing instrument of a qualified individual retirement account provide that if the individual who established the account dies before his entire interest has been distributed to him, or if distribution has commenced in accordance with the requirements of proposed section 408(a)(5) to his surviving spouse and such spouse dies before the entire interest has been distributed to such surviving spouse, the entire interest (or the remaining part of such interest if distribution has commenced) will be distributed or applied in a certain manner. The instrument would be required to provide that such entire interest (or such remaining part) will, within 5 years after his death (or the death of his surviving spouse), be distributed, or applied to the purchase of an immediate annuity for his beneficiary or beneficiaries (or the beneficiary or beneficiaries of his surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which will be immediately distributed to such beneficiary or beneficiaries. This is the same rule presently provided with respect to self-employed individuals who are owner-employees under section 401(d)(7) of the code.

If contributions to a qualified individual retirement account may be used for the purchase of annuity or similar contracts, paragrah (7) of proposed section 408 (a) requires the governing instrument to provide that any refunds of premiums are to be held by the issuer of the contract with respect to which such refund of premiums arises and applied within the current taxable year or the next succeeding taxable year of the account toward the payment of future premiums under such contract or toward the purchase of additional benefits This is the same rule presently provided with respect to qualified annuity plans under section 404 (a) (2) of the code.

Proposed section 408 (a) provides that section 408 (a) (6) (relating to requirement of distribution in the case of death) is not to apply if distribution of the interest of such individual has commenced and such distribution is for a term certain over a period permitted under proposed paragraph 408 (a) (5) (relating to requirements as to the time of distribution). These are the same rules presently provided under section 401 (d) (7) of the code.

Special rules—proposed section 408 (b)

Proposed section 408 (b) provides special rules for the application of section 408.

Excess contributions—proposed section 408 (b) (1)

Proposed section 408 (b) (1) provides that, if all or a portion of the contributions paid by an individual during any taxable year to a qualified individual retirement account are not deductible under section 219 of the code, as proposed to be added by section 3 (a) of the bill (other than by reason of proposed sec. 219 (c), relating to recontributed amounts), under regulations prescribed by the Secretary of the Treasury or his delegate, such contributions or portion thereof are to be treated in the same manner as an excess contribution within the meaning of section 401 (e) (1) of the code. For this purpose, section 401 (e) (2) and (3) of the code (relating to effect of excess contribution and contributions for premiums on annuity, etc., contracts) are to apply as if such individual were an owner-employee. Thus, for example, if a portion of the contributions during any taxable year to such an account is not deductible under proposed section 219 (a) because it exceeds the limitation of proposed section 219 (b), the account is to be considered as not meeting the requirements of proposed section 408 (a) for such taxable year and all succeeding taxable years unless such portion (and the net income derived therefrom) is repaid to the taxpayer before the close of the 6-month period beginning on the day on which the Secretary of the Treasury or his delegate sends notice to the person to whom such excess contribution was was paid of the amount of such excess contribution. In addition, if such a contribution were determined to have been willfully made, the taxpayer's interest in all individual retirement accounts is to be distributed to him, and any individual retirement account maintained by him during his taxable year in which such non-deductible contribution was made and the 5 succeeding taxable years is not to be considered a qualified individual retirement account.

The foregoing rules are not to apply to contributions to a qualified individual retirement account if, under the governing instrument of the account, such contributions must be applied to pay premiums or other consideration for one or more annuity, endowment, or life insurance contracts on the life of the individual making any such contribution and if the amount of such contributions does not exceed the average deductible amount under proposed section 219 for the first 3 taxable years preceding the year in which the last such contract was issued. Thus, for example, if an individual who has earned income of $6,000 for each taxable year of a 3-year period purchases through a qualified individual retirement account a life insurance policy on which the annual premium is $1,200 (i.e., 20 percent of $6,000), he may continue to contribute the amount of the premium annually even though his earned income falls below $6,000. However, amounts which may be contributed under this exception are to be deductible only to the extent that they do not exceed the limitations of proposed section 219(b).

Community property laws—proposed section (408)(b)(2)

Proposed section 408(b)(2) provides that proposed section 408 is to be applied without regard to the community property laws of any State. This provision is intended to allow a married individual in a community property State to establish and maintain a qualified individual retirement account even though under such laws contributions to the account or a portion thereof may be community property.

Treatment as qualified trust benefiting owner-employee—proposed section 408(c)

Proposed section 408(c) provides that, solely for purposes of subchapter F of chapter 1 of the code (relating to exempt organizations), chapter 44 of subtitle D of the code (relating to excise tax on prohibited transactions as proposed to be added by sec. 6(b) of the bill), and subtitle F of the code (relating to procedure and administration), a qualified individual retirement account is to be treated as a trust described in section 401(a) of the code which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in sec. 401(c)(3) of the code), the individual who established such account is to be treated as an owner-employee for whom such contributions and benefits are provided, and the person holding the assets of such account is to be treated as the trustee of such trust. Proposed chapter 44 (relating to excise tax on prohibited transactions) is not to be applied to a contribution to a qualified individual retirement account in the case of a contribution to which a "roll-over" provision applies. (For "roll-over" provisions, see sec 72(p)(2)(C) of the code (as proposed to be added by sec. 3(c)(9) of the bill), sec. 402(a)(6) of the code (as proposed to be added by sec. 5(a)(2) of the bill), and sec. 403(a)(4) of the code (as proposed to be added by sec. 5(b)(2) of the bill).)

Thus, the income derived from contributions to a qualified individual retirement account is to be exempt from tax except to the extent that such income constitutes unrelated business taxable income to which the tax imposed by section 511 (b) of the code applies. In addition, the excise taxes on prohibited transactions (other than in the case of certain "roll-over" contributions) provided by section 4971 of the code (as proposed to be added by sec. 6 (b) of the bill) are to apply to a qualified individual retirement account. (A contribution of property pursuant to the "roll-over"-provisions is not to constitute a prohibited transaction.) Moreover, the provisions of section 6033 of the code (relating to returns by exempt organizations) and section 6047 of the code (relating to information regarding certain trusts and annuity and bond purchase plans) are also to apply, and the person holding the assets of such an account would be required to file the information returns and other material required under those provisions.

Because a qualified individual retirement account is not to be treated as a trust described in section 401 (a) for purposes of subtitle B of the code (relating to estate and gift taxes), the exclusions provided by section 2039 (c) of the code (relating to annuities under certain trusts and plans) and section 2517 (relating to certain annuities under qualified plans) are not to apply with respect to the transfer of an interest in a qualified individual retirement account. Further, section 72 (n) of the code (relating to treatment of total distributions), section 402 (a) (2) of the code (relating to capital gains treatment for certain distributions from exempt employees' trusts), and section 403 (a) (2) of the code (relating to capital gains treatment for certain distributions under qualified annuity plans) are not to apply to any amount distributed or paid by a qualified individual retirement account. (Thus, no part of any such amount is to be treated as gain from the sale or exchange of a capital asset, and the income tax with respect to any such amount is not to be limited under section 72(n) of the code (relating to treatment of total distributions).

Taxability of beneficiary—proposed section 408 (d) (1)

Paragraph (1) of proposed section 408 (d) provides that, except as provided in proposed section 408 (d) (2) and (3) (relating to recontributed amounts and excess contributions, respectively), the amount actually paid, distributed, or made available to any payee or distributee by a qualified individual retirement account is to be taxable to such person in the year in which actually paid or distributed under section 72 of the code (relating to annuities).

Recontributed amounts—proposed section 408 (d) (2)

Proposed section 408 (d) (2) provides that amounts paid or distributed by a qualified individual retirement account, except such amounts distributed pursuant to provisions of the governing instrument meeting the requirements of proposed section 408 (a) (5) (relating to time of distribution), are not to be includible in gross income when so paid or distributed to the extent that such amounts are not subject to the tax imposed by section 72 (p) (3) (relating to the penalty on premature distributions (as proposed to be added by sec. 3 (c) (9) of the bill) by reason of the application of section 72 (p) (2) (C) (relating to a "roll-over" from a qualified individual retirement account to another such account). Thus, if an individual who established a qualified individual retirement account desires to change the funding medium or trustee and such change requires a "roll-over", the "roll-over" is not to be a taxable event if certain requirements are satisfied (see discussion under section 5 of the bill).

Applicability of section 72 (m)—proposed section 408 (d) (3)

Proposed section 408 (d) (3) provides that, under regulations prescribed by the Secretary of the Treasury or his delegate, an individual who establishes a qualified individual retirement account is to be treated as an owner-employee (as defined in sec. 401 (c) (3) of the code) for purposes of applying the provisions of paragraphs (2) and (4) of section 72 (m) of the code (relating to the computation of consideration paid by the employee and amounts constructively received). Thus, notwithstanding section 72 (m) (6) of the code (defining "owner-employee" for purposes of sec. 72 (m)), an individual who establishes a qualified individual retirement account is to be treated as an owner-employee for purposes of paragraphs (2) and (4) of section 72 (m) of the code.

For purposes of computing an individual's or employee's investment in the contract, amounts allowed as a deduction under section 219 (a) (as proposed to be added by sec. 3 (a) of the bill) and any portion of the premiums or other consideration for the contract which is properly allocable to the cost of life, accident, health, or other insurance are not to be taken into account. In this regard, any contribution to a qualified individual retirement account which is allowed as a deduction under proposed section 219 (a), and any income of such account, which is applied to purchase the life insurance protection under any retirement income, endowment, or other life insurance contract is includible in the gross income of the individual who established such account for the year in which so applied. This would be accomplished by amending section 72 (m) (2) and 72 (m) (3) (B) and by adding section 408 (d) (3) of the code (by sec. 3 (c) (2), (3), (4), (5), and (6) of the bill). This is the same treatment provided under present law in certain situations by sections 72 (m) (2) and (3) (B) of the code.

If an individual who establishes a qualified individual retirement account assigns or pledges (or agrees to assign or pledge) any portion of his interest in such account, such portion is to be treated as having been received by such individual as a distribution from such account for his taxable year in which such assignment, pledge, or agreement occurs. This is the same treatment provided under present law by section 72(m)(4)(A) of the code for owner-employees. This treatment would be extended to an individual who establishes a qualified individual retirement account under section 72(m)(4)(A) (as proposed to be amended by sec. 3(c)(7) of the bill) and proposed section 408(d)(3).

If the assets of a qualified individual retirement account include a life insurance contract, and the individual who established such account receives, directly or indirectly, any amount from the issuer of such contract as a loan under such contract, such amount is to be treated as an amount received under such contract. Thus, such an individual is to be considered to have received an amount under such a contract, if a premium which is otherwise in default is paid by the issuer of such contract in the form of a loan against the cash surrender value of such contract. This is the same treatment provided under present law by section 72(m)(4)(B) of the code for owner-employees. This treatment would be extended to an individual who establishes a qualified individual retirement account under proposed section 72(m)(4)(B) (as proposed to be amended by sec. 3(c)(8)) and proposed section 408(d)(3).

Treatment of nonexempt account—proposed section 408(e)

Proposed section 408(e) provides that if, for the preceding taxable year of a trust, custodial account, annuity contract, or other similar arrangement, such trust or arrangement was a qualified individual retirement account and was exempt from tax under section 501(a), and if for the taxable year such trust or arrangement is not exempt from tax under section 501(a), then the fair market value of the contract or the property held under the trust or arrangement at the beginning of the taxable year, reduced by contributions which were not deductible under proposed section 219 (other than "rollover" contributions which were not deductible by reason of proposed sec. 219(c)), is to be included in the gross income of the individual who established the trust or arrangement (or his beneficiary) as if such trust's or arrangement's assets had been distributed to him on the first day of the trust's or arrangement's taxable year.

Thus, for example, if A's account which is exempt from taxation under section 501(a) in its taxable year beginning in 1980 were to lose its exemption in 1981 because of a transfer from the account to a person not described in proposed section 408(a)(4), the fair market value of the account would be includible in A's 1981 gross income to the extent provided by proposed section 408(e).

Special rule—proposed section 408(f)

Proposed section 408(f) provides that solely for purposes of determining whether section 72(p)(2)(C) (as proposed to be added to the code by section 3(c)(9) of the bill) applies to a contribution under proposed section 408(a)(2) (relating to "roll-overs") or to an amount paid or distributed under proposed section 408(d)(2) (relating to "roll-overs"), the requirement of proposed section 72(p)(1) that the amount paid or distributed be received before age 59½ is not to apply. Thus, a "roll-over" could be made from a qualified individual retirement account to another such account by an individual who is older than age 59½.

Cross references—proposed section 408(g)

Proposed section 408(g) provides appropriate cross references.

(c) *Treatment of distributions from qualified individual retirement accounts.*—Section 3(c) of the bill would amend section 72 of the code (relating to annuities) to revise the rules relating to amounts received before the annuity starting date by an owner-employee and to provide rules for the taxation of distributions from qualified individual requirement accounts.

Paragraph (1) of section 3(c) of the bill would repeal section 72(m)(1) of the code (relating to certain amounts received before annuity starting date). Under present law, amounts received under a qualified plan, before the annuity starting date, which are not received as an annuity, are included in the recipient's gross income for the taxable year in which received to the extent that such amounts, plus all amounts previously received and includible in gross income, do not exceed the aggregate premiums or other consideration paid for the contract while the employee was an owner-employee which were allowed as deductions under section 404 of the code. Under this rule, tax-deferred amounts are deemed paid before previously taxed amounts are distributed. On the other hand, amounts received before the annuity starting date by an employee who is not an owner-employee are not includible in gross income under section 72(e) of the code to the extent such amounts do not exceed the employee's investment in the contract.

Under this rule, previously taxed amounts are deemed distributed before tax-deferred amounts. The effect of the proposed repeal of section 72(m)(1) would be to extend the rules of section 72(e) to an owner-employee (and an individual who establishes a qualified individual retirement account described in proposed sec. 408(a)).

Further, section 7(e) of the bill would amend section 401(d)(4)(B) of the code (relating to additional requirements for qualification of trusts and plans benefiting owner-employees) to permit distributions of an owner-employee's nondeductible contributions from a qualified plan before such owner-employee has attained the age of 59½ years.

Thus, the rules relating to amounts received before the annuity starting date would be uniformly applied. However, certain special rules relating to certain premature distributions would continue to apply with respect to owner-employees (sec. 72(m)(5) of the code) and, as detailed below, would also apply with respect to an individual who establishes a qualified individual retirement account (proposed sec. 72(p) (as proposed to be added by sec. 3(c)(9) of the bill)).

Paragraph (2) of section 3(c) of the bill would revise the rules, under section 72(m)(2), relating to the computation of consideration paid by the employee, to treat any amount allowed as a deduction under section 219 of the code (as proposed to be added by sec. 3(a) of the bill) as consideration contributed by the employer.

Paragraphs (3), (4), (5), and (6) of section 3(c) of the bill would amend section 72(m)(3) of the code (relating to life insurance contracts) to provide that amounts applied to purchase life insurance protection by a qualified individual retirement account are includible in gross income of the individual who established it for the taxable year when so applied. Upon the death of such individual, an amount equal to the cash surrender value of such contract immediately before his death is to be treated as distributed by such account and the excess of the amount payable by reason of such individual's death over such cash surrender value is to be treated in the manner provided in section 101 of the code (relating to certain benefits).

Paragraphs (7) and (8) of section 3(c) of the bill would amend section 72(m)(4) of the code (relating to amounts constructively received) so that the assignment or pledge of an interest in a qualified individual retirement account, or a loan under a contract purchased by such an account, would be treated in the same manner as if a qualified pension, etc., trust or a qualified annuity plan were involved.

Paragraph (9) of section 3(c) of the bill would redesignate section 72(p) of the code (relating to cross references) as section 72(q) and add a new section 72(p).

Taxation of premature distributions—proposed section 72(p)

Paragraph (1) of proposed section 72(p) provides that proposed section 72(p) is to apply to amounts paid or distributed (i) by a qualified individual retirement account or (ii) by an exempt qualified trust (described in sec. 401(a) of the code) or under a qualified annuity plan (described in sec. 403(a) of the code), but only to the extent that such amount is attributable, as determined under regulations to be prescribed by the Secretary of the Treasury or his delegate, to amounts with respect to which a deduction was allowed under proposed section 219(a). Proposed section 72(p) is to apply only to amounts which are includible in the gross income of the distributee or payee and which are received before the individual who was allowed such deduction attains the age of 59½ years.

Paragraph (2) of proposed section 72(p) provides three limitations which, if met, will cause the penalty (which would otherwise be imposed by proposed sec. 72(p)(3)) not to apply to the amounts described in proposed section 72(p)(1). The first limitation excludes payments or distributions made to such individual on account of his becoming disabled within the meaning of section 72(m)(7) of the code. For this purpose, amounts paid or distributed to the estate or other beneficiary of a deceased individual before the time he would have attained age 59½ if he had lived are to be treated as disability payments. The second limitation excludes any amount includible in gross income under section 72(m)(3)(B) of the code (relating to amounts applied to purchase life insurance protection). The third limitation excludes any amount paid or distributed by a qualified individual retirement account to the individual who established such account, if within 60 days after receipt, such amount is contributed in full (less any nontaxable portion) to another qualified individual retirement account established by such individual.

The third limitation is not to be applicable for a taxable year if during the three-year period ending on the date such amount is received, the individual previously received an amount from any qualified individual retirement account established by him to which the penalty tax imposed by proposed section 72 (p) (3) did not apply because of proposed section 72 (p) (2) (C) (the third limitation). The same property received in a payment or distribution must be contributed for the third limitation to be applicable. If, for example, a distribution to A described in proposed section 72(p) (1) consists of 500 shares of X Corporation stock and if a stock split occurs before the shares are contributed so that A receives 1,000 shares in exchange for the 500 shares, the same 1,000 shares of X Corporation stock would be required to be contributed for the third limitation to apply. The Secretary of the Treasury or his delegate is to prescribe regulations to carry out the purposes of proposed section 72(p) (2).

Paragraph (3) of proposed section 72(p) provides that if an individual is required to include in his gross income for any taxable year an amount to which proposed section 72(p) applies, there is to be imposed an additional tax for such taxable year equal to 30 percent of such amount.

The only credits by which the tax imposed by proposed section 72(p) (3) may be reduced are the credits allowed by section 31 of the code (relating to tax withheld on wages), section 39 of the code (relating to certain uses of gasoline and lubricating oil) and section 42 of the code (relating to overpayments of tax). In addition, such tax is not to be treated as a tax imposed by chapter 1 of the code (relating to normal taxes and surtaxes) for purposes of section 56 of the code (relating to imposition of minimum tax for tax preferences).

(d) *Excise tax on excessive accumulations.*—Section 3(d) of the bill would amend subtitle D of the code (relating to miscellaneous excise taxes) by adding a new chapter 43, containing section 4960. Section 4960 would impose an excise tax on the privilege of maintaining an individual retirement account in which excessive amounts are accumulated.

Proposed section 4960

Proposed section 4960 would provide that there is imposed for each taxable year on the assets of a qualified individual retirement account described in section 408(a) of the code (as proposed to be added by sec. 3(b) of the bill) which is exempt from tax under section 501(a) of the code a tax equal to 10 percent of an amount which bears the same ratio to the fair market value of the total assets in such account at the beginning of the account's taxable year as the minimum amount required to be distributed during such year under section 408 (a) (5) or (6) of the code (as proposed to be added by section 3(b) of the bill), whichever applies, reduced (but not below zero) by the total amount actually distributed during such year by the account to the individual who established such account or his beneficiary bears to the minimum amount required to be distributed during such year under section 408(a) (5) or (6) (whichever applies). The tax imposed by proposed section 4960 is to apply only for taxable years beginning after the taxable year in which the individual who established such account attains the age of 70½ years. For purposes of proposed section 4960, the minimum amount required to be distributed during a year under proposed section 408(a) (5) or (6) is to be determined under regulations prescribed by the Secretary of the Treasury or his delegate.

(e) *Conforming amendments.*—Section 3(e) of the bill would make conforming amendments to section 37(e)(1) (defining retirement income), section 62 (defining adjusted gross income), section 72(n)(4)(B) (relating to special rule for employees without regard to section 401(e)(1)), section 405(d) (relating to taxability of beneficiary of qualified bond purchase plan), section 801(g)(7) (relating to basis of assets held by life insurance company for qualified pension plan contract), section 805(d)(1) (defining pension plan reserves of life insurance company), section 1302(a)(2)(A) (defining averagable income), and section 1348(b)(1) (defining earned income).

(f) *Clerical amendments.*—Section 3(f) of the bill would make clerical amendments to the table of sections for part VII of subchapter B of chapter 1 of the code, to the table of sections for part I of subchapter D of chapter 1 of the code, and to the table of chapters for subtitle D of the code.

(g) *Effective date.*—Section 3(g) of the bill provides that the amendments made by section 3 of the bill are to apply to taxable years ending after the date of enactment of the bill.

Section 4. Contributions on behalf of self-employed individuals and shareholders-employees of electing small business corporations

(a) *Contributions on behalf of self-employed individuals.*—(1) *Special limitations for self-employed individuals.*—Section 4(a)(1) of the bill would amend section 404(e) of the code (relating to special limitations for self-employed individuals) by revising paragraphs (1) and (2)(A) thereof.

Section 404(e)(1) of the code provides that, in the case of a qualified pension, annuity, or profit-sharing plan which provides contributions or benefits for employees some or all of whom are employees within the meaning of section 401 (c)(1) of the code (i.e., self-employed individuals), the amounts deductible under section 404(a) of the code in any taxable year with respect to contributions on behalf of any such employee shall, subject to the provisions of section 404 (e)(2) of the code (relating to limitation where contributions are made under more than one plan), not exceed $2,500, or 10 percent of the earned income (as defined in section 401(c)(2) of the code) derived by him from the trade or business with respect to which the plan is established, whichever is the lesser.

Section 404(e)(2)(A) of the code provides an overall limitation on the amounts deductible with respect to contributions under two or more plans on behalf of an individual who is an employee within the meaning of section 401 (c)(1) of the code with respect to such plans. In such a case, the amounts deductible may not exceed $2,500, or 10 percent of the earned income derived by such individual from the trades or businesses with respect to which the plans are established whichever is the lesser.

Section 4(a)(1) of the bill would revise section 404(e) by increasing the limitations from $2,500 or 10 percent of earned income to $7,500 or 15 percent of earned income.

(2) *Excess contributions on behalf of owner-employees.*—Section 4(a)(2) of the bill would amend section 401(e) of the code (relating to excess contributions on behalf of owner-employees) to conform to section 404(e) of the code as proposed to be amended by section 4(a)(1) of the bill. Subparagraphs (A) and (B) of section 4(a)(2) would increase the limitations under section 401 (e)(1)(B) on the amount that an owner-employee may contribute as an employee (i.e., on a nondeductible basis). Subparagraph (C) of section 4(a)(2) would increase the limitation under section 401(e)(3) on the total amount which may be contributed to two or more plans requiring premiums for certain contracts without regard to the general limitations provided by section 401 (e)(1).

Contributions made as an employee—section 401(e)(1)(B) (iii) and (iv)

Section 401(e)(1)(B)(iii) of the code provides that the term "excess contribution" includes, with respect to a plan under which contributions are made on behalf of employees other than owner-employees, the amount of any contribution made by an owner-employee (as an employee) which exceeds the lesser of $2,500 or 10 percent of the earned income for the taxable year derived by such owner-employee from the trade or business with respect to which the plan is established. Section 401(e)(1)(B)(iv) of the code provides that the term "excess contribution" includes, in the case of an individual on whose behalf contributions are made as an owner-employee under more than one plan under which contributions are made on behalf of employees other than owner-employees, the amount of any contribution, made by such owner-employee (as an employee) under all such plans, which exceeds $2,500.

Section 4(a)(2)(A) of the bill would amend section 401(e)(1)(B)(iii) to increase the limitation on contributions made by an owner-employee (as an employee) to the lesser of $7,500 or 10 percent of earned income. Section 4(a)(2)(B) of the bill would amend section 401(e)(1)(B)(iv) to increase the limitation on contributions made by an owner-employee (as an employee) to more than one plan to $7,500.

Insured plans—section 401(e)(3)

Section 401(e)(3) of the code provides that a contribution on behalf of an owner-employee is not to be considered an excess contribution within the meaning of section 404(e)(1) of the code if (1) under the plan such contribution is required to be applied to pay premiums or other consideration for one or more annuity, endowment, or life insurance contracts on the life of such owner-employee, (2) the amount of such contribution exceeds the amount deductible under section 404 with respect to contributions made by the employer on behalf of such owner-employee, and (3) the amount of such contribution does not exceed the average of the amounts which were deductible under section 404 of the code with respect to contributions made by the employer on behalf of such owner-employee under the plan for the first 3 taxable years preceding the year in which the last such contract was issued and in which such owner-employee derived earned income from the trade or business with respect to which the plan is established or for so many of such taxable years as such owner-employee was engaged in such trade or business and derived earned income.

This exception does not apply in the case of an individual on whose behalf contributions (required to be applied to pay premiums or other consideration for one or more annuity, endowment, or life insurance contracts on the life of such owner-employee) are made under more than one plan as an owner-employee if the amount of all such contributions exceeds $2,500. Section 4(a)(2)(C) would amend the second sentence of section 401(e)(3) to increase this limitation to $7,500.

(3) *Penalties applicable to certain amounts received by owner-employees.*—Section 4(a)(3) of the bill would amend section 72(m)(5)(B)(i) of the code to increase from $2,500 to $7,500 the amounts described in section 72(m)(5)(A) of the code which must be received in any year before the penalty imposed by section 72(m)(5)(B) of the code would apply.

Under present law, amounts described in section 72(m)(5)(A) of the code are subject to the penalty imposed by section 72(m)(5)(B) if such amounts are $2,500 or more and are subject to the penalty imposed by section 72(m)(5)(C) if such amounts are under $2,500. The amounts described in section 72(m)(5)(A) of the code consist, generally, of amounts received by an individual who is or has been an owner-employee before he attains the age of 59½ (for any reason other than his becoming disabled), the amounts received by an owner-employee or by his successor in excess of the benefits provided for him under the plan formula, the amounts received by reason of a willfully made excess contribution. Under this proposal, if such amounts are $7,500 or more, the penalty provided by section 72(m)(5)(B) would apply, and if they do not equal or exceed $7,500, the penalty imposed by section 72(m)(5)(C) of the code would apply.

(b) *Contributions on behalf of shareholder-employees of electing small business corporations.*—Section 4(b) of the bill would amend section 1379(b)(1) of the code (relating to taxability of shareholder-employee beneficiaries of qualified pension, etc., plans) to increase the amount of the contributions paid by an electing small business corporation on behalf of a shareholder-employee (an employee or officer who owns (or is considered as owning within the meaning of sectin 318(a)(1) of the code) more than 5 percent of the outstanding stock of the corporation) which may be excluded from his gross income. Section 1379(b)(1) provides that the excess of such contributions for any taxable year of the corporation over the lesser of (i) 10 percent of the compensation received or accrued by the shareholder-employee from such corporation during its taxable year or (ii) $2,500, must be included in his gross income for his taxable year in which or with which the taxable year of the corporation ends. Section 4(b) of the bill would increase the amount which may be excluded by a shareholder-employee to the lesser of 15 percent of compensation or $7,500.

(c) *Effective date.*—Section 4(c) of the bill provides that the amendments proposed to be made by section 4 of the bill are to apply with respect to taxable years beginning after December 31, 1972.

Section 5. Limitation on application of section 402(a) and 403(a) in the case of certain contributions.

(a) Amendment of section 402.—Section 402(a) of the code provides that, in general, distributions from any employees' trust described in section 401(a) which is exempt from tax under section 501(a) are taxable under section 72 (relating to annuities). Section 402(a)(2), however, provides for capital gains treatment for certain lump-sum distributions. In the case of a lump-sum distribution paid after December 31, 1969, section 402(a)(5) limits the amount of such distribution that is subject to capital gains treatment.

Section 5(a) of the bill would amend section 402(a) of the code (relating to the taxability of a beneficiary of an exempt trust) by adding new paragraphs (6) and (7) which would limit the application of section 402(a). Section 5(a) of the bill also would make a conforming change to section 402(a)(1) of the code to reflect proposed sections 402(a) (6) and (7). Under proposed sections 402(a) (6) and (7), a total distribution received from a trust forming a part of a qualified pension, etc., plan may be excluded from gross income if it is contributed by an employee within a specified period to a qualified individual retirement account, another qualified trust or a qualified annuity plan. These provisions would, therefore, allow a tax-free reinvestment, or "roll-over", of a distribution. Taxation of amounts "rolled-over" would generally be deferred until the time such amounts are distributed by the individual retirement account, trust, or plan to which they were paid.

Proposed section 402(a) (6)

Proposed section 402(a)(6) would limit the application of section 402(a) by providing that in the case of an employees' trust described in section 401(a), which is exempt from tax under section 501(a), if the total distributions payable with respect to any employee are paid to him within one taxable year of the employee on account of his separation from the service other than by reason of his death, such distribution is not to be includible in gross income in such taxable year if, not later than the 60th day after the close of the taxable year, he contributes the entire amount otherwise includible in his gross income to one or more qualified individual retirement accounts described in section 408(a). Proposed 402(a)(6) is not to apply unless the same property received in the total distribution is contributed to the individual retirement account. The Secretary of the Treasury or his delegate would be authorized to prescribe regulations to carry out the purposes of paragraph (6).

Proposed section 402(a)(7)

Proposed section 402(a)(7)(A) would limit the application of section 402(a) by providing that in the case of an employees' trust described in section 401(a), which is exempt from tax under section 501(a), if the total distributions payable with respect to any employee are paid to him within one taxable year of the employee on account of his separation from the service other than by reason of his death, such distribution is not to be includible in gross income of such taxable year if, not later than the 60th day after the close of such taxable year, he contributes the entire amount otherwise includible in his gross income to another employees' trust described in section 401(a), which is exempt from tax under section 501(a), or contributes such amount for the purchase of retirement annuities under an annuity plan which meets the requirements of section 404(a)(2). If less than the entire amount is contributed, section 402(a)(7)(A) will not apply and the entire amount (including both the portion retained and the portion contributed) will be includible in gross income.

Proposed section 402(a)(7)(B) provides that proposed subparagraph (7)(A) is not to apply to a distribution paid to any distributee to the extent such distribution is attributable to contributions made by or on behalf of a self-employed person. Thus, a self-employed individual could not "roll-over" a lump-sum distribution from an H.R. 10 plan to another H.R. 10 plan or to a corporate plan. Proposed section 402(a)(7)(B) also provides that proposed paragraph (7) is not to apply unless the same property received in the total distribution is contributed to the qualified plan. It is anticipated that regulations under proposed section 402(a)(7)(B) would provide rules for determining how much property must be contributed where a distribution of property is made and less than the entire amount of the distribution is includible in gross income.

Proposed section 402(a)(7)(C) provides that a contribution made pursuant to proposed section 402(a)(7)(A) is generally to be treated as an employer contribution made on the date contributed. Thus, to the extent of a contribution made pursuant to proposed section 402(a)(7)(A), a later lump-sum distribution under the qualified plan to which such contribution was made would not be eligible for capital gains treatment under section 402(a)(2) because it would be treated as an employer contribution for purposes of section 402(a)(5) (relating to limitation on capital gains treatment). Furthermore, in the case of an employee-contributory plan, this treatment would affect the computation of the estate tax exclusion under section 2039(c) and the gift tax exclusion under section 2517(b).

In addition, the recipient plan would not be required to maintain records as to contributions made by employers to the previous plan.

Proposed section 402 (a) (7) (C) also provides that a contribution made pursuant to proposed section 402 (a) (7) (A) is to be treated as an employee contribution under certain code sections. Thus, the employer's limit on deductible contributions either to a qualified individual retirement account or to a qualified plan is not to be thereby reduced under section 219 (b) (2), as proposed to be added by section 3 (a) of the bill. Further, under section 401 (a) (12), as proposed to be added by section 2 (a) (2) of the bill, the employee's rights in his accrued benefit derived from the amount contributed by him pursuant to proposed section 402 (a) (7) (A) are to be nonforfeitable (except in the case of death if so provided by the plan). Also, with respect to a contribution made pursuant to proposed section 402 (a) (7) (A), no amount would be deductible under section 404 of the code nor includible in gross income under either section 409 (a), as proposed to be added by section 7 (1) of the bill (relating to inclusion of certain employer contributions in gross income) or section 1379 (b) of the code (relating to inclusion in gross income of excess contributions made on behalf of a shareholder-employee of an electing small business corporation).

Proposed section 402 (a) (7) (D) would provide authority for the Secretary or his delegate to issue regulations to carry out the purposes of paragraph (7).

(b) *Amendment of section 403.* Section 5 (b) of the bill would make amendments to section 403 (a) of the code (relating to taxability of a beneficiary under a qualified annuity plan) which correspond to the amendments which would be made by section 5 (a) of the bill to section 402 (a) of the code (relating to taxability of a beneficiary of an exempt trust).

(c) *Effective date.* Section 5(c) of the bill provides that the amendments proposed to be made by section 5 of the bill are to apply to taxable years ending after the date of enactment of the bill.

Section 6. Prohibited Transactions.

(a) *Requirements for exemption from taxation for a trust forming part of a qualified plan.*—Section 503 of the code provides that a trust forming a part of a qualified pension, profit-sharing, or stock bonus plan will be denied exemption from taxation if such trust engages in certain prohibited transactions. Generally, under section 503(b) of the code, a prohibited transaction is a transaction, between the trust and the employer who established or maintains the plan of which the trust is a part, or a related person, in which the trust (1) makes a loan without adequate security or a reasonable rate of interest, (2) pays more than a reasonable amount of compensation, (3) makes services available on a preferential basis, (4) makes a substantial purchase of property for more than an adequate consideration, (5) sells a substantial part of its property for less than an adequate consideration, or (6) engages in any other transaction which results in substantial diversion of its assets. In the case of a qualified trust which is part of a plan providing contributions or benefits for owner-employees who control the trade or business (i.e., a sole proprietor, or partners who own more than 50 percent of the capital or income interest of a partnership) with respect to which the plan is established, certain other transactions are treated as prohibited transactions under section 503(g) of the code. Under this provision, a transaction in which the trust makes any loan, pays any compensation, makes services available on a preferential basis, or sells any property to such owner-employees or certain related persons is also a prohibited transaction. Further, the purchase of any property from such owner-employees or persons is a prohibited transaction under section 503(g).

In the event of the commission of a prohibited transaction, certain special tax benefits provided under the code are denied to the trust, the employer and the employee because the plan is thereafter disqualified and is no longer exempt from taxation. Thus, the trust is taxed on income earned on its assets, the employer may deduct contributions to the trust under section 404(a)(5) of the code only in the taxable year in which an amount attributable to the contribution is includible in the gross income of employees participating in the plan and, under sections 402(b), 403(c), and 83 of the code, the employee is taxed on any contributions made on his behalf for his first taxable year in which his rights are not subject to a substantial risk of forfeiture. Furthermore, any distributions received by the employee will not be eligible for the special averaging treatment or capital gains treatment accorded total distributions from qualified plans. Thus, under present law, persons who gained no benefit from a prohibited transaction may suffer adverse tax consequences because of it.

Section 6(a) of the bill, in order to eliminate adverse consequences to innocent parties, would amend section 503 of the code so that a trust forming part of a qualified plan will noa be denied exemption from taxation if the trust engages in a prohibited transaction.

(b) *Excise taxes on prohibited transactions.*—Section 6(b) of the bill would amend subtitle D of the code (relating to miscellaneous excise taxes) by adding thereto a new chapter 44 and a new section 4971. Proposed section 4971 would impose an excise tax on the amount involved in a prohibited transaction. Proposed section 4971 is similar to the self-dealing tax imposed by section 4941 of the code with respect to private foundations. Thus, under the bill, sanctions would be applied only against persons participating in a prohibited transaction rather than against plan participants and others who may in fact have been injured by the prohibited transaction. The sanctions would not depend on whether or not the trust benefits self-employed individuals who are owner-employees.

Proposed section 4971(a)

Proposed section 4971(a) imposes for each year (or part thereof) in the taxable period (as defined in proposed section 4971(e)(2)) an excise tax equal to 5 percent of the amount involved (as defined in proposed section 4971(e)(3)) in a prohibited transaction (as defined in proposed section 4971(d)). The tax imposed by proposed section 4971(a) would be payable by any party in interest (as defined in proposed sec. 4971(e)(1)) who participates in the prohibited transaction.

Proposed section 4971(b)

Proposed section 4971(b) imposes an excise tax equal to 200 percent of the amount involved in a prohibited transaction if a tax is imposed under proposed section 4971(a) and the transaction is not corrected within the correction period (as defined in proposed sec. 4971(e)(5)). The tax imposed by proposed section 4971(b) would be payable by any party in interest who participated in the prohibited transaction.

Proposed section 4971(c)

Proposed section 4971(c) provides that, if more than one person is liable for a tax imposed by proposed section 4971(a) or (b), with respect to any one prohibited transaction, all such persons would be jointly and severally liable for such tax.

Proposed section 4971(d)

Proposed section 4971(d) defines a prohibited transaction as an act which is (1) described in section 14(b)(2) of the Welfare and Pension Plans Disclosure Act of 1958, and not excepted from the prohibitions of that provision by section 14(c) of such Act, and which is (2) Committed by a fiduciary (as defined in proposed sec. 4971(e)(6)) for a trust described in section 401(a) or 408(a) which is exempt from tax under section 501(a). Under section 14(b)(2) of the Welfare and Pension Plans Disclosure Act of 1958, as proposed to be amended by the Employee Benefits Protection Act (S. 1557, 93rd Cong.), a fiduciary would be prohibited from engaging in certain specified acts. Unless excepted, the fiduciary would generally be prohibited from (1) leasing or selling property to or from a party in interest, (2) acting adversely to the fund, its participants or beneficiaries, (3) receiving compensation from a party dealing with the fund, (4) lending money or other assets of the fund to a party in interest, (5) furnishing goods, services or facilities to a party in interest, or (6) transferring any property of the fund to, or for the use of, any party in interest.

Section 14(c) of the Welfare and Pension Plans Disclosure Act of 1958, as proposed to be amended by the Employee Benefits Protection Act, (S. 1557, 93rd Cong.), would expressly allow a fiduciary to engage in certain transactions. Generally, these excepted transactions would permit a fiduciary (1) to receive benefits to which he is entitled as a participant or beneficiary and to receive reasonable compensation for services rendered to the fund (which certain exceptions), (2) under certain conditions, to invest in employer securities aggregating no more than 10 percent of fund assets (except that such limit would not apply in the case of a profit-sharing, stock bonus, thrift or savings plan if the plan explicitly provided for the investment in employer securities), (3) to purchase or sell securities listed on a regulated exchange from or to a party in interest, (4) to make loans to plan participants or beneficiaries if such loans are made on a non-discriminatory basis, and (5) to take action pursuant to an authorization in the trust instrument or other document governing the fund, provided such action is consistent with the provisions of section 14(b) of the Welfare and Pension Plans Disclosure Act of 1958. Thus, the proposed definition of a prohibited transaction would be broader than the definition contained in section 503 (b) or (g) of the code. Further, with respect to qualified trusts, the proposed definition of a prohibited transaction would be uniform for purposes of the internal revenue laws administered by the Treasury Department and the proposed fiduciary standards to be administered by the Department of Labor.

Proposed section 4871(e)(1)

Proposed section 4971(e)(1) defines the term "party in interest" as a person described in section 3(m) of the Welfare and Penson Plans Disclosure Act of 1958. Under section 3(m) of such Act as proposed to be amended by the Employee Benefits Protection Act (S. 1557, 93rd Cong.), a party in interest would be defined as any administrator, officer, trustee, custodian, counsel, or employee of an employee benefit plan, or a person providing benefit plan services to any such plan; an employer any of whose employees are covered by such a plan or any person controlling, controlled by, or under common control with, such employer, or an officer, employee, or agent of such employer or person; an employee organization having members covered by the plan, or an officer, employee, or agent of such employee organization; or a relative, partner or joint venturer of any of the described persons.

Proposed section 4971(e)(2)

Proposed section 4971(e)(2) defines the term "taxable period" as the period beginning with the date on which the prohibited transaction occurs and ending on the earlier of the date of mailing of a notice of deficiency pursuant to section 6212 with respect to the tax to be imposed by this proposed section or the date on which correction of the prohibited transaction is completed.

Proposed section 4971(e)(3)

Proposed section 4971(e)(3) defines the term "amount involved" as the greater of the amount of money and the fair market value of the other property given in a prohibited transaction or the amount of money and the fair market value of the other property received in a prohibited transaction. In the case of the tax which would be imposed by proposed section 4971(a), the fair market value of property would be determined as of the date on which the prohibited transaction occurs. In the case of the tax which would be imposed by proposed section 4971(b), the fair market value of property would be the highest fair market value during the correction period. If no amount is involved in a prohibited transaction, no tax would be imposed under proposed section 4971(a).

Proposed section 4971(e)(4)

Proposed section 4971(e)(4) defines the terms "correction" and "correct" as undoing a prohibited transaction to the extent possible, but in any case placing the trust in a financial position not worse than that in which it would be if the prohibited transaction had not occurred.

Proposed section 4971(e)(5)

Proposed section 4971(e)(5) defines the term "correction period" as the period beginning with the date on which a prohibited transaction occurs and ending 90 days after the date of mailing of a notice of deficiency with respect to the tax to be imposed under proposed section 4971(b), extended by any period in which a deficiency cannot be assessed under section 6213(a) and any other period which the Secretary of the Treasury or his delegate determines to be reasonable and necessary to bring about correction of the prohibited transaction.

Proposed section 4971(e)(6)

Proposed section 4971(e)(6) would define the term "fiduciary" as including a person described in section 3(w) of the Welfare and Pension Plans Disclosure Act of 1958, as proposed to be amended by the Employee Benefits Protection Act (S. 1557, 93d Cong.), or in section 7701(a)(6) of the code. Section 3(w) of the Welfare and Pension Plans Disclosure Act of 1958, would define "fiduciary" as meaning any person who exercises any power of control, management or disposition with respect to any moneys or other property of an employee benefit fund, or has authority or responsibility to do so.

Proposed section 4971(f)

Proposed section 4971(f) provides that the Secretary of the Treasury or his delegate is to prescribe such regulations as would be necessary to carry out the provisions of the proposed section.

(c) *Conforming, clerical, etc., amendments.*—Section 6(c) of the bill would make a clerical amendment to the table of chapters for subtitle D of the code (relating to miscellaneous excise taxes) to reflect proposed chapter 44, and would make conforming amendments to section 6161 (relating to extension of time for paying tax), section 6201(d) (relating to assessment authority), section 6211 (relating to definition of a deficiency), section 6212 (relating to notice of a deficiency), section 6213 (relating to restrictions applicable to deficiencies and petition to Tax Court), section 6214 (relating to determinations by Tax Court), section 6344 (relating to cross references), section 6501(e)(3) (relating to limitations on assessment and collection), section 6503 (relating to suspension of running of period of limitations), section 6512 (relating to limitations in case of petition to Tax Court), section 6601(d) (relating to interest on underpayment, nonpayment, or extensions of time for payment of tax), section 6653(c) (relating to failure to pay tax), section 6659(b) (relating to applicable rules), section 6676(b) (relating to failure to supply identifying numbers), section 6677(b) (relating to failure to file information returns with respect to certain foreign trusts), section 6679(b) (relating to failure to file returns as to organization or reorganization of foreign corporations and as to acquisition of their stock) and section 7422(g) (relating to civil actions for refunds).

(*d*) *Effective date.*—Section 6 (d) of the bill provides that the amendments proposed to be made by section 6 of the bill are to be effective on and after the day after the date of enactment of the bill.

Section 7. Miscellaneous Provisions.

(a) *Penalties applicable to forfeitures received by owner-employees.* Section 72 (m) (5) (A) (i) of the code currently describes amounts to which the penalty imposed by section 72 (m) (5) (B) or (C) of the code is applicable. Generally, section 72 (m) (5) applies to amounts received by an owner-employee before he attains the age of 59½ years for any reason other than his becoming disabled. Section 72 (m) applies only to the extent attributable to contributions made on his behalf while he was an owner-employee. Section 7 (a) of the bill would amend section 72 (m) (5) (A) (i) by adding to the amounts described therein, premature distributions attributable to forfeitures credited to an individual's account or applied for his benefit, while he was an owner-employee. Thus, for this purpose, forfeitures would be treated in the same manner as employer contributions. Forfeitures may arise, although only from other self-employed individuals, as a result of the application of the proposed "rule of 35" vesting standard under section 401 (d) (2) (A) of the code, as proposed to be amended by section 2 (b) (1) of the bill.

(b) *Coverage and nondiscrimination requirements.*—Section 401 (a) (3) of the code provides two alternative tests as to the number of employees who must be covered by a plan (other than a plan benefiting an owner-employee) if a trust forming part of the plan is to qualify under the code. Section 401 (a) (3) (A) of the code requires that the plan benefit 70 percent or more of all employees, or 80 percent or more of all eligible employees if at least 70 percent of all employees are eligible. In making this computation, certain short service, part-time and seasonal employees may be excluded. Section 401 (a) (3) (B) of the code requires that the plan benefit such employees as qualify under a classification which is not discriminatory in favor of officers, shareholders, supervisory employees, or highly compensated employees.

Section 7 (b) (1) of the bill would amend section 401 (a) (3) (A) to provide that, for purposes of satisfying the percentage coverage requirement, employees who are included in a unit of employees covered by an agreement which the Secretary of the Treasury or his delegate finds to be a collective bargaining agreement are to be excluded, unless the agreement provides that the bargaining unit employees are to be included in the plan. See section 2 (b) of the bill which would make a similar amendment with respect to plans which include self-employed individuals who are owner-employees.

Section 7(b)(2) of the bill would amend section 401(a)(5) to provide that, for purposes of determining whether a plan is discriminatory within the meaning of paragraph (3)(B) or (4), there are not to be taken into account any employees who are included in a unit of employees covered by a collective bargaining agreement, if such agreement does not provide that such employees are to be included in the plan.

No change is made with respect to the exclusion for short service employees (employees who have been employed not more than a minimum period, not in excess of 5 years), part-time employees (employees who customarily work not more than 20 hours in a week) or seasonal employees (employees whose customary employment is for not more than 5 months in a year). However, the 5 year minimum period under the exclusion for short service employees would become less significant when a qualified plan is required to satisfy the minimum eligibility requirements under section 401(a)(11), as proposed to be added by section 2(a)(2) of the bill. It would retain significance during the transitional period and, in the case of a plan, other than an H.R. 10 plan, which requires, as a condition of participation, service in excess of 3 years by an employee younger than age 30.

Proposed section 401(a)(14), as proposed to be added by section 2(a)(2) of the bill. provides for certain transitional periods during which the minimum eligibility requirements would not apply.

(c) *Plans benefiting self-employed individuals.*—Under present law the full and immediate vesting requirement of section 401(d)(2)(A) of the code prevents forfeitures in a plan which provides contributions or benefits for employees some or all of whom are owner-employees. Section 2(b)(1) of the bill would amend section 401(d)(2)(A) to provide a "rule of 35" vesting standard. Accordingly, forfeitures may arise as a result of the operation of this proposed vesting standard.

Section 7(c) of the bill would amend section 401(c) of the code (relating to definitions and rules relating to self-employed individuals and owner-employees) by adding a new paragraph (6). Under proposed section 401(c)(6), a trust forming a part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all or whom are employees within the meaning of section 401(c)(1) of the code (i.e., self-employed individuals) is to constitute a qualified trust only if, under the plan, forfeitures attributable to contributions made on behalf of an employee other than an employee within the meaning of section 401(c)(1) (i.e., a common-law employee) may not inure to the benefit of any individual who, at any time during the period beginning with the taxable year for which the contribution is made and ending with the taxable year during which the forfeiture occurs, is a self-employed individual.

Under present law, a defined benefit pension plan may cover a self-employed individual. Under such a plan, however, a separate account consisting of contributions and gains, income, losses, and expenses must be maintained for each self-employed individual to assure that forfeitures do not inure to his benefit.

Proposed section 401(c)(6) provides that, in the case of a defined benefit pension plan, a separate account or accounts are to be maintained with respect to all participants under the plan who are not self-employed individuals (i.e., common-law employees) and another separate account or accounts are to be maintained with respect to all participants under the plan who are self-employed individuals. Thus, a separate account would not be required to be maintained with respect to each participant, provided that an aggregate account is maintained for common-law employees and a separate aggregate account is maintained for self-employed individuals covered under a plan. Consequently, although the limitations on contributions on behalf of self-employed individuals would be separately computed on the basis of each such individual's earned income covered by a plan, the benefits payable under the plan with respect to a particular self-employed individnal would not be required to be determined by reference to the separately computed contributions on his behalf.

Under proposed section 401(c)(6), if an individual who was covered under a plan as a common-law employee becomes covered under the plan as a self-employed individual, the aggregate account for common-law employees is not to be reduced and the aggregate account for self-employed individuals is not to be increased by reason of his change of status. His benefits accrued as a common-law employee, however, may be paid out of the common-law employee accounts.

(d) *Trustee of a trust benefiting an owner-employee.*—Section 401(d)(1) of the code provides that only a bank may be the trustee of a trust benefiting an owner-employee. Section 7(d) of the bill would amend section 401(d)(1) of the code to provide that such a trust would be qualified only if, in addition to satisfying the other requirements for qualification, the assets thereof are held by a bank or other person who demonstrates to the satisfaction of the Secretary of the Treasury or his delegate that the manner in which he will hold such assets will be consistent with the requirements of section 401 of the code.

(e) *Employee contributions of owner-employees.*—Under section 401(d)(4)(B) of the code, a plan will not qualify under section 401 of the code if it permits an owner-employee who has not attained age 59½ or become disabled to make any withdrawals, including withdrawals of his nondeductible employee contributions. (See Rev. Rul. 72–98, 1972–1 Cum. Bull. 113). There is no similar restriction with respect to employees who are not owner-employees.

Section 7(e) of the bill would eliminate this restriction on withdrawals by owner-employees by amending section 401(d)(4)(B) to provide that the restriction on withdrawals applies only to benefits in excess of contributions made by an owner-employee as an employee. Thus, withdrawal of contributions made by an owner-employee as an employee would be allowed under the same circumstances as contributions made by any other employee. See also section 3(c)(1) of the bill, which would repeal section 72(m)(1) of the code relating to amounts received before the annuity starting date.

(f) *Certain custodial accounts.*—Section 401 (f) of the code (relating to certain custodial accounts) currently treats a custodial account as a qualified trust, and the custodian as trustee thereof, if (1) the account would, except for the fact that it is not a trust, constitute a qualified trust, (2) the custodian is a bank, (3) the investments are made solely in stock of regulated investment companies with respect to which the employee is beneficial owner, or solely in annuity, endowment, or life insurance contracts issued by an insurance company, (4) the shareholder of record of any such stock is the custodian or its nominee, and (5) any insurance contracts are held by the custodian until distributed under the plan. Section 7(f) of the bill would amend section 401(f) of the code to provide that, in addition to a bank, another person may be a custodian if he demonstrates to the satisfaction of the Secretary of the Treasury or his delegate that the manner in which he will have custody of the assets will be consistent with the requirements of section 401 of the code. Further, the restriction placed upon investment of the funds of the custodial account would be eliminated.

Section 401(f) of the code would be amended so that an arrangement similar to a custodial account or similar to an annuity contract might be treated as a trust constituting a qualified trust, if otherwise qualified. It is contemplated that, in an appropriate case, a plan similar to a dividend reinvestment plan of a regulated investment company might constitute a "similar arrangement", even though no certificates are issued, provided there is an appropriate governing instrument for the plan.

(g) *Excess contributions.*—Section 401(e)(1)(B)(ii) of the code provides that the amount of any contribution made by an owner-employee (as an employee) at a rate which exceeds the rate of contributions permitted to be made by employees other than owner-employees is an "excess contribution". Section 7(g) of the bill would amend section 401(e)(1)(B)(ii) of the code to make its provisions applicable only with respect to a plan other than a defined benefit pension plan. This amendment would facilitate the establishment of defined benefit pension plans by owner-employees because owner-employees could make nondeductible contributions (up to the lesser of $7,500 or 10 per cent of earned income) in order to finance nondiscriminatory benefits.

(h) *Amendments to section 404(a) of the code.*—Generally, section 404 of the code allows a deduction for contributions of an employer to or under a qualified plan, and for compensation paid under a plan of deferred compensation.

Generally, under section 404(a)(1)(A) and (B) of the code, deductible contributions paid to a qualified pension trust are limited to (1) 5 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the plan, plus (2) the excess (if any) of the "level cost" under the plan for the taxable year over 5 percent of such compensation. Alternatively, section 404(a)(1)(G) limits deductible contributions made to a qualified pension plan to contributions determined under a "normal cost" method. Provision is also made under section 404(a)(1)(C) for a deduction with respect to contributions for past service. Thus, under present law, deductible contributions in excess of "level cost" or "normal cost" may be made so long as they do not exceed 5 percent of compensation.

Section 7(h)(1) of the bill would repeal section 404(a)(1)(A) of the code which provides the 5 percent limitation. Thus, deductible contributions under a qualified pension plan would be limited under either the "level cost" method or the "normal cost" method under section 404(a)(1)(B) or (C), respectively.

Section 7(h)(2) of the bill would amend sections 404(a)(B) and (C) of the code (relating to deductible contributions under the "level cost" method and to deductible contributions under the "normal cost" method, respectively) to conform them to the proposed repeal of section 404(a)(1)(A) of the code.

Section 7(h)(3) of the bill would amend section 404(a)(1) of the code to conform that section to the proposed amendment of section 401(a)(7) of the code by section 2(a)(1) of the bill. Section 7(h)(3) of the bill would add a new sentence at the end of section 404(a)(1) to provide that the limitations under section 404(a)(1)(B) and (C) (as proposed to be amended by sec. 7(h) of the bill) would not apply with respect to the amount of a contribution made to or under a pension plan to the extent such contribution does not exceed the minimum funding standard described in section 401(a)(7), as proposed to be added by section 2(a)(1) of the bill.

Section 7(h)(4) of the bill would amend section 404(a)(6) of the code (relating to taxpayers on the accrual basis). Under section 404(a)(6), for purposes of section 404(a)(1) (relating to pension plans), 404(a)(2) (relating to employees' annuities), and 404(a)(3) (relating to stock bonus and profit-sharing plans), a taxpayer on the accrual basis is deemed to have made a payment on the last day of the year of accrual if the payment is on account of that year and is made not later than the time when the return for that year is filed. Proposed section 404(a)(6) would eliminate the requirement of establishing an accrual and would extend this treatment to cash basis taxpayers by providing that for purposes of section 404(a)(1), 404(a)(2), and 404(a)(3) of the code, a taxpayer is to be deemed to have made a payment on the last day of the preceding taxable year if the payment is on account of such preceding taxable year and is made not later than the time prescribed by law for filing the return for such preceding taxable year (including extensions thereof). This permits a cash basis taxpayer to compute the applicable limits on the maximum deductible contribution during the taxable year immediately following the year to which the contribution relates.

Section 7(h)(5) of the bill would amend section 404(a)(7) of the code (relating to the limit of deduction) to allow deductions with respect to amounts contributed to meet the minimum funding standard under section 401(a)(7), as amended by section 2(a)(1) of the bill. Section 7(h)(5) of the bill also amends section 404(a)(7) by reducing the amount deductible as a carryover from 30 percent to 25 percent of compensation.

(i) *Inclusion of certain employer contributions in gross income.*—Section 7(i) of the bill would add a new section 409 to the code, which is similar in concept to section 1379 of the code (relating to certain qualified plans of electing small business corporations).

Proposed section 409(a)

Proposed section 409(a) provides that, notwithstanding the provisions of section 402 of the code (relating to taxability of beneficiaries of employees' trusts), section 403 (relating to taxation of employee annuities), or section 405 (relating to taxability of beneficiaries under qualified bond purchase plans), an individual is to include in gross income, for his taxable year in which or with which the taxable year of his employer ends, an amount equal to the excess of the amount of the contributions made on his behalf (reduced by any amount includible in gross income under sec. 1379(b)(1) with respect to such contributions) by the employer during the taxable year of the employer (including amounts deemed to be paid during such year under sec. 404(a)(6) of the code) to or under a money purchase pension plan (including a "target benefit" plan) which satisfies the requirements of section 401(a), 404(a)(2) or 405(a), over 20 percent of such individual's compensation otherwise paid or accrued by him from such employer during the employer's taxable year, whether or not his rights in such excess contribution are forfeitable. In any taxable year of an individual in which he is covered under two or more money purchase pension plans maintained by an employer, the amount includible in gross income would be the amount by which the total of such contributions exceeds 20 percent of the compensation received or accrued by such individual during the taxable year of his employer.

Proposed section 409(b)

Proposed section 409(b) provides that any amount included in the gross income of an individual under proposed section 409(a) would be treated as consideration for the contract contributed by the individual for purposes of section 72 of the code (relating to annuities). Accordingly, any amount included in the gross income of the individual would be treated as a contribution made by him for purposes of sections 2039(c) (relating to exemption for certain annuities) and 2517 (relating to certain annuities under qualified plans). However, such amounts would be treated as employer contributions for purposes of qualification under section 401 of the code.

Proposed section 409(c)

Proposed section 409(c) provides that if amounts are included in the gross income of an individual under proposed section 409(a), and the rights of such individual (or his beneficiaries) under the plan terminate before payments under the plan which are excluded from gross income equal the amounts included in gross income under proposed section 409(a), then the individual is allowed as a deduction, for the taxable year in which such rights terminate, an amount equal to the excess of the amounts included in gross income under proposed section 409(a) over such payments.

Proposed section 409(d)(1)

Proposed section 409(d)(1) provides that subsection (a) would not apply for a taxable year of an employee if at all times during the employee's taxable year in which or with which the taxable year of the employer ends, under the money purchase pension plans maintained by the employer (considering all such plans as a single plan) the rate at which employer contributions are to be made with respect to employee compensation (as defined under the plan) does not exceed 20 percent. Thus, for example, if contributions are made with respect to an employee at the beginning of his taxable year at a rate which does not exceed 20 percent of his anticipated annual compensation determined under the plan, no amount would be includible in the employee's gross income under proposed section 409(d). This result would obtain even though, because of the employee's separation from the service during the year, the contributions exceed 20 percent of the employee's actual compensation paid or accrued for the employer's taxable year ending with or within the employee's taxable year. If any employee is covered under two or more qualified money purchase pension plans maintained by an employer, the rate of employer contributions thereunder for each employee is to be determined as if the plans constituted a single plan, by computing an aggregate rate of contributions. In such a case, the 20 percent limitation provided by proposed section 409(d)(1) is to be applied to this aggregate rate.

Proposed section 409(d)(2)

Proposed section 409(d)(2) provides that subsection (a) would not apply to contributions made to or under a money purchase pension plan on behalf of an individual who is an employee within the meaning of section 401(c)(1) of the code (i.e., a self-employed individual) with respect to such plan. Deductible contributions made on behalf of such an individual are subject to the limitations of section 404(e) of the code (as proposed to be amended by sec. 4(a)(1) of the bill). As amended, the deductible limit would be the lesser of $7,500 or 15 percent of earned income. Consequently, the proposed 20 percent limitation upon excludable contributions made to or under a qualified money purchase pension plan is not made applicable to contributions made on behalf of a self-employed individual.

Proposed section 409(e)

Proposed section 409(e) would authorize the Secretary of the Treasury or his delegate to prescribe such forms and regulations as may be necessary to carry out the purposes of section 409, including forms on which employers may be required to furnish needful information to their employees. Such forms would be furnished to employees at such time as the Secretary of the Treasury or his delegate may by regulations prescribe. Section 6690 (as proposed to be added by sec. 7(j) of the bill) would prescribe assessable civil penalties for an employer's failure to furnish information to his employees as required under this section.

(j) *Penalty for failure to furnish information.*—Section 7(j) of the bill would amend subchapter B of chapter 68 by adding a new section 6690, relating to reports by employers which would be required by section 219(g) of the code (as proposed to be added by sec. 3(a) of the bill) or section 409(e) of the code (as proposed to be added by section 7(i) of the bill).

Reports by employers—proposed section 6690

Proposed section 6690 of the code would provide an assessable penalty for failure to furnish certain information. The usual deficiency procedures prescribed by the code would not apply in respect of the assessment of such a penalty.

Civil penalty—proposed section 6690(a)

Proposed section 6690(a) provides that if any person, who is required by regulations prescribed under section 219(g) of the code (relating to retirement savings, as proposed to be added by sec. 3(a) of the bill) or section 409(e) of the code (relating to inclusion of certain employer contributions in gross income, as proposed to be added by sec. 7(i) of the bill) to furnish information to an employee, fails to comply with such requirement at the time prescribed by such regulations, such person is to pay a penalty of $10 for each such failure unless it is shown that such failure is due to reasonable cause.

Deficiency procedures—proposed section 6690(b)

Proposed section 6690(b) provides that Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift and certain excise taxes) is not to apply in respect of the assessment or collection of any penalty imposed by Section 6690(a).

(k) *Net operating loss.*—Under present law, section 172(d)(4)(D) of the code (relating to net operating loss modifications) provides that in computing a net operating loss, no deduction is allowed to a self-employed individual to the extent that the deduction allowed under section 404 or 405(c) of the code together with all other nonbusiness deductions exceeds nonbusiness income. Section 7(k) of the bill would amend section 172(d)(4) of the code by adding a new subparagraph (E) which would impose the same treatment as to the deduction allowed to individuals under section 219 of the code (as proposed to be added by sec. 3(a) of the bill).

(l) *Certain retroactive changes.*—

Under present law, section 401(b) of the code (relating to certain retroactive changes in plans) allows retroactive, remedial amendments to be adopted by a newly established plan to satisfy certain requirements of section 401(a) of the code (relating to qualified pension, etc., plans). Specifically, these requirements are those of paragraph (3) (relating to coverage), paragraph (4) (relating to discrimination in contributions of benefits), paragraph (5) (relating to discrimination in coverage, and discrimination in contributions and benefits), and paragraph (6) (relating to coverage) of section 401(a) of the code. Under section 401(b), the retroactive amendments must be adopted by the fifteenth day of the third month following the close of the taxable year of the employer.

Proposed section 401(b) of the code would permit retroactive, remedial amendments of a plan regardless of whether such failure was precipitated by establishment of a new plan or an amendment to an existing plan.

Proposed section 401(b) of the code would also extend the time permitted to adopt a retroactive, remedial amendment to the time for filing of the return of the employer for the taxable year in which the plan or amendment was put into effect (including extensions thereof) or such later time as the Secretary of the Treasury or his delegate may designate.

It is anticipated that regulations would provide for extension of the period for reasonable cause, such as the filing of a bona fide request for a determination by the Secretary of the Treasury or his delegate with respect to the plan or amendment.

Section 7(l)(2) of the bill would make amendments to section 1379(a) of the code (relating to certain qualified pensions, etc., plans) which correspond to amendments which would be made by section 7(l)(1) of the bill to section 401(b) of the code (relating to certain retroactive changes in plans).

(m) Conforming and clerical amendments.—A conforming amendment would be made by section 7(m)(1) of the bill to section 62 of the code (relating to definition of adjusted gross income).

Clerical amendments would be made by section 7(m)(2) of the bill to the table of sections for part I of subchapter D of chapter 1 of the code and to the table of sections for subchapter B of chapter 68. Section 7(m)(2) would also redesignate section 6687 of the code (as added by section 1(c) of Public Law 92–606 (86 Stat. 1494)), as section 6688.

(n) *Effective dates.*—Section 7(n) of the bill provides that the amendments proposed to be made by section 7 of the bill (other than the amendment proposed to be made by section 7(i) of the bill) are to be effective on and after the date of enactment of the bill. The amendment proposed to be made by section 7(i) of the bill is to apply with respect to taxable years of an employer beginning after December 31, 1973.

RETIREMENT BENEFITS TAX ACT

(S. 1631, 93D CONGRESS, WITH PROPOSED TECHNICAL REVISIONS)

1. *Introduction.*—Since 1942 the Internal Revenue Code has accorded special tax benefits to qualified retirement plans established by employers for the benefit of their employees and the beneficiaries of their employees. To insure that benefits are provided under these plans for a broad range of the employees of the sponsoring employer and not merely for a small group of select employees, the availability of these special tax benefits is conditioned upon the plan's meeting certain statutory requirements.

Private retirement plans form an important part of the total framework of income maintenance for older Americans. As such, it is appropriate to provide tax incentives to encourage employers to establish these plans and thus provide for their employees' post-retirement needs. In so doing the employer performs a function and assumes a burden which otherwise might be thrust upon society at large. Private retirement plans are a significant supplement to the social security system as a source of income for retired and disabled Americans and their dependents. Because private retirement plans are established by individual employers, they can be shaped to respond to unique needs and situations in a manner that a public system covering tens of millions of individuals cannot.

The experience of the past 30 years has demonstrated that while the private retirement system has the capacity to deal with an important social problem through individual initiative, changes in existing law are needed. In the first place, recent surveys indicate that, in spite of the incentives provided by existing law, approximately one-half of the non-agricultural labor force does not now participate in private retirement plans and that coverage is not likely to expand significantly under existing conditions. Moreover, overly restrictive requirements for participation in, or acquisition of vested benefits under, private retirement plans have resulted in effectively denying to millions of employees the full benefits of the private retirement system. Special limitations upon contributions on behalf of self-employed individuals and requirements for the plans in which they participate are so restrictive that they have created an artificial preference for the corporate form over other business forms which might be more suitable or desirable for a particular enterprise.

2. *Eligibility Requirements.*—(Section 2 of Bill.)

A. *Present Law.*

The Internal Revenue Code does not now contain any specific requirements concerning eligibility conditions based on age or service that may be included in a qualified private retirement plan established by a corporate employer. Existing administrative practice does permit such a plan to provide that participation in the plan is limited to employees who have attained a specified age or have been employed for a specified number of years if the effect of such provisions is not discrimination in favor of officers, shareholders, supervisory employees, or highly compensated employees. Likewise, such a plan may exclude from participation employees who have attained a specified age close to retirement when they otherwise become eligible to participate in the plan.

On the other hand, the Internal Revenue Code specifically requires that a qualified plan established by an unincorporated business in which an owner-employee (*i.e.*, a sole proprietor or a partner with a greater than 10 percent interest in capital or income) participates must provide that no employee with 3 or more years of service may be excluded from the plan.

B. *Proposal.*

Reasonable service or age requirements are an appropriate means of preventing the dissipation of plan assets. The benefits earned by employees with short periods of service are usually small, both in absolute terms and in relation to the administrative costs attributable to these benefits. Overly restrictive requirements may, however, result in the arbitrary exclusion of employees from participation in private retirement plans and thereby frustrate the effective functioning of the private retirement system.

The proposed bill would, therefore, provide that a qualified private retirement plan not be permitted to require, as a condition of participation, that an employee have completed a period of service with the employer in excess of 3 years, that he have attained an age in excess of 30 years, or that he not have attained an age which is less than the normal retirement age under the plan reduced by 5 years.

In the case of a qualified plan in which self-employed individuals who are owner-employees participate, the bill would provide that the plan not be permitted to require, as a condition of participation, that the employee have completed more than 1 year of service with the employer if his then age is 35 years or greater, more than 2 years of service if his then age is 30 years or greater but less than 35 years, or more than 3 years of service if his then age is less than 30 years.

C. *Effective Date.*

These rules would be effective upon the day after the date of enactment with respect to all private retirement plans established after December 31, 1972. In the case of plans in effect on December 31, 1972, these rules would apply to plan years beginning after December 31, 1974, except that in the case of plans which are collectively bargained, these rules would not apply to plan years ending before the expiration of the collective bargaining agreement in effect on December 31, 1972.

3. *Vesting Requirements.*—(Section 2 of Bill.)

A. *Present Law.*

There is no generally applicable requirement under existing law that a participant in a qualified private retirement plan have at any time before he attains normal retirement age a nonforfeitable right to receive his accrued benefit under the plan. However, the failure to provide pre-retirement vesting is taken into account by the Internal Revenue Service in determining whether a plan satisfies the statutory requirement that it not discriminate in favor of officers, shareholders, supervisory employees, or highly compensated employees, and in appropriate circumstances the Service will not issue such a determination if a plan does not provide pre-retirement vesting. Neither the circumstances in which pre-retirement vesting is required nor the degree of such vesting is well defined, and considerable variation has arisen. The Internal Revenue Code requires that a plan established by an unincorporated business in which an owner-employee participates must provide that each participant have an immediately nonforfeitable interest in the contributions made on his behalf under the plan.

B. Proposal

Some measure of pre-retirement vesting is essential if the private retirement system is to exist as a functioning and effective supplement to the social security system. This is especially true in view of our highly mobile labor force. An individual whose participation in a private retirement plan terminates before his rights in his benefits accrued under the plan have become nonforfeitable has, for all practical purposes, not really participated in the plan. In addition, pre-retirement vesting is needed to reinforce the non-discrimination requirements of existing law in cases where most of the employer contributions under a plan are made on behalf of participants with a proprietary interest in the employer.

The proposed bill would, therefore, require a qualified private retirement plan to meet new minimum pre-retirement vesting standards. A participant's rights in his accrued benefits derived from his own contributions would have to be fully vested at all times. His rights are at least 50 percent of his accrued benefits derived from employer contributions would have to be nonforfeitable when the sum of his age and his years of participation in the plan equals or exceeds 50 years, and this percentage would have to increase not less rapidly than ratably to 100 percent over the next succeeding 5 plan years. Under this rule, the rights of older employees would vest more rapidly than the rights of younger employees, reflecting the fact that an older employee has less of an opportunity to earn a reasonably pension with a new employer or to save for his retirement.

A participant's accrued benefit is defined in the proposed bill. For a profit-sharing plan or a money purchase pension plan, the accrued benefit is defined as the balance in his account. For a defined benefit pension plan, a participant's accrued benefit, as of any applicable date prior to normal retirement age, is defined as a fraction of the annual benefit commencing at normal retirement age which the employee would receive if he continued employment at his current rate of compensation until normal retirement age. The numerator of the faction is the total number of his years of service with the employer; the denominator is the total number of years of service he would have performed as of normal retirement age if he continued to be employed by the employer until normal retirement age. However, the denominator cannot be less than 15 nor more than 40.

To avoid providing a disincentive against hiring older workers, the proposed bill would permit a qualified plan to provide that an employee's rights in his accrued benefits derived from employer contributions remain forfeitable until he has completed 3 years of continuous service with the employer. The plan would have to provide that upon completing this period of service his rights in at least 50 percent of his accrued benefits derived from employer contributions are nonforfeitable, and this percentage would be required to increase at least ratably to 100 percent over the next succeeding 5 plan years.

To avoid additional costs for defined benefit pension plans in difficult financial condition, pre-retirement vesting would not be required with respect to benefits accrued for any plan year for which benefit payments to retired participants exceed benefit accruals by active participants and the present value of accrued liabilities to retired and active participants exceeds the fair market value of plan assets. If, however, the plan is amended to provide greater benefits during a plan year when this exception would otherwise be operable, the exception would not apply with respect to that plan year, any succeeding plan years, or the 5 plan years preceding such year in which the plan is amended. This exception is designed to provide relief for defined benefit pension plans that have a large number of retired participants in relation to the number of active participants and that are not fully funded. These plans are typically found in industries where employment is declining and where any increase in pension costs would be especially burdensome.

In the case of qualified private retirement plans in which self-employed individuals who are owner-employees participate, an employee's rights in at least 50 percent of his accrued benefits derived from employer contributions would be required to be nonforfeitable when the sum of his age and his years of participation equals or exceeds 35 years. His rights in the remaining percentage of such accrued benefits would be required to become nonforfeitable not less rapidly than ratably over the next succeeding 5 plan years of participation.

C. *Effective Dates.*

Generally, these rules are effective with respect to benefits accrued after the date of enactment. However, in the case of plans in existence on December 31, 1972, the rules would generally apply to benefits accrued for a plan year beginning on or after January 1, 1975. In the case of collectively bargained plans, however, these rules would not apply to benefits accrued during plan years ending before the expiration of the collective bargaining agreement in effect on December 31, 1972. In applying these rules, all participation in the plan (whether before or after the applicable effective dates) would be considered in determining whether the sum of the employee's age and his years of participation equals or exceeds 50 years or 35 years, whichever is applicable.

4. *Minimum Funding Standard.*—(Section 2 of the Bill.)

A. *Present Law.*

Under present regulations, in order to prevent full vesting of all accounts, a defined benefit pension plan generally must be funded in a sufficient amount so that the unfunded past service cost does not exceed the unfunded past service cost as of the date of establishment of the plan, plus any additional past service or supplemental costs added by amendment. An employer generally will satisfy this requirement by annual funding of the sum of normal cost and interest on the unfunded liability. There is no requirement that unfunded liability ever be reduced.

Thus, the current requirement provides only minimal assurance that plans will be funded sufficiently to pay pension benefits according to the terms of the plan.

B. *Proposal.*

The proposed bill would provide a higher minimum standard, in order to increase the security of participants. The proposed standard would, in general, require defined benefit pension plans to be funded annually in an amount at least equal to the sum of normal cost, interest on the unfunded liability, and 5% of the unfunded vested liability. This standard would make the average employee less dependent for his pension upon his employer continuing in business and continuing to maintain the plan.

The proposed standard is similar in concept to a standard widely used by accountants to compute the minimum pension cost for accounting purposes.

5. *Deduction for Personal Savings for Retirement.*—(Section 3 of Bill.)

A. *Present Law.*

Under present law, employer contributions on behalf of an employee to a private retirement plan satisfying the qualification requirements of the Internal Revenue Code and investment earnings on these contributions are generally not subject to tax until paid to the employee or his beneficiaries, even though the employee's right to receive these amounts becomes nonforfeitable before payment is made. Employee contributions to such a plan are subject to tax currently (i.e., no deduction or exclusion is allowable), but investment earnings on these contributions are not subject to tax until distributed or paid to the employee. Amounts saved by an individual for his retirement outside the scope of a qualified plan are not deductible or excludable from gross income, and investment earnings on such amounts are subject to tax currently.

B. *Proposal.*

The effect of existing law relating to saving for retirement purposes is to discriminate substantially against individuals who do not participate in qualified private retirement plans or who participate in plans providing inadequate benefits. Frequently, this situation is the result of a unilateral decision of the employer not to establish a private retirement plan for its employees or not to improve benefits under an existing plan. Many other individuals, because of the nature of their occupations, never have a sufficient period of service with any one employer to accrue adequate retirement benefits.

To remedy this inadequacy in existing law, the proposed bill would allow individuals a deduction in computing adjusted gross income for amounts contributed to qualified individual retirement plans which they have established or to qualified private retirement plans established by their employers. In addition, investment earnings on amounts contributed to individual retirement plans would be excludable from gross income.

In the case of an individual who does not participate in an employer-financed private retirement plan, the amount deductible would be limited to 20 percent of earned income or $1,500, whichever is the lesser. In the case of a married couple, each spouse would be eligible to claim this deduction, and the limit would be applied separately to each spouse. Thus, if a husband had earned income of $12,000 and his wife had earned income of $7,000, the maximum deduction for him would be $1,500, and the maximum deduction for her would be $1,400, permitting a total deduction of $2,900.

If an individual participates in an employer-financed plan, the amount deductible, after application of the $1,500 or 20 percent of earned income limitation, would be further reduced to reflect employer contributions to such plan on his behalf. For this purpose, an individual would be permitted to assume that employer contributions on his behalf are 7 percent of his earned income. He could show, however, that a lesser amount had been contributed on his behalf. Such amount would be determined in accordance with Treasury Department regulations on the basis of the particular facts and circumstances of his situation.

In the case of individuals who have earned income which is not covered by the social security system or the railroad retirement system, the limitation on the deduction would be further reduced by the amount of tax that would be imposed under the Federal Insurance Contributions Act if that income were covered by the social security system. This reflects the fact that taxes imposed on employees under the Federal Insurance Contributions Act are not deductible.

No deduction would be allowed with respect to amounts contributed to a qualified retirement plan by an individual who has attained the age of 70½.

Under the proposed bill, an individual would be allowed to invest these amounts in a broad range of assets, including stocks, bonds, mutual fund shares, annuity and other life insurance contracts, face-amount certificates, and savings accounts with financial institutions. While these assets could not be commingled with other property, they could be held in custodial accounts, and a taxpayer would not be required to establish a trust for this purpose.

To insure that amounts contributed to individual retirement programs and investment earnings on such amounts are used only for retirement purposes, withdrawals before the individual attains age 59½ would not qualify for the general income averaging provided under existing law and would also be subject to an additional penalty tax of 30 percent of the amount withdrawn. This penalty would not apply, however, if the taxpayer has died or has become permanently disabled or if the amount withdrawn is deposited in another individual retirement account within 60 days. This last exception is designed to permit transfer of individual retirement amounts from one type of investment to another, or from one trustee or custodian to another.

Moreover, withdrawals would be required to begin by the time the taxpayer reaches age 70½ and would have to be sufficiently large so that the entire accumulation will be distributed over his life expectancy or the combined life expectancy of the taxpayer and his spouse. If sufficient amounts are not withdrawn to meet these rules after age 70½, an annual excise tax of 10 percent would be imposed. The 10 percent excise tax would be applied against the assets in the account multiplied by a fraction, the numerator of which is the minimum amount required to be distributed for the year reduced by the amount actually distributed, and the denominator of which is the minimum amount required to be distributed for the year.

To insure compliance with the foregoing requirements, trustees, custodians, and other persons having control of amounts deducted under the proposal would be required to submit annual reports to the Internal Revenue Service similar to those which are now required of trustees of plans benefiting self-employed individuals who are owner-employees.

C. *Effective Date.*

This proposal would apply to taxable years ending after the date of enactment of the proposed bill.

6. *Contributions on Behalf of Self-Employed Individuals and Shareholder-Employees of Electing Small Business Corporations.*—(Section 4 of Bill.)

A. *Present Law.*

The Internal Revenue Code now limits the deductible contribution to a qualified private retirement plan on behalf of a self-employed individual to the lesser of 10 percent of earned income or $2,500. In certain circumstances, an additional $2,500 nondeductible contribution may be made. Penalties are imposed if excessive contributions are made and are not returned. With respect to a shareholder-employee of an electing small business corporation, no limit is imposed on the amount that may be contributed on his behalf, but if the contribution exceeds the lesser of 10 percent of compensation or $2,500, the excess is includible in his gross income.

The limitation on contributions on behalf of self-employed individuals has had a number of undesirable effects. In the first place, while the limitation applies by its terms only to contributions on behalf of self-employed individuals, as a matter of practice, it applies as well to their employees with the result that the contributions on their behalf may be less than the contributions which would otherwise be made on their behalf. Furthermore, the inadequacy of the amount presently deductible creates an artificial incentive for the incorporation of businesses and professional practices.

B. *Proposal.*

The proposed bill would increase the limitation on deductible contributions to a qualified private retirement plan on behalf of a self-employed individual to an amount which is the lesser of $7,500 or 15 percent of his earned income.

The limitation on excludable contributions on behalf of shareholder-employees of electing small business corporations would likewise be increased to an amount which is the lesser of $7,500 or 15 percent of compensation.

C. *Effective Date.*

These increased limitations would apply to taxable years beginning after December 31, 1972.

7. *Treatment of Lump-Sum Distributions Recontributed to Qualified Retirement Plans.*—(Section 5 of Bill.)

A. *Present Law.*

Under existing law, if a lump sum distribution is made under a qualified private retirement plan, the distribution is subject to income taxation even if the distribution is received by an employee before his retirement and is set aside by him for his future retirement security. Often, if an employee leaves his employer for a new employer under circumstances where he has a vested right to retirement benefits from his first employer, his retirement benefits will be distributed to him in a lump sum at the time he leaves his first employer. This is convenient for the employer or trustee because he thereby avoids continuing to administer funds for the benefit of a former employee. However, because of the income tax payable at that time, the employee will have a smaller fund available for his retirement years. On the other hand, an employee who, throughout his working career, is employed by a single employer will typically avoid any tax on his retirement funds until actual retirement. Such a result creates an inequity between employees who work for only one employer and employees who are more mobile.

B. *Proposal.*

Under the proposed bill, an individual would not be subject to tax upon receipt of a lump-sum distribution from a qualified retirement plan if the individual reinvests the funds in a qualified individual retirement account or a qualified employer-sponsored retirement plan within 60 days after the close of the employee's taxable year. If the individual receives the distribution in property, other than cash, he would have to reinvest the same property in order to take advantage of this tax deferral opportunity. The proposal would encourage retirement savings by enabling an employee to defer taxation of an amount received as a lump-sum distribution until retirement.

C. *Effective Date.*

These rules would apply to taxable years ending after the date of enactment.

8. *Prohibited Transactions.*—(Section 6 of Bill.)

A. *Present Law.*

Under present law, a trust forming part of a qualified retirement plan is denied exemption from taxation if it engages in a prohibited transaction. Within this context, a prohibited transaction usually involves a transaction at less than arm's length, between the trust and the employer who established the plan, under circumstances which may result in the diversion or dissipation of the trust assets required to be held for the exclusive benefit of the employees covered by the plan. If exemption from taxation is denied to the trust, other special benefits under the Code relating to qualified plans are also denied. Special benefits affecting employees include deferral of the taxation of nonforfeitable amounts contributed on their behalf by employers, and special averaging provisions available with respect to lump sum distributions.

The denial of the trust's exemption from taxation, accompanied by the denial of the employee's exclusions for employer contributions and the employer's current deduction, has not been a satisfactory deterrent in discouraging participation in a prohibited transaction. An employer, in need of working capital or in failing financial condition, may find it advantageous to forego a deduction for any contribution made under a plan in order to divert trust assets to his own use. In far too many instances, the fiduciary for the trust acquiesces in the employer's demand to divert assets to the detriment of the employees.

In many cases, the consequences of the denial of exemption for the trust fall upon innocent rank-and-file employees covered. For example, if a trust is disqualified because of an act of the trustee and the employer, any income tax imposed upon the disqualified trust may diminish the funds available to provide the retirement benefit promised to the employee. Furthermore, because of the prohibited act in which he did not participate, the employee may have to include in his gross income the contributions made on his behalf in a taxable year before he actually receives the amounts attributable to the contributions.

B. *Proposal.*

Any sanction against prohibited transactions should be directed only toward those who participate in them. An employee who is a stranger to the transaction should not be penalized through denial of the special tax benefits to which he would be entitled but for the transaction of another. An effective sanction against prohibited transactions would prevent the wrongful dissipation of plan assets.

The proposed bill would impose excise taxes on the amount involved in a prohibited transaction. The taxes would be paid by any party in interest (*e.g.*, the trustee, employer, or officers of the employer, and other persons having a close relationship to the trust or employer) who are participants in the transaction. An initial tax would be imposed at the rate of 5 percent of the amount involved in the prohibited transaction. An additional tax would be imposed at the rate of 200 percent if the transaction is not corrected within 90 days after notice of deficiency for such tax is mailed. An additional period for correction of the transaction may be allowed if reasonable and necessary to bring about correction of the prohibited transaction. These provisions are similar to taxes imposed by the Tax Reform Act of 1969 with respect to private foundations.

Under the proposed bill, a prohibited transaction would be any act which is prohibited under the Administration's proposed Employee Benefits Protection Act. Thus, there would be a uniform meaning of a prohibited transaction for purposes of the tax law and the law relating to fiduciary standards. Furthermore, the effect of a uniform definition of the term would be to extend the fiduciary standards to qualified private retirement plans that are not covered, for administrative and other reasons, under the Employee Benefits Protection Act (*e.g.*, plans covering fewer than 26 participants).

C. *Effective Date.*

These provisions would be effective beginning on the day after the date of enactment.

9. *Miscellaneous Provisions.*

A. *Premature Distributions to Owner-Employees.*—(Section 7(a) of Bill.)

Under existing law, certain penalties are applicable to distributions made to an owner-employee before he attains the age of 59½ years but only to the extent the distributions are attributable to contributions made on his behalf. Under the proposed bill, this provision is made applicable to forfeitures which may arise under the rule of 35 vesting standard.

B. *Employees Covered Under Collective Bargaining Agreement.*—(Section 7(b) of Bill.)

Under existing law, a qualified private retirement plan must cover (1) specified percentages of employees (generally, 70 percent of employees or 80 percent of those eligible if 70 percent are eligible to participate) or (2) such employees as qualify under a classification that does not discriminate in favor of officers, shareholders, supervisors, or highly compensated employees. In making the computation under the percentage requirement, certain short service, part-time and seasonal employees are excluded. In addition, contributions or benefits under a plan may not discriminate in favor of officers, shareholders, supervisors or highly compensated employees.

In many cases, employees covered under a collective bargaining agreement prefer current compensation or other benefits to the benefits provided under a qualified plan. Thus, many employers are unable to establish a plan for other employees because the coverage and discrimination requirements cannot be satisfied if the bargaining unit employees are not covered. Under the proposed bill, employees who are included in a unit of employees covered by a collective bargaining agreement may be excluded for purposes of satisfying the coverage requirements and the discrimination requirement unless such agreement provides that the employees are to be included in the plan.

C. *Plans Benefiting Self-Employed Individuals.*—(Section 7(c) of Bill.)

Under existing law, there is full and immediate vesting in contributions made or benefits accrued under a plan covering an "owner-employee." In a plan which does not cover any owner-employee, forfeitures may not benefit self-employed individuals. Under the proposed bill, forfeitures attributable to contributions made on behalf of common law employees (which may arise under the rule of 35 or 50 vesting standards) may not inure to the benefit of self-employed individuals. However, forfeitures by a self-employed individual may inure to the benefit of other participants, whether or not those other participants are self-employed.

D. *Trustee of a Trust Benefiting on Owner-Employee.*—(Section 7(d) of Bill.)

Under existing law, the trustee for a trust forming part of a retirement plan benefiting an owner-employee must be a bank. Under the proposed bill, any person who demonstrates to the satisfaction of the Secretary or his delegate that he will hold the trust assets in a manner consistent with the requirements for qualification may be a trustee for a plan benefiting an owner-employee. This provision is identical with the corresponding requirement the bill would establish with respect to individual retirement accounts.

E. *Custodial Accounts.*—(Section 7(f) of Bill.)

Under existing law, a custodial account may be treated as a trust if the custodian is a bank and investment of the funds is either solely in mutual funds or solely in annuity contracts. Under the proposed bill, a person other than a bank may be a custodian if he demonstrates that he will hold the assets consistently with the requirements for qualification of a trust. The restrictions relating to investment would be eliminated. This provision is identical with the corresponding requirement the bill would establish with respect to individual retirement accounts.

F. *Time When Contributions Deemed Made.*—(Section 7(h) of Bill.)

Under existing law, a taxpayer who reports his income on an accrual basis may deduct the contributions made after the close of a taxable year on account of that year, if they are made at any time prior to filing a tax return for that year. In many cases, it is impossible to determine the amount to be contributed under the plan for a year by the end of that year. Under the proposed bill, the rule applicable to accrual basis taxpayers would be extended to cash basis taxpayers.

G. *Inclusion of Certain Employer Contributions in Gross Income.*—(Section 7(i) of Bill.)

Under existing law, there is no limit upon the amount contributed under a qualified private pension plan on behalf of an employee, other than a shareholder-employee of an electing small business corporation, which may be excluded from gross income by the employee. Furthermore, there is no meaningful limitation on the deductible amount which may be contributed by an employer under a money purchase pension plan. Under the proposed bill, an employee would be required currently to include in his gross income the amount of employer contributions made on his behalf under a money purchase pension plan to the extent in excess of 20 percent of his compensation. Any amount included in gross income would be considered as part of the employee's investment in the contract for purposes of computing the taxable amount of a distribution from the plan to the employee. However, these amounts would be considered to be contributed by the employer for purposes of qualification of the plan. A deduction would be allowed for amounts included in gross income that are not received before all rights under the plan terminate.

H. *Defined Benefit Pension Plans Benefiting Self-Employed Individuals.*—(Section 7 (a), (c), (g) of Bill.)

Under existing law, defined benefit pension plans are permitted for self-employed individuals. However, these plans are seldom established because of the low limits on deductible contributions and because separate accounts are required to be maintained for each self-employed individual to assure that forfeitures do not inure to his benefit. Defined benefit pension plans would be more feasible for self-employed individuals under the proposed bill because of the increased deductible limit of $7,500 and because forfeitures by one self-employed individual would be permitted to inure to the benefit of other self-employed individuals. Under the proposed bill, a separate account would be required to be maintained with respect to the self-employed individuals covered under a defined benefit pension plan. Another separate account would be required to be maintained with respect to the common law employees covered under the plan.

I. *Voluntary Contributions by Owner-Employees.*—(Sections 3(c) and 7(e) of Bill.)

Under existing law, amounts received from a retirement plan before retirement are tax-free to all participants other than owner-employees (self-employed persons who own 10% or more of the business) to the extent of all non-deductible amounts contributed to the plan by the participants. Under the proposed bill owner-employees would have the same rights upon withdrawal of non-deductible contributions as all other participants.

10. *Major Changes from Individual Retirement Benefits Act of 1971.*—The proposed bill is a revised and expanded version of the Individual Retirement

Benefits Act of 1971, a bill proposed by the Administration in the 92nd Congress. The major changes from the earlier bill are as follows:

A. *Minimum Funding Standard.*

The earlier proposed bill did not deal with funding.

B. *Accrued Benefits.*

The earlier proposed bill did not define "accrued benefits" for vesting purposes.

C. *Vesting.*

Provisions in the earlier proposed bill for special vesting in lieu of the rule of 50 intended to prevent discrimination in favor of officers, etc., of closely held partnerships and corporations have been dropped because of administrative complexities.

D. *Contributions on Behalf of Self-Employed.*

The earlier proposed bill provided that deductible contributions on behalf of self-employed individuals and shareholder-employees of electing small business corporations could not exceed 15% of so much of earned income as does not exceed $50,000. This proposed bill provides that deductible contributions are limited to the lesser of $7,500 or 15% of all earned income.

E. *Reinvestment of Lump-Sum Distributions.*

The earlier proposed bill did not permit tax-free reinvestment of lump-sum distributions.

F. *Prohibited Transactions.*

The earlier proposed bill did not change the law concerning prohibited transactions.

G. *Barga:ning Unit.*

The earlier proposed bill did not deal with collective bargaining unit employees.

H. *Forfeitures.*

The provision prohibiting the allocation of a forfeiture of a common law employee's benefits to a self-employed individual is new.

I. *Trustees and Custodians.*

The earlier proposed bill did not change the rules concerning trustees and custodians of existing qualified retirement plans.

J. *Money Purchase Pension Plans.*

The provision requiring an employee to include in gross income amounts contributed on his behalf under a purchase money pension plan to the extent in excess of 20 percent cf his compensation, is new.

L. *Withdrawals by Owner-Employees*

The earlier proposed bill would not have repealed the provision prohibiting an owner-employee from withdrawing his voluntary nondeductible contributions before the taxable recovery of deductible contributions.

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