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 2 OF 2 PARTS

(MAY 31; AND JUNE 4 AND 12, 1973)

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE
96-235 WASHINGTON : 1973

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price $4.20 cents
Stock Number 5270-01957

BEST COPY AVAILABLE

COMMITTEE ON FINANCE

RUSSELL B. LONG, Louisiana, *Chairman*

HERMAN E. TALMADGE, Georgia
VANCE HARTKE, Indiana
J. W. FULBRIGHT, Arkansas
ABRAHAM RIBICOFF, Connecticut
HARRY F. BYRD, Jr., Virginia
GAYLORD NELSON, Wisconsin
WALTER F. MONDALE, Minnesota
MIKE GRAVEL, Alaska
LLOYD BENTSEN, Texas

WALLACE F. BENNETT, Utah
CARL T. CURTIS, Nebraska
PAUL J. FANNIN, Arizona
CLIFFORD P. HANSEN, Wyoming
ROBERT DOLE, Kansas
BOB PACKWOOD, Oregon
WILLIAM V. ROTH, Jr., Delaware

TOM VAIL, *Chief Counsel*
MICHAEL STERN, *Assistant Chief Clerk*

SUBCOMMITTEE ON PRIVATE PENSION PLANS

GAYLORD NELSON, Wisconsin, *Chairman*

ABRAHAM RIBICOFF, Connecticut
HARRY F. BYRD, Jr., Virginia
LLOYD BENTSEN, Texas

CARL T. CURTIS, Nebraska
ROBERT DOLE, Kansas
WILLIAM V. ROTH, Jr., Delaware

CONTENTS

(Parts 1 and 2)

Page

Discussions between members of the Committee on Finance and the witnesses:

Russell B. Long (chairman) 241-243, 339-343, 450, 451, 525, 627, 637, 638, 1075

Vance Hartke 441-443, 450, 451, 459, 460

Abraham Ribicoff 345, 346, 352-354

Harry F. Byrd, Jr. 349, 350

Gaylord Nelson 243-246, 251, 252, 254, 255, 262-265, 275-277, 287-292, 303-305, 307, 319-323, 332, 333, 335, 337, 339, 343-346, 349, 352, 369, 371, 372, 375, 378, 397, 398, 410, 412, 419, 420, 422, 431, 436, 438-440, 451, 453, 456, 462, 472, 474, 501-508, 510-513, 515, 526, 528, 529, 538, 539, 543-547, 619, 620, 622, 623, 625, 635, 637-639, 641-657, 827-829, 837, 838, 841, 845-848, 850-852, 857-859, 862-864, 867, 868, 871-874, 1050-1052, 1054, 1076-1078, 1088, 1090, 1091, 1094-1096, 1101

Lloyd Bentsen 337, 338, 350, 369-372, 377, 378, 400, 443, 444, 460, 461, 828, 834, 840, 841, 844-846, 849-851, 853, 854, 856, 857, 861, 865, 866, 1088-1092, 1094, 1099-1101

Wallace F. Bennett 344, 350-353, 372, 377, 420, 1077, 1078, 1083, 1084, 1093, 1094, 1096, 1097, 1100

Carl T. Curtis 1, 217, 220-224, 232-235, 254, 255, 265, 276-278, 344, 346, 354, 369, 456, 628-631, 839, 840, 843, 845, 852, 853, 855, 860

Robert Dole 215-217, 235, 371, 460

William V. Roth, Jr. 461, 462, 866-870

ADMINISTRATION WITNESSES

Fasser, Paul J. Assistant Secretary of Labor for Labor-Management, accompanied by:

Frank M. Kleiler, Deputy Assistant Secretary for Labor-Management Relations; and

Henry Rose, Associate Solicitor for Legislation, Department of Labor 431

Shultz, Hon. George P., Secretary of the Treasury, accompanied by Frederick Hickman, Assistant Secretary for Tax Policy 335

PUBLIC WITNESSES

AFL-CIO, Bert Seidman, director, social security department, accompanied by:

Richard Shoemaker, assistant director; and

Kenneth A. Meiklejohn, legislative representative of AFL-CIO 375

Albright, Robert A., vice chairman, employee benefits committee, National Association of Manufacturers, vice president, administration, U.S. Steel and Carnegie pension fund, accompanied by:

Kenneth Schweiger, director, employee relations, industrial relations department of the NAM 397

American Bankers Association, Fred E. Seibert, chairman, employee trusts committee, trust division, and vice president, Bank of America, accompanied by:
Page
Robert L. Bevan, assistant Federal legislative counsel, ABA 274

American Bar Association, Sheldon S. Cohen, chairman, special committee on retirement benefits, accompanied by:
Donald McDonald, chairman of the tax section, ABA; and
Andrew H. Cox, vice chairman of the committee on employee benefits, ABA 251

American Institute of Certified Public Accountants, Robert G. Skinner, chairman, division of Federal taxation, 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 418

American Life Insurance Association, Douglas B. Hunter, second vice president of Connecticut General Life Insurance Co. of Hartford, Conn., accompanied by:
Verne J. Arends, superintendent of pension research, Northwestern Mutual Life Insurance Co. of Milwaukee, Wis 262

American Society of Pension Actuaries, William W. Hand, president, accompanied by:
William Evans, co-chairman, national legislative committee; and
Solaman Lippman, general counsel 508

American Telephone & Telegraph Co., William G. Burns, assistant treasurer, accompanied by:
Stanley L. King, Jr., assistant vice president, A.T. & T.; and
Donald Harrington, actuary, A.T. & T 217

Backe, Richard, chairman, Engineers Joint Committee on Pensions, accompanied by:
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; and
Larry Spiller, Consulting Engineers Council 319

Bassett, Preston C., vice president and actuary, Towers, Perrin, Forster & Crosby, Inc., accompanied by:
John W. Fisher, vice president 281

Bentsen, Hon. Lloyd, a U.S. Senator from the State of Texas 869

Berger, Paul, law firm of Arnold & Porter 620

Bernstein, Merton, professor of law, Ohio State University Law School 828

Biegel, Herman, law firm of Lee, Toomey & Kent 828

Bland, Willard, assistant corporate secretary and director, corporate benefits from GENESCO, accompanied by:
Martin Amdur, attorney; and
Gerald Guralnick, president of ISI-Woodward, Ryan, Sharp & Davis, Inc 501

Burns, William G., assistant treasurer, American Telephone & Telegraph Co., accompanied by:
Stanley L. King, Jr., assistant vice president; and
Donald Harrington, actuary, A.T. & T 217

Chamber of Commerce of the United States, Robert T. Thompson, member, board of directors, accompanied by:
Andrew A. Melgard, private pension on social security committee 472

Cohen, Edwin S., counsel, law firm of Covington & Burling 828

Cohen, Sheldon S., chairman, Special Committee on Retirement Benefits, American Bar Association, accompanied by:
Donald McDonald, chairman of the tax section, ABA; and
Andrew H. Cox, vice chairman of the committee on employee benefits, ABA 251

Cummings, Frank, law firm of Gall, Lane, Powell & Kilcullen 828

DuRose, S. C., commissioner of insurance, State of Wisconsin 525

Engineers Joint Committee on Pensions, Richard Backe, chairman, accompanied by:
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; and — Page
Larry Spiller, Consulting Engineers Council 819

GENESCO, Willard Bland, assistant corporate secretary and director, accompanied by:
Martin Amdur, attorney; and
Gerald Guralnick, president, ISI-Woodward, Ryan, Sharp & Davis, Inc 501

Greenberg, Bernard, Pension Department, United Steelworkers of America, accompanied by:
John Sheehan, director, legislative department, Washington, D.C 240

Halperin, Prof. Daniel, professor of law, University of Pennsylvania Law School 620

Hand, William W., president, American Society of Pension Actuaries, accompanied by:
William Evans, cochairman, national legislative committee; and
Solaman Lippman, general counsel 508

Hartke, Hon. Vance, a U.S. Senator from the State of Indiana 450

Hubbard, Buckley, Jr., vice chairman, Committee on Federal law and Legislation, National Association of Life Underwriters, accompanied by:
Gerald H. Sherman; and
Nicholas P. Damico, counsels for Association of Advanced Life Underwriters 808

Hunter, Douglas B., 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 262

Javits, Hon. Jacob K., a U.S. Senator from the State of New York 1075

Lesser, Leonard, general counsel of the Center for Community Change, Washington, D.C 828

Lindquist, John R., in behalf of Profit Sharing Council of America 409

Murdoch, Converse, president, law firm of Murdoch, Longobardi, Schwartz & Walsh 620

National Association of Life Underwriters, Buckley Hubbard, Jr., vice chairman, committee on Federal law and legislation, accompanied by:
Gerald H. Sherman; and
Nicholas P. Damico, counsels for Association of Advanced Life Underwriters 808

National Association of Manufacturers, Robert A. Albright, vice chairman, employee benefits committee, vice president, administration, U.S. Steel and Carnegie pension fund, accompanied by:
Kenneth Schweiger, director, employee relations, industrial relations department of the NAM 397

National Small Business Association, Robert C. Ware, president, Trustee Life Insurance Co., accompanied by:
Joseph L. Seligman, Jr.; and
Jerome R. Gulan 286

Nolan, John S., law firm of Ivins, Phillips & Baker 620

Nyhart, Eldon H., president, Howard E. Nyhart Co. of Indianapolis 588

Profit Sharing Council of America, John R. Lindquist 409

Savage, Carroll, law firm of Ivins, Phillips & Baker 620

Seibert, Fred E., 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, ABA 274

Page

Seidman, Bert, Director, social security department, AFL-CIO, accompanied by:
Kenneth A. Meiklejohn, legislative representative of AFL-CIO 875

Shapiro, Leon, National Marine Engineers Beneficial Association, AFL-CIO, accompanied by:
Robert Leaf, president, benefit services; and
Brian Jones, associate actuary, pension and welfare plan 542

Skinner, Robert G., 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 418

State of Wisconsin, S. C. DuRose, commissioner of insurance 525

Swartz, Harold T., accounting firm of Coopers & Lybrand 620

Thompson, Robert T., member, board of directors, Chamber of Commerce of the United States, accompanied by:
Andrew A. Melgard, private pension on social security committee 472

Towers, Perrin, Forster & Crosby, Inc., Preston C. Bassett, vice president and actuary, accompanied by:
John W. Fisher, vice president 281

United Auto Workers, Leonard Woodcock, president, accompanied by:
Jack Beidler, legislative director;
Jacob Hurwitz, UAW social security department consultant;
Mike Daly;
Vivienne Hampson; and
Ray Battestilli 453

United Steelworkers of America, Bernard Greenberg, pension department, accompanied by:
John Sheehan, director, legislative department, Washington, D.C.... 240

Ware, Robert C., president, Trustee Life Insurance Co., in behalf of the National Small Business Association, accompanied by:
Joseph L. Seligman, Jr.; and
Jerome R. Gulan 286

Williams, Hon. Harrison A., a U.S. Senator from the State of New Jersey.. 1051

Woodcock, Leonard, president, United Auto Workers, accompanied by:
Jack Beidler, legislative director;
Jacob Hurwitz, UAW social security department consultant;
Mike Daly;
Vivienne Hampson; and
Ray Battestilli 453

PANELISTS

May 31, 1978

Berger, Paul, of Arnold & Porter 624

Halperin, Daniel, professor of law, University of Pennsylvania Law School 631

Murdoch, Converse, president, law firm of Murdoch, Longobardi, Schwartz & Walsh 628

Nolan, John, law firm of Miller & Chevalier 620

Savage, Carroll, law firm of Ivins, Phillips & Baker 634

Swartz, Harold T., accounting firm of Coopers & Lybrand 632

June 4, 1978

Bernstein, Merton, professor of law, Ohio State University Law School.... 828

Biegel, Herman, law firm of Lee, Toomey & Kent 837

Cohen, Edwin S., law firm of Covington & Burling 842

Cummings, Frank, law firm of Gall, Lane, Powell & Kilcullen 847

Lesser, Leonard, general counsel of the Center for Community Change, Washington, D.C 854

COMMUNICATIONS

	Page
Allegheny Ludlum Industries, Inc., Robert J. Buckley, president	1222
American Actuaries, Inc., Ted H. Retan	1267
American Association of Retired Persons and National Retired Teachers Association	1255
American Dental Association, Louis A. Saporito, D.D.S., president	1145
American Federation of State, County & Municipal Employees, AFL-CIO, Jerry Wurf, president	1141
American Paper Institute, Edwin A. Locke, Jr., president	1157
American Society for Personnel Administration, Ernest J. E. Griffes, chairman, retirement income systems	1241
American Textile Manufacturers Institute, Inc., Claude Farrar, chairman, tax committee	1159
Associated General Contractors of America, Inc	1282
ATO Inct., M. D. Furman, corporate risk manager	1162
Augenblick, Robert L., president, Investment Company Institute	1268
Bassett, Preston C., vice president and actuary, Towers, Perrin, Forster & Crosby, Inc	1165
Beirne, Joseph A., president, Communications Workers of America	1226
Bernstein, Meyer, public affairs director, United Mine Workers of America	1196
Bilger, R. P., general manager, Texas, Sears, Roebuck Co	1118
Blue Bell, Inc., G. E. Dixon	1181
Broxterman, W. F., executive assistant managing director, Credit Union National Association, Inc	1196
Buckley, Robert J., president, Allegheny Ludlum Industries, Inc	1222
Caterpillar Tractor Co., M. H. Glick, manager, compensation department	1249
Credit Union National Association, Inc., W. F. Broxterman, executive assistant managing director	1196
Communications Workers of America, Joseph A. Beirne, president	1226
Cruikshank, Nelson H., president, National Council of Senior Citizens	1268
Daume, W. B., director, Monsanto Co	1112
Department of the Treasury, Frederic W. Hickman, Assistant Secretary	1156
Dixon, G. E., Blue Bell, Inc	1181
Elder, Harmon L., in behalf of Southern States Industrial Council	1189
Eli Lilly Co., Walter C. Taylor, Jr	1115
Equity Market Research, Norman H. Tarver, superintendent	1166
Farrar, Claude, chairman, tax committee, American Textile Manufacturers Institute, Inc	1159
First Investment Annuity Co. of America, W. Thomas Kelly, chairman of the board	1168
Fletcher, N. H., assistant treasurer, Uniroyal, Inc	1211
Ford Motor Co., Marc M. Twinney, Jr., pension manager	1125
Fortuin, Henry J. L. Jr., senior vice president and actuary, Marsh & McLennan	1124
Frimet, Gilbert M., Frimet, Goren & Bellamy	1215
Furman, M. D., corporate risk manager, ATO Inc	1162
Glick, M. H., manager, compensation department, Caterpillar Tractor Co	1249
Greenberg, Bernard, Insurance, Pension & Unemployment Benefits Department, United Steelworkers of America	1196
Griffes, Ernest J. E., chairman, retirement income systems, American Society for Personnel Administration	1242
Grubbs, Donald S., Jr., vice president and actuary, National Health & Welfare Retirement Association	1158
Hickman, Frederic W., Assistant Secretary, Department of the Treasury	1156
Honeywell, Inc., R. W. Laxson	1218
Household Finance Corp., J. Thomas Nelson, Washington representative	1160
Howarth, Thomas, director of government relations, United States Independent Telephone Association	1241
Huge, Harry, Esq., Arnold & Porter, special counsel to UMWA president	1196
Investment Company Institute, Robert L. Augenblick, president	1268
Isler, Robert F., president, Oregon Society of Certified Public Accountants	1211

Page

Jackson, Paul H., consulting actuary, Wyatt Co ---- 1228

Jones, Paul A., staff vice president, Kimberly-Clark Corp ---- 1158

Kelly, W. Thomas, chairman of the board, First Investment Annuity Co. of America ---- 1168

Kimberly-Clark Corp., Paul A. Jones, staff vice president ---- 1158

Laxson, R. W., Honeywell Inc ---- 1218

Litton Industries, Inc., John H. Martin, vice president ---- 1122

Locke, Edwin A., Jr., president, American Paper Institute ---- 1157

Lucey, Hon. Patrick J., Governor, State of Wisconsin ---- 1111

Marsh & McLennan, Henry J. L. Fortuin, Jr., senior vice president and actuary ---- 1124

Martin, John H., vice president, Litton Industries, Inc ---- 1122

Michigan Credit Union League ---- 1225

Monsanto Co., W. B. Daume, director ---- 1112

National Council of Senior Citizens, Nelson H. Cruikshank, president ---- 1268

National Health & Welfare Retirement Association, Inc., Donald S. Grubbs, Jr., vice president and actuary ---- 1158

National Retired Teachers Association and American Association of Retired Persons ---- 1255

National Society of Public Accountants, Irving Rosen, president ---- 1180

Nelson, Hon. Gaylord, a U.S. Senator from the State of Wisconsin ---- 1156

Nelson, J. Thomas, Washington representative, Household Finance Corp ---- 1160

Nethercott, J. W., vice president-comptroller, Procter & Gamble Co ---- 1185

Nolan, John S., Miller & Chevalier ---- 1155

Northwestern Mutual Life Insurance Co., Milwaukee, Wis ---- 1187

Oregon Society of Certified Public Accountants, Robert F. Isler, president ---- 1211

Procter & Gamble Co., J. W. Nethercott, vice president-comptroller ---- 1185

Retan, Ted H., American Actuaries, Inc ---- 1267

Review of U.S. Private Pension Plans, Frank Rodio, Jr ---- 1275

Rodio, Frank, Jr., Review of U.S. Private Pension Plans ---- 1275

Rosen, Irving, National Society of Public Accountants ---- 1180

Saporito, Louis A., D.D.S., president, American Dental Association ---- 1145

Schmitt, John W., president, Wisconsin State AFL-CIO ---- 1111

Sears, Roebuck Co., R. P. Bilger, general manager, Texas ---- 1118

Severance, H. L., Standard Oil Co. of California ---- 1188

Southern States Industrial Council, Harmon L. Elder ---- 1189

Southland Corp., John P. Thompson, chairman of the board ---- 1200

S. S. Kresge Co., A. Robert Stevenson, assistant secretary ---- 1284

Standard Oil Co. of California, H. L. Severance, secretary ---- 1188

Stevenson, A. Robert, assistant secretary, S. S. Kresge Co ---- 1284

Tarver, Norman H., superintendent, Equity Market Research ---- 1166

Taylor, Walter C., Jr., in behalf of Eli Lilly Co ---- 1115

Thompson, John P., chairman of the board, Southland Corp ---- 1200

Twinney, Marc M., Jr., pension manager, Ford Motor Co ---- 1125

Uniroyal, Inc., N. H. Fletcher, assistant treasurer ---- 1211

United Mine Workers of America, Meyer Bernstein, public affairs director ---- 1196

United States Independent Telephone Association, Thomas Howarth, director of government relations ---- 1240

United States Savings & Loan League ---- 1253

United Steelworkers of America, Bernard Greenberg, insurance, pension and unemployment benefits department ---- 1285

Wisconsin State AFL-CIO, John W. Schmitt, president ---- 1111

Wurf, Jerry, president, American Federation of State, County & Municipal Employees, AFL-CIO ---- 1141

Wyatt Co., Paul H. Jackson, consulting actuary ---- 1228

Young, Howard, actuary ---- 1146, 1216

VI

ADDITIONAL INFORMATION

Committee on Finance press releases relative to the pension hearings ---- 2

Text of:

S. 4 ---- 6

S. 1179 ---- 109

S. 1631 ---- 152

APPENDIX A—PART 1

Page

Department of the Treasury responses to questions submitted by Senator Gaylord Nelson, chairman of the Subcommittee on Private Pension Plans 553

APPENDIX B—PART 1

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; and (c) revised general explanation of S. 1631 as proposed to be revised........ 571

APPENDIX A—PART 2

Communications received by the subcommittee expressing an interest in the subject of private pension-plan reform........ 1109

PRIVATE PENSION PLAN REFORM

THURSDAY, MAY 31, 1973

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

The subcommittee met, pursuant to recess, at 10:10 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, Curtis, and Dole.

Senator NELSON. We will open our hearings this morning with a distinguished panel of experts who will consider first the question of whether it is better for the vesting, funding, and any other 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 and Senator Curtis' bill, S. 1631, the administration's proposal.

The second question will be 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?

As you know, we operate under some constraints of time, regrettably.

We have your prepared statements and they will be printed in full in the hearing record. It would be helpful if each of you would summarize your viewpoint on the first question first. We will cover just one question at a time in your summary. If you could do that in 5 minutes or so, that would help us. Then we will go to the second question.

To get the full benefit of your expertise, it would be helpful if you would feel free after your presentations to comment on the issues on which you differ so that when we end up with a hearing record, the members of the committee and the Members of the Senate will be able to look at it and have a good feel for what the arguments pro and con are.

I don't need to describe the background of each of the experts since they have such distinction that everybody in the field knows who they are anyway, and those who don't wouldn't understand what they are saying.

We have today Prof. Daniel Halperin, professor of law at the University of Pennsylvania Law School; Mr. Converse Murdoch, president of the Wilmington, Del., law firm of Murdoch, Longobardi, Schwartz, and Walsh; Mr. John Nolan, attorney, the law firm

Miller and Chevalier; Mr. Carroll Savage, attorney, law firm of Ivins, Phillips and Barker; and Mr. Harold T. Swartz, member of the accounting firm of Coopers and Lybrand; and Mr. Paul Berger, member of the law firm of Arnold and Porter.

We will open today with a summary of remarks by Mr. Nolan. Mr. Nolan, I am very pleased to have you back visiting us from the other side of the table for a change.

STATEMENTS OF PANELISTS JOHN S. NOLAN [1] OF MILLER & CHEVALIER; CONVERSE MURDOCH,[2] OF MURDOCH, LONGOBARDI, SCHWARTZ & WALSH; PAUL BERGER,[3] OF ARNOLD & PORTER; DANIEL HALPERIN,[4] PROFESSOR OF LAW, UNIVERSITY OF PENNSYLVANIA LAW SCHOOL; HAROLD T. SWARTZ,[5] OF COOPERS LYBRAND; AND CARROLL SAVAGE,[6] OF IVINS, PHILLIPS & BARKER

Mr. NOLAN. Thank you.

Mr. Chairman, it is an honor and privilege to address these important subjects before the committee.

The extraordinary tax benefits granted to qualified pension and profit sharing plans, these substantial tax benefits are granted to induce private savings, particularly for retirement, and they are an essential element in our system of providing post retirement security for our citizens. They permit the development of private plans tailored to the needs of particular groups of workers; that is, they permit necessary flexibility through private rather than public action. They provide investment discretion to such groups, and also the greater efficiency of decentralized administration of savings plans by the interested parties themselves. They build on the incomes provided by the social security system. They give the individual the independence and dignity that proceeds from the provision by him for his own future out of his own earnings during his lifetime.

These substantial tax benefits have been an effective inducement to the adoption of qualified plans—some 30 million persons are now covered by such plans. This rapid growth has highlighted some major problems in the development of employee benefit plans—coverage of employees, vesting, funding, the treatment of self-employed persons, and other matters. The major legislative proposals now under study by this subcommittee deal in varying degrees with these problems; but they differ completely on the matter of responsibility for the administration of these new provisions. This is a most important issue which deserves the subcommittee's closest attention.

The development of our existing extensive private system over the past 30 years has been under the supervision almost solely of the Internal Revenue Service. Working with the barest and broadest form of statutory standards—such as requirements that the amounts set aside be used "for the exclusive benefit of employees," and that contributions or benefits not discriminate in favor of persons who are

[1] Prepared statement, p. 658.
[2] Prepared statement, p. 693.
[3] Prepared statement, p. 722.
[4] Prepared statement, p. 785.
[5] Prepared statement, p. 795.
[6] Prepared statement, p. 805.

officers shareholders, or highly compensated employees—and the Service has been an effective overseer of a system that now covers, as previously stated, some 30 million persons in the United States. The Service has steadfastly developed and enforced such roles as requirements that plans be fully vested on termination, that vesting requirements be included in plans of smaller employers to insure that the prohibited nondiscrimination of highly paid employees does not occur, and that at the minimum, the employer fund each year current service liabilities plus the interest due on unfunded past service liabilities.

These are merely examples of literally hundreds of other detailed rules and requirements built by the Service only on the bare, broad statutory standards previously described. These rules have been generally accepted by employers and employees alike, and by the courts, as fair and reasonable and as having contributed immensely to the development of the highly effective private pension system which exists in the United States today.

During the past 30 years, the Internal Revenue Service has intensively reviewed the organization or adoption of substantially every qualified plan in the United States, and has monitored the subsequent operation of a high percentage of such plans. The Service has developed and applied extensive rules as to the necessary coverage of the plan to insure nondiscriminatory coverage of the employee groups; the Service has required inclusion of various provisions to protect the right and benefits of lower-paid employees; and the Service has required inclusion of provisions to prevent diversion of the fund to any purpose other than the exclusive benefit of the employee group. The practical necessity of an employer obtaining a "determination letter" from the Service approving the plan so as to insure the favorable tax benefits has given the Service the opportunity to enforce effectively its extensive network of regulations and rulings.

To accomplish these objectives, the Service, over 30 years has developed a cadre of personnel highly skilled in the operation of private pension plans. These personnel are to a large extent decentralized into district offices. They are complemented by a group of experts, including qualified actuaries in the National Office of the Service, who deal with the most complex of the problems presented. These personnel are not only involved in the approval of plans when first created, but also in the regular monitoring of plan operations under the Service's extensive audit and compliance programs.

The Service has collected extensive files and data on the operation of particular plans and through its computer system master file has developed a special employees' plan master file system which produces invaluable information in the tax audit of employee benefit plans.

The problems which exist in the existing private pension plan system—that is lack of adequate vesting and funding, the absence of uniform fiduciary standards, and insufficient reporting and disclosure—are attributable to the absence of sufficiently comprehensive statutory requirements for the development of the system, not to inadequate supervision by the Service. Tax men would generally agree that the treatment of employee benefit plans by the Service reflects a history of administration over the years in which the Service has been most aggressive in insuring that plans are operated for the exclusive benefit of employees without discrimination in favor of higher paid personnel. The Service has thereby guided the development and operation of employee benefit plans to an extraordinary degree.

Now that legislative proposals are being considered to provide the necessary statutory requirements, it would seem highly inadvisable to commit their administration to any agency other than that department—the Internal Revenue Service—which has the proven background, experience, personnel, and demonstrated fortitude to enforce them effectively.

Accordingly, I recommend strongly based, on my own experience, for the reasons just outlined that administration of new requirements governing coverage, vesting, and funding be committed solely to the Treasury Department. These particular matters with which the Internal Revenue Service has had extensive experience in the past are best enforced in the existing framework of grant or denial of the favorable tax treatment.

Otherwise, we will have an overlapping and duplicating system of administration which will be highly inefficient, with unnecessary costs to both the Government and industry.

With respect to uniform fiduciary standards, and improved reporting and disclosure requirement, I would recommend continuation of the present dual administration that presently exists, but with much closer integration of requirements and sanctions than any of the pending bills, except possibly S. 1631 would provide.

The Labor Department has been administering the Welfare and Pension Plans Disclosure Act, which would be greatly strengthened by all of the pending bills and——

Senator NELSON. Did you say you would or wouldn't continue that administration in labor?

Mr. NOLAN. I would.

Some duplication in reporting and disclosure already exists as between Internal Revenue Service and Labor Department requirements. I think it could be eliminated by closer coordination of the requirements of the two agencies.

Senator NELSON. How would you do that? By specific statutory direction?

Mr. NOLAN. Yes. And as I will indicate, the provisions of S. 1631 already begin to move in that direction, but I think more can be done than is done even in S. 1631 to integrate these requirements.

Now, the purpose of the prohibited transaction rules of the Internal Revenue Code and the fiduciary standards rules of the above-referenced Disclosure Act are essentially the same. They should be integrated into a single set of requirements, along the lines that are suggested in S. 1631, but enforcement should be by penalty excise taxes similar to those provided in the Tax Reform Act with respect to private foundations and also as provided in S. 1631, but improved somewhat with the benefit of hindsight, as to the operation of the private foundation provisions over the last 3 years.

The effectiveness of that tax penalty system has now been proven and accordingly could easily be adopted here.

I think that concludes my remarks.

Senator NELSON. Thank you, Mr. Nolan.

If anybody on the committee has any questions as we go along, I would ask you to hold them until we get to the end.

Our next witness is Mr. Murdoch.

Mr. MURDOCH. Thank you, Mr. Chairman. I am cast in a peculiar role here this morning because I am here to urge your subcommittee to adopt the approach of S. 4 and to give maximum enforcement power to the Department of Labor. I say I am in an odd role in presenting that point of view because I am probably the only man in this room who started his political career making a campaign speech for Alf Landon, and I have not moved very far in the political spectrum since.

Senator NELSON. Did you end it that way too?

Mr. MURDOCH. You can tell by the lack of titles with my name that my star never rose high.

My basic thesis is that everything I have read about the need for pension reform seems to revolve around the idea that there should be congressionally mandated protection to make sure that a worker who works long years for an employer when he reaches retirement age, and in fact retires, is going to receive the pension which he has been promised for all of those years. And this to me is primarily a matter of labor law; it is not a matter of tax law.

And I believe to assume that through the tax laws, we can guarantee workers that they will get the pensions they have been promised, is to deal with an illusion.

If I have a client who calls me and says under my pension plan, I have to put money into the fund every year and there is no money in the bank account, it is not going to move that client one iota if I say "If you don't fund it like you promised Internal Revenue you are going to fund it, there is going to be a tax imposed on you when a Revenue agent finds out about it." He is going to come back and tell me "I just told you at the beginning of the conversation there is no money in the bank account, so I can't pay it." So no matter how much excise tax you impose, that is not going to do any good for that man's workers. What will do some good is enforcement authority which permits the Secretary of Labor to go into court and get an injunction which says to the man. Never mind paying all of those other bills, pay that pension bill first.

That is the kind of sanction which I think will be effective. Now this is an especially important area for protection of workers' rights because if you take something like a minimum wage law, if an employer is violating that law, that is not good, but at least his employees have the possibility of moving to another employer where they can get just wages. That is not true, however, in the case of pensions. If after a man has worked 40 years for an employer with the promise of a pension, if his employer says to him the day after he retires, "Oh, I'm sorry, but we are broke, and you don't get a pension even though I told you would get it, but I can't deliver," that man is not in a position then to go out and get another job and work another 40 years to earn a pension. He has had it at that point.

That is why I say that imposing tax penalties on that man's employer will do no good. It may move some money into the Treasury, but it certainly is not going to get that man his pension.

BEST COPY AVAILABLE

Finally, I think it is important to note that the reform which is proposed in the various bills having to do with the tax law will only be applicable to funded plans. As I read these bills, the reform will have nothing to do with an unfunded pension plan where the employer has merely promised the man during active employment that he will get a pension. I think a worker under such a plan is entitled to as much protection and possibly more protection than a worker whose employer has set up a qualified and funded plan.

Thank you, Mr. Chairman.

Senator NELSON. Thank you. Mr. Berger?

Mr. BERGER. Thank you, Mr. Chairman.

Well, I also appreciate the opportunity of testifying on this subject. I believe in general that the topic we are talking about here is not only important, but it is like other matters; it is extraordinarily complex.

In my prepared statement, I have tried to deal with the complexities at some length, although even there I believe there are future details that are required in order to fully develop the details of the implementation of the general proposals.

In terms of summarizing what I would consider to be the highpoints of this, though, first of all, I have come to believe over the years that the private system in large measure enhanced through the collective bargaining system has developed a program of providing benefits to the American worker and his family providing welfare benefits, that improve his lot and provide him with the kind of standard of living and quality of life that would not otherwise be available to him.

This is a situation that has developed in this country over a long period of time and it is continuing to grow. Now, to a large measure, this program has been able to grow because of tax incentives. I think this must be recognized as a reality and that it should be continued because of the lack of any clear understanding that in the absence of these incentives, these benefits would otherwise be available through some other system.

Now, as you noted in your opening remarks, of this subcommitttee's session on this subject, there has been an extraordinary amount of study in Congress of this, in the executive branch and elsewhere about the needs for developing legislation which will provide people who are going to retire reasonable assurances that they will have benefits when they do retire. This fundamentally is a nonrevenue purpose. It is a social purpose. And I think an understanding of the bottom line purpose of your legislation, whatever form it takes, better allows us to consider what agency of Government is better equipped to deal with implementing the legislative purpose.

Now, this question of administration has not been considered in this overall process as fully as the substantive questions, The substantive questions in and of themselves are extraordinarily complex, but I think if we start from the beginning—and I think it is possible to start from the beginning and look at what Congress is interested in doing and preserving and providing—we can see that we are dealing with a nonrevenue function and from that I think we are better able to look to what sections and remedies should be provided to allow Congress purpose to be better effectuated, and who in government and which branch of government should do which job.

BEST COPY AVAILABLE

Now, I believe that the administration and Senator Bentsen are correct to prescribe a system of tax incentives, as I have indicated before, however, I don't believe that tax remedies should be the only or principal means of enforcement of these new standards. I also do not believe that the Internal Revenue Service should be the primary administrative home for the legislation, however, I share the concerns that have been voiced by a variety of sources on the proposal in S. 4 to house pension reform in the labor department without further action might require funds, pension funds, to satisfy different and conflicting requirements under different statutes and also it would fail to take advantage of the expertise that Mr. Nolan has referred to.

This might create and would create two parallel bureaucracies with perhaps similarly trained staffs or at least staffs that are supposed to be doing similar jobs. It could impose a vast number of private interests to have afflicted on them by this legislation extremely burdensome and expensive requirements of processing in dealing with the regulators; in dealing with the two regulators. For I recognize those problems. I think I would solve them, or I would recommend that they be solved in a different manner, though.

My specific general recommendations are, first, Congress should with this legislation seize the opportunity and establish one set of minimum Federal standards that should cover pension plans and these standards should determine whether a plan is entitled to approval by the Labor Department and whether it merits favorable tax treatment by the Internal Revenue Service. I see absolutely no justifications for a different set of standards governing this public purpose.

Second, I think that the legislation should provide for both traditional tax sanctions as is provided in two of the bills pending before Congress, and the regulatory sanctions and other remedies similar to those established in S. 4.

Third, I believe that primary administrative responsibility should be located outside of the Internal Revenue Service, and in the Department of Labor.

Fourth, I think that consideration should be given to the transfer of the Internal Revenue Service pension experts to the Department of Labor. As indicated in my statement at greater length, this is not the first time that suggestion has been made in areas of law, and it has been done. Furthermore in my experience as a tax lawyer, the pension trust branch of the Internal Revenue Service is uniquely a world unto itself. It operates as a clear independent department almost of the other operations of the Internal Revenue Service.

Senator NELSON. You mean that is their sole function?

Mr. BERGER. Their sole function, Senator, is administration of the pension laws and that includes the field offices around the country whose personnel are charged exclusively with administering Internal Revenue laws with the exception of those who conduct audits, and there we have a great problem because the people who conduct audits know very little about pension plans, and they are not very well equipped to consider whether or not the social purposes of pension plans are being carried out in the operation of a plan.

Fifth, I think that consideration should be assured and duplication minimized by instituting a certification procedure whereby labor would certify to the Internal Revenue Service that particular plans were in compliance with Federal standards and, therefore, they would be entitled to Federal tax treatment.

One of the major reasons that I come to the view that I do about the Internal Revenue Service, Senator, is I believe that the mission of the Internal Revenue Service is the collection of taxes and the administration of revenue laws.

Many people have recognized that the Internal Revenue laws have become so complex that they almost get to the point of infringing on our constitutional rights. Without a highly trained tax specialist, it is extraordinarily difficult for the average citizen, whether it is an individual, a small business, a medium business, and of course the large business, to comply with the Internal Revenue laws. To understand them is very difficult. One of the major reasons for this complexity is that the Internal Revenue laws have been used continuously to attain other social purposes.

And I think this is a very good time for Congress to—and again, as I have said—start from the beginning with respect to this subject and say, well, now, what are we trying to do and what is it you have to do with the Internal Revenue laws? And I think it would be a useful step in avoiding additional complexities of the laws to provide for these new standards in a nontax law.

Now, I think——

The CHAIRMAN. Excuse me. Would you stop right there?

Mr. BERGER. Yes, sir.

The CHAIRMAN. I have labored in that matter of trying to simplify these tax laws and I invite anybody else to join in the effort. It is very frustrating to say the least, but we will try again, and we will succeed in doing some things and getting rid of some of the deadwood that doesn't belong in the Code, and we will try to simplify some of the things that are there and give somebody an alternate simplified method. We will do everything we can along those lines.

I value the suggestions that may be offered in that regard, but there is absolutely no hope between now and the time the Good Lord calls any of us sitting here home that we are going to take the complications out of that tax law for no better reason than we would put a lot of tax lawyers out of business and a lot of accountants out of business. There always is somebody who has some advantage that he is going to fight to the bitter end to keep in that tax law, even though it is terribly complicated.

So the simplification suggestion, while it is a good idea, is just something we are not going to be able to achieve.

Now, when you talk about this thing of not using the Revenue law to achieve other purposes, you are talking about a thought that has been suggested from time to time but nobody who has had that responsibility for as much as 6 months has been able to stay by that resolve. I recall when George Humphrey came down here saying we should do that, and the Revenue laws should be used only to raise revenue. The ink wasn't dry on the print before he came down here with something about having an accelerated depreciation to stimulate somebody to make investments.

The truth is that these revenue laws are just a fantastic tool that can be used to achieve all kinds of things and there has never been an administration as far back as I can recall that has been able to resist the temptation to use them that way. They have achieved some things like speeding the economy up, slowing it down, or keeping somebody from doing something or taxing somebody out of business or putting somebody in jail. So they have been used to do practically anything you could want to do.

At this point I just don't know of anybody who has been in that position of responsibility for any period of time who has stayed with the thought that the Revenue law should be used entirely and exclusively to produce revenue. It is just a very efficient thing to do all kinds of other things with it, and sometimes it is the most efficient tool.

Mr. BERGER. Senator Long, if I may, I think that the tax law in this case does have to be used to accomplish a social purpose, but that in my view, that doesn't in my view mean that the Internal Revenue Service and the Treasury Department has to be the repository of the administration of the entire aspect of this law. I think that there should be a tax exemption and there has to be a tax exemption if we are going to continue to encourage the private pension plan system, but that doesn't mean we have to have 75 pages of Internal Revenue Code dealing with social requirements and so on. And I am not saying these requirements don't have to be in the law, but I am saying that they belong in this case in my view in the labor law where the Labor Department, which is used to problems of dealing with collective bargaining and sensitive problems of employer-employee relationships, can deal with it.

The CHAIRMAN. Well, now, if you put this thing in the Labor Department, for example, you have a management-labor arrangement. It is generally felt by the labor people, with considerable justification, that Labor is their Department. If you put it in the Labor Department, they are going to be partial to that side of the argument. When a difference appears between labor and management, they will be partial townard labor.

Now, if you put it in the Commerce Department, that would be the management's friend. We had one Secretary of Commerce up here who just proclaimed he thought he was there to look after the business people and not other people, but just the business groups.

If you put it in the Treasury, they are nobody's friend. Nobody loves the tax collector. So they are impartial, and on the basis it can be contended that they aren't going to favor anybody because they are not supposed to.

Mr. BERGER. And I don't think with all deference that they are going to favor the accomplishment of the objectives for which this legislation is enacted, Senator. I have an example, and the few people here sitting at the table are well familiar with this example because I worked with them when they were in the service of the Treasury.

In 1928, the Congress passed a statute which voluntary employee benefit associations associations paying life, sick, accident, or other benefits to members or their dependents. This statute was modified from time to time. And back in, I guess it was the 1940's and 1950's the

Internal Revenue Service decided that that is the statute under which collectively bargained health and welfare plans would be exempted, if at all, under the Internal Revenue Code. When this statute was enacted in 1928, the legislative history reflects—at least as it is further reflected through studies made of the kinds of plans in existence at that time—that these plans were put together to provide to the American worker and his family a means of providing him with aspects of living that he could not otherwise provide. It included all kinds of benefits. It included pension benefits, it included death benefits, flower arrangements for funerals, scholarship and loan funds. It included every aspect of human existence that workers were not able to provide on their own. So it was provided through pooled funds. These funds, as it was developed in the 1940's, were substantially funded through employer contributions, through collective bargaining, or through voluntary established plans.

Well, I was sitting in a conference in Mr. Swartz' office in 1958 with about 15 people around the table, and we had a question of whether a certain kind of benefit could be paid under these plans. And Mr. Swartz got up and said, let me take a look at the regulations under these plans. And we said, "There are no regulations."

And he said, "Oh, the statute was enacted in 1928, and this is 1959, what do you mean there are no regulations?" And he went over to the side of his desk and took out his book of regulations and lo and behold; there were no regulations.

The next day, a regulation project was established, and that was in 1958. It is now 1973, and there are still no regulations. Now why are there no regulations?

In 1969, the Treasury Department, as Mr. Halperin knows, proposed regulations, and one of the big areas in those regulations of controversy was just what kind of benefits could these funds pay but still remain tax exempt. It said life, sick, accident, or other benefits. Now, our contention was—and in this contention I was presenting materials as special counsel to the AFL–CIO, but we developed a brief based on the legislative history and the nature of these plans, that other benefits should be broadly interpreted to achieve a social purpose, to try to provide a kind of quality of life to people who could not otherwise provide a variety of benefits. Then we went around and around with the Treasury Department on just what is another benefit. Is group accident insurance another benefit? Are group legal services another benefit? What about scholarship fund, another benefit? What about day care centers?

Now, I don't know that the Internal Revenue Service of the Treasury Department has infinite wisdom in determining what kinds of benefits should be provided to the American working man. I think this is a congressional policy, and it is a policy which should be implemented. I think this should go in an agency of Government that has a function other than preserving the revenue.

Senator Curtis. May I ask right there, is your point that instead of saying "other benefits," the Congress should have stated the other benefits?

Mr. Berger. I think they could have said other benefits, and given it to a department of Government such as Labor to decide what kinds of benefits.

Senator CURTIS. Isn't the entire undergirding of our entire pension programs a matter of tax law?

Mr. BERGER. I think in large measure the private pension system has been encouraged by a tax incentive system.

Senator CURTIS. Weren't the early ones brought into being by means other than collective bargaining?

Mr. BERGER. Surely. Except they grew tremendously as a result of collective bargaining.

Senator CURTIS. I can't follow that argument at all. This is basically a tax question. If someone says in making out his tax return that his taxes should be lowered because he gave *x* dollars to his church, that is not a matter to be determined by the church law, is it?

Mr. BERGER. No.

Senator CURTIS. That is a tax matter to ascertain, whether that money went for religious purposes under the tax law.

Now, because of the provisions of the tax law, employers are paying annually about $14 billion into pension plans each year. The money goes in there free of taxes. The followthrough on whether or not it is used for a qualified pension plan and a qualified pension plan meets certain basic requirements which the Congress should determine, including such things as vesting and funding and so on, is a tax question all of the way through because they are relieved from paying taxes on $14 billion because it is going into a prescribed program, a qualified program.

You can have all of the additional law you want and give it to the Department of Labor, but all you do is end up with two systems, because this has to be and must remain a tax enforcement function.

I have heard a lot of speeches in my time about simplification of tax laws and most of them were pretty good political speeches, unless the listeners knew better. Our economy is complex, a highly complex economy. We have a great variety of businesses and a great variety of doing business. The American people are ingenious. Our business operations are innovative. And I hope they will always be innovative. That is what has caused our growth in such a marvelous way. And as long as our business isn't static and isn't in a straitjacket, nobody is going to come up with very much of a simplified tax system.

If you have a complex economy and you are going to tax justly, you have to have a complex tax law. That doesn't mean that we shouldn't strive in every way possible for simplicity to eliminate all of the unnecessary things and we shouldn't state things just as clearly as possible, but to place overemphasis on the simplicity and to argue against having the Treasury Department perform tax functions because they are complex, that just isn't very impressive to me.

Now, most of the people I represent—and this is why I am so very much interested in the individual pension plans, most of the people I represent aren't the beneficiaries of company pension at all. They aren't covered by collective bargaining, for the most part, or anything else, but their tax burden has to be higher because there is $14 billion of earnings of companies that is not being taxed and, after the pension fund is established, has the enviable position of being free of taxes, so how much we would add to that $14 billion a year I don't know. Anyway, because of those two activities, there is a sizable amount of income that is totally free of taxation and everybody else has to help make up the cost.

Now, the followthrough to see that this tax exempt money is not only paid out for the purposes that it was intended, but that it is paid out with justice and equity and fairness and with the rights of the beneficiaries in mind, is a tax function, and I would hate to see it, just for political reasons, because of the great real political force of unions and others, transferred into the Labor Department. Either the Treasury Department is going to have to keep their hands on it anyway because you are going to have dual administration, or they are going to abandon a very important administrative and tax enforcing function.

Now, I am fully aware that Treasury is behind in writing regulations and sometimes they never write a regulation. They are not the only Department that is negligent in those things. They are not the only Department that is called upon to administer the law where the Congress has not been specific. So I, speaking for people who are outside these pension programs, think that we must insist that the great tax exemptions—which I am for and believe are a wonderful thing for individuals and our economy—be monitored by the proper administrative agency. Not to have the main and simple control in the tax administrative departments would just be wrong.

Mr. BERGER. Senator, you have touched, I think, on key aspects of the determination of this question. There is not question that when a contribution is made to a church, there is a tax question involved, but I would hope that the Internal Revenue Service and the Treasury Department never gets into the job of determining the nature of the animal; namely, what is a church. I think that is for the church to decide. In certain cases, perhaps, there would be appropriate Government consideration of that, but very little.

I think the question we have here is what is the nature of the animal that Congress wants to stimulate. I think the nature of the animal is determined by nontax questions and that these questions for the little man and the big man, for those collectively bargained plans and private plans—and because our firm represents as many private plans that are not collectively bargained as they do collectively bargained plans—I have had experience with both of them—but I think the problem is here for Congress to decide what should be the attributes of a pension plan which the Government wants to encourage. These attributes have characteristics and——

Senator CURTIS. Excuse me, but how would the Government encourage that?

Mr. BERGER. As I indicated in my testimony, they will encourage it through a tax incentive.

Senator CURTIS. Well, let's be more blunt. They will encourage it by allowing income to go untaxed into a fund to earn more income that will go untaxed. The followthrough on such a program is a problem of tax administration and tax enforcement.

Mr. BERGER. Oh, I think part of it probably is definitely tax enforcement, but what is the tax enforcement job? Is it to decide how they protect the revenue or is it to decide how this social purpose is accomplished? And I think that is where the difficulty is.

I think that when the people are looking after to making sure that the employer hasn't deducted too much money—the people in Internal Revenue Service—they are not going to be as much concerned about whether the beneficiary, whether he be a small person or a larger person, is going to get his benefit or whether he is going to get his pension on retirement. That is not the function of the Internal Revenue Service. They want to make sure that the tax dollar has not been overdeducted.

Senator CURTIS. I can't see how they can do their job in determining if the tax dollar has been overly deducted until they determine that it has gone into a qualified program and been paid out according to the law that the Congress has written.

Mr. BERGER. I think the issues are drawn on that.

Senator NELSON. Let's move along. We may want to get back to the question after the other witnesses have testified.

Our next witness is Prof. Daniel Halperin.

Professor HALPERIN. I think I want to make one brief point on this issue of administration. It seems to me that the key question when we put in these new rules, is what kind of sanction will be effective in assuring compliance with these rules. We shouldn't select the agency first and then let the kind of agency we got blindly set the sanction, but we ought to start with what the sanction should be.

Now, that may determine the agency, but I don't think it necessarily has to. For example, we now deal with so-called prohibitive transactions; the selling of things to the fund at too high a cost or borrowing from the fund without security. The sanction is tax disqualification. I think that is a bad sanction. S. 1631 recognizes that. As Mr. Nolan mentioned, it proposes putting an excise tax on those who deal improperly with the fund, but yet that kind of enforcement authority remains with the Internal Revenue Service. Now, I don't see anything wrong with that.

One case where I think S. 1631 does not have the proper sanction is, it talks about new mandatory funding requirements and it sanctions for failure to fund. It treats the plan as if in effect it is terminated and treats the money that is now in it as immediately vested. And that is not, I think, an effective sanction. If an employer were supposed to contribute $10,000 to a fund this year, and he failed to do so, to say that the amount of money that is already in there is now vested, without regard to the plan's vesting provisions, will not protect the employees as to the failure to contribute that additional $10,000. I think the sanction for that has to be something that will insure that the money will get into the fund. Now, it could be imposing employer liability on the employer for the contribution that has not yet been made. It would be some kind of disclosure requirement which will perhaps create a public relations problem for the employer if he does not go ahead and make the contribution. But I think the vesting of the amount already in there is probably not going to be very effective, and I think that is the thing that we ought to keep in mind. The key question is the sanction. With that in mind, I am not sure that the agency makes that much difference. And I think it is probably best if I kept out of that one.

Thank you, Mr. Chairman.

Senator NELSON. Thank you, Professor Halperin.

Our next witness is Harold T. Swartz.

Mr. SWARTZ. My statement is limited generally to the administrative and enforcement of the provisions in the Internal Revenue Code relating to employees' pension plans.

As you know, in the present law, section 401 of the code sets for the requirements for the qualification of these plans and the tax results of many other provisions of the code depend on whether or not a particular plan meets the requirements of section 401.

For example, whether the income earned by a pension trust is exempt from taxation under section 501, or when the contributions by an employer are deductible under section 404; or when the beneficiary of an employee's trust is taxable on the contributions made to the trust in his behalf; or whether the beneficiary of a plan is entitled to capital gain treatment or the 7-year averaging treatment on total lump sum distributions from a trust; or whether a life insurance company may treat certain reserves as "pension plan reserves" under section 805(d); or whether for State tax purposes, the value of certain annuity or other payments are excluded from the gross estate under section 2039 (c); or whether for gift tax purposes, an election by an employee to provide a survivor annuity to his beneficiary is an exempt gift under section 2517.

Thus, whether any agency of the Government, other than the Treasury is granted enforcing authority over the vesting, funding, or other similar provisions of private retirement plans, the Commissioner of Internal Revenue will still have to examine into the qualifications of all such plans under section 401 of the Internal Revenue Code in order to determine the tax results in all of the situations I have just stated.

Prior to the pension trust legislation in the Revenue Act of 1942, when there was a general overhauling of this and the welfare plans, there were some large corporations that maintained pension trusts and group annuity plans for their rank and file employees, but it wasn't until the 1942 act that more employers started to put these plans in. One reason was because in 1942 there was an excess profits tax and the 1942 act provided that contributions to a qualified plan would be deductible for excess profits tax purposes.

Another reason why so many plans sprung up in 1942 was that under the rules governing salary and wage restrictions then in effect, a contribution made to such a plan by an employer on behalf of an employee was not considered to be a prohibited increased in salary or wages.

So upon enactment of the 1942 act, the Commissioner of Internal Revenue was faced with the responsibility of administering and enforcing these plans. Very few, if any, corporation wanted to establish a plan without getting a ruling in advance from the Commissioner as to whether that plan qualified.

As a result, the Commissioner set up a separate pension trust office within the Internal Revenue and the actuaries were given training with respect to the pension laws and they brought in some insurance experts.

At the present time, there are approximately 400 experts in the field offices of the Internal Revenue Service, and about 60 specialists in the national office in Washington who devote their entire time to the administration and enforcement of these provisions of the code.

Now, under section 401(a)(7) of the code, a qualified plan must provide that an employee's rights are to become vested upon termination of the plan or upon complete discontinuance of contributions thereunder. In addition, the regulations require full vesting of benefits at the time an employee reaches normal retirement age.

While there are not other specific provisions in the code with respect to vesting of benefits, the Internal Revenue Service has required vesting in many plans seeking qualification under section 401. This is particularly true of profit-sharing and stock bonus plans. Such plans usually provide that the nonvested portion of the credits in an employee's account are forfeited when an employee leaves the employer before retirement. These forfeited amounts are allocated among the accounts of the remaining participants. Since the officers and highly compensated employees tend to remain with the employer until retirement, these allocations of nonvested forfeitures often result in final benefits, discriminating in their favor.

So the Service, by its rulings, has insisted in qualifying these profit-sharing plans so that there should be a much faster vesting so that the forfeitures by employees who do leave don't end up with a prohibited group.

Now, with regard to funding, the code contains no specific provisions relating to the funding of benefits, but Treasury regulations and rulings require that contributions to a qualified pension or annuity plan must be funded to the extent of the current pension liabilities, plus interest on the unfunded past service costs.

The Service often checks the status of the funding of a plan during the course of an audit. While it is true it is concerned also with a plan that may be overfunded because a contribution to an overfunded plan is not considered to be deductible as an ordinary and necessary expense, it at the same time enforces the rules regarding underfunding.

There is no provision in the code that requires planned termination insurance, although there are regulations and rulings that are designed to protect employees in the event of the termination of a plan. For example, in the event a plan is terminated or if contributions are curtailed, the Internal Revenue Service requires that certain information is to be filed so that a determination may be made as to the effect of the termination or curtailment on the prior qualification of the plan.

The regulations also contain provisions that are designed to benefit the lower paid participants in the event a plan is terminated within 10 years after its establishment or where the current costs for the first 10 years of the plan have not been fully funded.

While not required by the code, almost all funded deferred compensation plans are submitted to the Internal Revenue Service before they are put into effect. These plans are thoroughly examined by Internal Revenue pension specialists before a determination is made as to whether the plan qualifies under section 401. In addition, when a substantial amount is made to the plan, it is usually submitted to the Internal Revenue Service for a new determination letter. The Internal Revenue Service will determine whether that amendment will still permit the plan to qualify.

After the plan has been established, the Internal Revenue Service, during the audit of the tax return of the employer, examines the continued qualification of the plan in operation.

There is also an appeals procedure under which a taxpayer may request that a proposed disqualification of a plan, or a proposed disallowance of a contribution deduction, be submitted to the pension specialist in the national office of the Internal Revenue Service for review. The taxpayer is entitled to file a brief and is entitled to be heard in conference in the national office.

The same procedures are available where a district director proposes to revoke the exemption of a trust when he is of the opinion that the trust has entered into a prohibited transaction under section 503 of the code.

In conclusion, the Internal Revenue Service has more than 400 pension experts in its field offices and more than 50 pension specialists and actuaries in its national office. They all have had experience with the problems relating to vesting, funding, termination, and qualification of pension, profitsharing, stock bonus, and annuity plans. The Internal Revenue Service has been administering and enforcing the existing provisions of the Internal Revenue Code relating to these plans for more than 30 years and will have to continue to do so.

During the first 9 months of fiscal year 1973, Internal Revenue agents have examined more than 23,000 returns involving code section 404 deductions and the employee plans pertaining thereto. In addition, they audited more than 9,000 forms 990-P filed by trustees of pensions and profit-sharing trusts.

As Mr. Nolan mentioned, a new employees' plan master file system has been adopted by the Internal Revenue Service which, starting with the taxable year 1971, will enable it to account for all plans, the employer entities adopting such plans, the trust funds involved, and the fiduciaries of such plans. The system will also provide data for statistical purposes, detection of nonfilers, and selection for audit examinations.

Therefore, it would seem to me logical and preferable that any additional vesting, funding, and other similar provisions that may be required of these plans be enforced and administered through the Treasury Department.

Senator NELSON. Thank you very much.

Our next witness is Mr. Savage.

Mr. SAVAGE. Thank you very much.

I am very tempted to vary my remarks pretty much from the summary I was going to give and comment on some of the remarks that have been previously made as I go along. I will try to do that, because I think it will be more meaningful. I strongly feel that in the area of proposed new rules concerning eligibility, vesting, and funding, the administration of these rules should remain with the Internal Revenue Service. I think there are ancillary questions which may involve somewhat different considerations.

If determination insurance or portability rules should be enacted and there are somewhat different questions involved in the area of disclosure and fiduciary responsibility, but on the principal question of rules concerning vesting, funding, and eligibility—the substantive issues that are primarily involved in all of the proposed legislation—I think there are very compelling reasons for staying with the Internal Revenue Service administration.

I won't elaborate on the question of expertise, which has been covered very well by Mr. Nolan and Mr. Swartz.

A second reason, avoidance of the creation of a new Federal bureaucracy of perhaps staggering size when one already exists with a very creditable record, I think is certainly a worthwhile reason.

Now, the question of dual administration, which has been addressed at some length already, first, I must disagree with Mr. Berger. I see no way out of that difficulty. Even if you were to repeal the tax laws, except to the extent of requiring that the taxpayer has to present a certification from the Secretary of Labor to obtain his tax exemption, if that is feasible, it is not proposed by S. 4. I have not heard it proposed by anyone actually. But even if it were done, that wouldn't avoid the problem unless S. 4 were vastly extended. It would have to do extended to all plans with 25 and under employees to eliminate IRS administration. It would have to be extended to areas of integration of social security, it would have to be extended to the coverage rules. Now, none of these things are dealt with in S. 4. No one is proposing that they be put in the Department of Labor. I don't see any way around a dual bureaucracy if vesting, funding, and eligibility rules are given or put under the primary administration of the Department of Labor.

I think that the fourth reason that I would like to refer to for preferring Internal Revenue Service administration is effectiveness. Mr. Murdoch expressed the view that the labor laws are more effective than the tax sanctions, if I understood him correctly. I find that a very startling proposition actually.

Senator NELSON. I think he said enforcement through the court procedures. Is that correct?

Mr. SAVAGE. Yes, but I was saying——

Senator NELSON. That isn't labor law, though.

Mr. SAVAGE. I feel that precisely the opposite is true. I think that the tax laws, the sanctions under those that have been in effect for 30 years have proved to be amazingly effective and that compliance has been very consistently excellent. Every time the Internal Revenue Service issues a new ruling on any area, my clients simply scamper to comply with it. The horrendous tax results of disqualification of a pension plan are something that no one has ever to my knowledge, that no one of my clients has ever intentionally tried to set up a plan to avoid compliance with any of these rules.

So the system is to a large extent, as is often said, self-administering. By contrast, in my experience court-ordered compliance is slow, it is cumbersome, it is on a case-by-case basis. You can find many example of this.

In my written statement, I refer to the sex discrimination area where the Civil Rights Act in 1964 said that you could not discriminate against women in employment. The equal Employment Opportunity Commission finally got around in 1968 to making a specific regulation to that effect.

You are still finding cases where employees, both men and women are suing because pension plans don't have equal benefits for both men and women. So, no one has complied unless they had to.

The ones that had to were plans that were integrated with social security. In 1971, the Internal Revenue Service changed its rules on integration with social security to make retirement for men and women the same, and they gave companies less than a year to comply. I know of no instances in which compliance was not voluntarily obtained. And I think that is the kind of example that you can find many more of which support the reasons I mentioned for retaining enforcement and administration, primarily in the Internal Revenue Service. I think the tax sanctions are more effective and they are more efficient.

Now, on Mr. Halperin's point that fully vesting a trust is not a good sanction for funding rules, I would have to agree with that. I think that S. 1631 and 1179, would make that a condition of qualification so that would have the same sanctions you have for vesting and other rules to comply with funding requirements.

Addressing myself briefly to Mr. Berger's point that the Labor Department is the place to administer social security legislation and not the Treasury Department, I guess it would follow that HEW should administer the private foundation rules. They are exactly the same arguments, it appears to me.

I don't think you can say the private pension movement—unless the time comes when you make pensions mandatory—it is the natural charge of any particular agency that is now existing. It is certainly not a natural charge of the Treasury but it is there because of historical reasons and because it is effective. I think it should stay there.

I have never in dealing with Internal Revenue agents in the pension field encountered an agent who seemed to have revenue considerations only in mind in administering the pension rules that have been legislated by Congress. I have never seen one who seemed to have revenue considerations in mind at the time he was attempting to enforce the law. He was thinking in terms of protection of the worker, of keeping the plan nondiscriminatory. Naturally, revenue is the base for the authority that is given to Treasury but the agents are not sitting around thinking how they can disqualify a plan in order to collect more taxes.

I think if we have a social purpose in this legislation, it can go into any agency. The question is, who is going to best enforce the law. The Internal Revenue Service has the expertise.

And my only other remarks on this would be to say that with respect to disclosure, my experience on that has been that the Welfare and Pension Plan Disclosure Act which has been in effect for over a decade has not been enforced by the Department of Labor to nearly its full potential. In fact, only this year the regulations have finally been issued that would have been authorized at least since 1962, which makes that act much tougher. And if they had been in effect all along, we might have obligated the need for a lot of the disclosure rules which are now proposed in S. 4 and S. 1557. So I agree that lack of enforcement can come anywhere and Labor's record with that act is not particularly good. Again, for historical reasons, I think that probably beefed up disclosure rules should remain with the Department of Labor.

As to fiduciary responsibility, that is a dual system now. The administration proposal tends to keep it dual. They propose new rules in both 1557 and 1631, which would give dual enforcement powers to both Labor and Internal Revenue. I think that someone has not coordinated those two pieces of legislation successfully. As Mr. Nolan has suggested, I think some work ought to be done on that.

You have two whole separate proposed sets of sanctions: One is a court order procedure, fines, penalties, and civil liability and the other is an excise tax.

I think that is not a good idea. In one instance, you go to the Federal district court and in another instance you go to a tax court, all for exactly the same offenses, and nobody says who goes where first. I think some work is definitely needed on that.

If you are going to give priority to one or the other of these means of enforcement, I would opt for the excise tax method. I think the experience in the private foundation area so far has been good.

That concludes my remarks.

Senator NELSON. Thank you, Mr. Savage.

In order to be sure we get all of your viewpoints on the second question, we will move to that and then we will have questions on both issues.

The second question is, 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 provided, what should they be?

The CHAIRMAN. I am going to have to leave, but this might help clarify this whole matter. How did these pensions plans get started to begin with? Was it because labor started it. Was it because managemen wanted to set it up for the benefit of their laborers?

Maybe you know, Mr. Swartz? How did it all get started?

Mr. SWARTZ. Well, as I said, in 1941, I think the record shows that many of the large corporations have set up pension arrangements, annuity arrangements through a group annuity contract. The vesting wasn't very fast. In general, it required age 55 and 15 years of service before they got pensions. And some of them were employee contributor plans. However, as I said, in 1942 with the excess profits tax and, particularly, with the restrictions on increases in salaries and wages, employers could set up these plans and they could postpone the amounts that were put in these plans for the employees until such time as they drew them out, insofar as any present tax was concerned.

Now, the amount set aside for employees was not considered to be increases in salaries and wages for purposes of salary restrictions, so the employers could set up these plans and they could increase their compensation without violating the salaries and stabilization rules. They could postpone this deferred income, this tax on the deferred income, and they could take the contribution deductions for excise profits for tax purposes, which was extremely high and that encouraged thousands of plans to be set up during that period.

As a result of that, however, after the excess profits tax and after the war was over, there were so many of these in effect, that you almost had to put another one in to compete with respect to getting employees. In other words, the employees got used to saying what kind of pension plan would they have and they grew that way in leaps and bounds.

The CHAIRMAN. Do you want to comment on the same thing?

Mr. BERGER. Well, I think that the Bankers Trust issued a report—which I have here—on private pension plans just recently and in it,

BEST COPY AVAILABLE

it indicates the history of the private pension system in America. I don't subscribe to all of the editorializations that are made herein, but they do indicate that the first pension plans came out of the railroad system, which was the first large employer, the first employer of large numbers of people, and that the trend-setting development, or the thing which really pushed through additional numbers of employers joining this was the tax exemption which came in 1926. But then after World War II the Supreme Court decided in the *Inland Steel* case that pensions were an appropriate aspect of collective bargaining——

The CHAIRMAN. When was that again?

Mr. BERGER. That was in 1949. This report states that the full impact of that case was not solved until the fifties when the growth of pension plans and mass production industries rapidly increased the number of workers covered under collective bargaining agreements. And they covered almost 10 million persons or more than 23 percent of all of those employed by industry. This was in the fifties. It has increased since them.

The CHAIRMAN. I suggest that information be made available to our staff then. That sounds like a pretty good résumé.

Do you want to comment?

Mr. NOLAN. The only thing I would add is, prior to 1942 there wasn't a large element of employers adopting plans with full vesting provisions. There wasn't because they were trying to create permanence in their work force. In other words, to insure that they would tend to stay with them over their working years. That, of course, is one of the problems that give rise to lack of adequate vesting in some plans. Today, we have had a change of thinking on that.

Mr. MURDOCH. One comment about your question, Senator Long. One thing that hasn't been mentioned here is the inception of the Federal social security system. I think that gave an impetus to the private pension system. It got more people thinking about retirements and pensions. That is based purely on surmise, of course. I wasn't discussing those thing in the midthirties.

Senator NELSON. Let's go to the second question.

Mr. Nolan?

Mr. NOLAN. On the limitations on contributions or benefits, the heart of these benefits is that a plan participant may defer tax on employer contributions which are funded for his benefit and on the earnings for such contributions and on additional voluntary contributions which the employee may make under the plan until he draws them down in cash or other property individually at a later time. This tax deferral is a substantial tax benefit and the question arises whether the benefits to any individual participant under the qualified plan system should be subject to some overall limit——

Senator NELSON. If I may interrupt?

I want to suggest that each of you try to keep your summary to about 5 minutes. Otherwise, I am afraid that we won't get everybody's viewpoints.

Mr. NOLAN. Except for shareholder employees of subchapter S, small business corporations, and self-employed persons, the existing rules do not in practice serve to limit contributions or benefits on behalf of individual highly paid employees to any substantial extent and,

BEST COPY AVAILABLE

accordingly, retirement annuities on behalf of corporate executive exceeding $100,000 per year are not uncommon.

In the case of self-employed persons, deductible contributions are presently limited to $2,500 per year, or 10 percent of earned income if less. As a consequence of this limitation, self-employed persons have increasingly organized themselves into so-called professional corporations pursuant to special provisions of State laws permitting professional persons to incorporate under conditions whereby the professional responsibility of the lawyer, doctor, accountant, or other member of a profession to the client or patient is preserved. But this development has served to circumvent the limitations on contributions on behalf of self-employed persons which are contained in the tax law.

The special limitations applicable to self-employed persons and shareholder-employees of subchapter F corporations reflect the fact that the nondiscrimination standard is not adequate to prevent excessive tax benefits to owner-employees under the qualified plan provisions.

In recognition of this difference in treatment, the administration bill proposes to increase the limit on deductible contributions for self-employed persons and shareholder employees of subchapter 5 corporations to $7,500 or 15 percent of earned income if less. It is apparent, however, that this will not eliminate the difference in treatment; it will simply reduce its scope. The incentive for operation through professional corporations will continue to exist to obtain the greater tax benefits available to corporate employees.

Senator NELSON. May I ask just one question?

Does the creation of professional corporations for the purpose of permitting unlimited deduction for retirement require special legislation in each State?

Mr. NOLAN. Yes, except that it has been adopted in every State.

Senator NELSON. Every State has it?

Mr. NOLAN. Yes, at the present time.

Senator NELSON. They did that awfully fast.

Mr. NOLAN. Yes, they did.

Senator NELSON. I guess if you have important legislation you can get it through fast; can't you?

Mr. NOLAN. There is no basis for a difference in the treatment of corporate employees and self-employed persons under the qualified plan provisions.

In each case the plan must be nondiscriminatory as to contributions or benefits as between high-paid and low-paid employees. Differences should not arise by reference to the form of business organization utilized or the existence of ethical considerations which make operation in corporate form less appropriate. There should be complete equality of treatment in the application of the qualified plan provisions with respect to all earned income.

And that analogy points up the question whether limitations are appropriate to any extent and, if so, for what reason.

Equality of treatment may be achieved by removing all special limitations on the treatment of self-employed persons and shareholder-employees of subchapter S corporations. It may also be achieved by extending the same limitations to all corporate plans. It may be partially achieved by extending such limitations to closely held corporations, including professional corporations, but this merely moves the point of difference in treatment, or discriminations, to high-paid employees of closely held corporations versus high-paid employees of publicly held corporations, and equally unsatisfactory result.

The analysis points up the question whether limitations are appropriate to any extent and, if so, for what reason.

The essential public policy underlying the qualified plan provisions is to encourage personal saving, particularly for retirement, out of earned income employer-sponsored plans which are not discriminatory. Employer sponsorship of nondiscriminatory plans assures reasonably wide coverage and efficient operation. It is not necessary to achieve these objectives, however, to permit tax deferral benefits to individual participants which are unduly large or permit the funding of postretirement income beyond what is reasonably needed for maintaining the individual's standard of living after he ceases work.

The qualified plan provisions are not designed to sponsor wealth accumulation beyond what is appropriate to maintain such standard.

The realization by some individuals of excessively large tax benefits through the qualified plan system undermines public confidence in the integrity and fairness of our income tax system.

Accordingly, while I recommend strongly that the Congress increase the limitations for self-employed persons and shareholder-employees of subchapter F corporations, I recommend that a uniform limitation be applied to all qualified plans including those of all corporations. In the case of defined benefit plans, the limitation should be in terms of benefits under the plan. In the case of money purchased pension plans or profitsharing plans, the limitation should be somewhat higher than the administration has recommended for self-employed plans, and should contain provisions for automatic increase as inflation occurs.

As an example, benefits under a defined benefit pension plan might be limited to 2 percent for each year of service based on final-average compensation, except that here the amount of final average compensation to be taken into account for this purpose would not exceed $100,000. Thus, the annual retirement benefit for a participant with 25 years of service whose final average compensation was $100,000 or more would be limited to $50,000 in terms of a single life annuity at normal retirement age. If the participant had 30 years service, the maximum would be $60,000. Additional benefits attributable to employee contributions would be permitted.

In the case of a money purchase pension plan, the maximum annual deductible employer contribution would be at the rate of 10 percent of compensation, taking into account a maximum amount of compensation for this purpose of $100,000. In the case of a profit-sharing or spot-bonus plan, such maximum would be at the rate of 10 percent on compensation up to $100,000 per year, or at higher rates up to 15 percent on lower maximum compensation amounts so as to permit a maximum annual deductible employer contribution for any participant of $10,000 per year.

Using a six and one-half earnings assumption, this would produce a single life annuity for a male retiring at age 65 for whom maximum contributions of $10,000 per year had been made for 25 years of about $50,000.

The $100,000——

Senator NELSON. For 25 years at $10,000 for the last half dozen years and covered for 25? Is that what you are saying?

Mr. NOLAN. I am saying in the case of a money purchased pension plan, that it would take 25 years of contributions.

Senator NELSON. At $10,000?

Mr. NOLAN. At $10,000, to fund an annuity of $50,000 per year at normal retirement age.

The $100,000 amount of other maximum compensation base should be automatically adjusted upward to steps of $10,000 each time the cost-of-living index rises an additional 10 percent over its base at the time such new limitations are adopted.

Now, these limits are reasonable enough to assure that sufficient incentive remains for voluntary adoption of qualified plans by employers. My experience tells me that officers of publicly held corporations, owner-employees of closely held corporations, and self-employed persons will be persuaded sufficiently even under these limits to adopt nondiscriminatory qualified pension and profit sharing plans for themselves and their employees as much as thjey would do so under present law.

If such persons wish to defer a larger portion of their current compensation to post retirement years, they will remain entirely free to do so under nonqualified plans, which do not provide the same substantial tax advantages and which may be adopted for individual employees, or high paid groups, without regard to any nondiscrimination requirement.

Deferred compensation contracts, phantom stock plans, restricted property arrangements, and nonqualified stock option plans provide a variety of means for the higher paid executive to defer receipt of his compensation, but without the extraordinary tax benefits which are granted to qualified plans.

Such an overall limitation is more appropriate in light of the 50 percent maximum tax rate on earned income which became fully effective in 1972. High bracket earners no longer require the same protection from high marginal rates under the progressive rate structure to achieve a reasonable degree of lifetime averaging of their compensation.

I would couple these limits with a restriction generally applicable to all qualified plans preventing withdrawal of alienation of interest attributable to employer contributions until age 59½. I would also require withdrawals to begin by age 70½ on the same basis as is present required for self-employed plans.

These requirements are consistent with the public policy underlying the qualified plan provisions of encouraging retirement savings and help prevent undue tax advantage.

Thank you.

Senator NELSON. Thank you very much.

Mr. MURDOCH. The form of the announcement of this hearing indicates to me that someone believes that there should be some limitations of a special nature imposed on closely held and small businesses and professional corporations. I think it would be a great mistake if the tax law was changed to put special and more onerous limitations on the owners of small businesses or closely held businesses.

Senator NELSON. You mean as contrasted with publicly held corporations.

Mr. MURDOCH. Yes, sir.

Senator NELSON. I happen to favor the position of Mr. Nolan that you make everybody equal.

Mr. MURDOCH. I think if there are to be limitations, they should certainly be equal and if there are not going to be equal limitations, I think the owners of small businesses should have equal protection, which points toward a law which gives them better breaks, better tax breaks, for their deferred compensation plan.

The reason I say that is because the owner of a small business and his employees face risks in retirement plans which are unknown to the officers and employees of large public corporations. If you assume a law office with a single lawyer and a single secretary, and if that lawyer has a stroke at age 40, I don't care what the tax law has said about how much he can deduct and set aside until he is age 65 to fund a pension for himself and his secretary, when he has the stroke, his income stops and there will be no pension for him or his secretary except the limited amounts he had been able to set aside up to age 40.

On the other hand, if that attorney worked for the law department of a manufacturing corporation and he has a stroke at age 40, his secretary will go on working for that corporation and there will be other income flowing into that corporation which will assure that the attorney who has been striken at age 40 and his secretary will get some sort of retirement benefits. That is why I believe it is unrealistic to talk about special limitaitions on closely held business.

If anything, closely held businesses should be permitted to fund their retirement plans faster than publicly held businesses.

The arguments that I have heard in favor of special limitations on closely held businesses, run along these lines: In a large, publicly held corporation, the executives are not free to set their own compensation level and that has to be done through arms-length negotiations whereas in a small, closely held business, the owners can set their compensation at any level they want.

I think a person who makes an argument like that has never had to negotiate his compensation with fellow directors named Lombardi, Schwartz & Walsh. I can assure you, there is arms-length negotiation in at least one small business with which I am familiar.

In addition, a small business does not have unlimited income. A lawyer cannot charge whatever the traffic will bear and keep jumping his fees to get as much income as he wants. There is a competitive factor and there is also a factor of fairness. Compensation to a professional and even a nonprofesional small business is not just a matter of a unilateral decision by the owner. There is the limiting factor of how much income is available for this purpose.

Senator NELSON. Do you see any difference between a closely held manufacturing corporation with a substantial number of employees as contrasted with a professional corporation in which the ratio of employees to employers is the type situation where you have more employers to employees—this is so in most professional areas, at least in the law.

Do you see any difference in any rule that would be applicable to that situation? After all, I assume they have to pay, under the law, equal treatment to all of their employees.

Mr. MURDOCH. No, I see no real difference there. In a manufacturing business owned by one man who is active in running that business, in the event of his death or disability, the odds are the business is going to be sold and that in turn puts a special risk for retirement benefits for his employees because the purchaser of the business may not continue the plan.

Senator NELSON. Do you or do you not basically agree with Mr. Nolan's position on equality among all plans; equality among major corporations, closely held and professional corporations, and individuals?

Mr. MURDOCH. Yes; I do. I think that if there is such a law no one could object to it as being discriminatory. People might object to it as not setting high enough limits.

I think the Congress would be concerned about the discrimination if certain businesses are singled out for special treatment. That is the thing they should be concerned about.

Senator NELSON. But disregarding the details, you agree with the principle?

Mr. MURDOCH. Yes: I do.

Senator NELSON. Thank you.

Due to the time situation and since we have been moving from right to left, I would ask Mr. Savage to speak next and we will move from left to right. This way, we won't have the people on my left run out of time.

Mr. SAVAGE. All right.

I basically agree with Professor Nolan's and Mr. Murdoch's viewpoints also that there should be equality between businesses of all types with respect to the question of limits.

Senator NELSON. And individuals?

Mr. SAVAGE. Yes, Senator. I do not, however, agree with Mr. Nolan that there should be any limits. I think that the argument for limits of any kind usually starts with the idea that the pension laws are some sort of tax subsidy that is being granted and that high-paid executives shouldn't be able to build a large estate out of that tax subsidy. I think that really sort of obscures the real issues.

Senator NELSON. I don't understand that. You said there should be equality but no limits?

Mr. SAVAGE. Equality but no limits; yes. I don't think anyone can really conclude the statutory tax treatment of qualified plans is any more of a tax advantage in that the statutory tax treatment of nonqualified plans is a special tax penalty.

I think what you have here is an obviously legislated difference in treatment between qualified and nonqualified plans that was done to encourage employers voluntarily to set up nondiscriminatory plans as opposed to discriminatory plans.

Senator NELSON. Don't you create a discrimination immediately because of the current tax laws? That is to say, if a corporate executive is at the maximum tax bracket, it is very advantageous for him to be getting the money as a pension, nontaxed, vis-a-vis, somebody who is in the 30 percent tax bracket? So isn't that discriminatory in favor of the one in the higher income, the higher tax bracket?

Mr. SAVAGE. I don't think so. I think that the only result of him being in a higher tax bracket is that you do have progressive rates. When the money comes out to him, he will be taxed at progressive rates. There is only a deferral there, which naturally would have been more beneficial to him because otherwise he would have paid a higher tax.

I think if you go around and pick out different areas of the tax law and say, here, we think higher pensions should be taxed less favorably than low pensions, then you are really just saying in this particular area you should have more and steeper progressive rates than you do in other areas. I don't think that it is a fair scientific approach to tax policies. You might as well limit deductions, for instance, for all rich people.

Senator NELSON. We aren't talking so much about tax policy as we are the principle of being sure that everybody has an opportunity to retire at some reasonable income. The advantage of the man in the high tax bracket if you have no limit is very great against the man in the modest or low- or middle-class bracket in his opportunity to accumulate an adequate retirement annuity; isn't it?

Mr. SAVAGE. I think, Senator, you are starting with the same assumption that Mr. Nolan started with, and all of those who advocate limits start with, and that is the objective to simply permit people to accumulate what someone considers to be a reasonable retirement income and no more. I am starting with the premise that I think the purpose here is to create an incentive to set up nondiscriminatory plans. And as a practical matter, I think that limits will dull that incentive. I think that management will go out and take care of their top people anyway, through nonqualified plans and just gross up the benefits if it is more costly, and I think that there will be less incentive on the part of management to improve the plans for the rank and file. So I think you have a practical reason, as well as what I regard to be a reason of sound tax policy for not having limits. I think you also have a practical reason why you might impose limits in the closely held area and that is the reason why they are there now, because of the fear that there would be abuses resulting, I think, mainly from the fact that it is hard to determine what the real earned income is of the man who owns the business but who may be taking out profits in some fashion in the form of a salary.

Senator NELSON. When you say "equality but no limits," that is really a principle without any substance, since, after all, the limits are absolutely imposed upon the person who has a $10,000 or $15,000 or $20,000 income because there is an absolute limit on how much he can set aside because he has to live; whereas, the person in the higher bracket has all of the money he needs to live, in any style he wishes; and then you have no limit, on top of that, in the amount that he can put into his pension plan.

If he is salaried into the 70-percent bracket, it is very beneficial to have that going into pensions; but I don't think it is fair to say that it means much to say that you favor equality but no limits; because the limits are flatly imposed, depending upon the amount of income a person has; aren't they?

Mr. SAVAGE. Well, my reference to equality was equality between all types of business organizations, based on the form or size of the business.

Senator NELSON. And self-employed, wasn't it?

Mr. SAVAGE. Self-employed, small business corporations; what have you.

Senator NELSON. Well, the equality is that you impose no limits, then?

Mr. SAVAGE. That is correct.

Now, I think you do have control. We now have a section in the law that has to administer the maximum tax rate of 50 percent on earned income and there will be a body of rules developing around this which will have to be applied to determine on what income a man is entitled to a 50-percent rate and on what income he will have to pay a 70-percent rate.

I think these rules will be a control on the thing for which limits are now imposed on subchapter F corporations and self-employed individuals. I think if you do impose limits, that the only justification, in my view, is because of this practical difficulty of preventing supposed abuses in the closely held area and it should be limited solely to that. But I don't think there should be any difference based on the form of business organization.

So I think the increased limits proposed by S. 1631 are a commendable step. I don't think they go far enough, though, and I agree with Mr. Nolan that, if you do have limits of any sort, that you should tie them into an automatic cost-of-living index.

I think that it is inadvisable to put dollar amounts in the code that might stay there year after year and become outdated.

Senator NELSON. You mean permanent, specific dollar amounts?

Mr. SAVAGE. Yes.

Senator NELSON. Mr. Swartz?

Mr. SWARTZ. I have no comments on this phase of the bill.

Senator NELSON. Mr. Halperin.

Professor HALPERIN. I think the only reasonable argument you can make against limits is the one that Mr. Savage has made; namely, that it is going to destroy the entire incentive for qualified pension plans. It seems to me, however, there is really no evidence that an unlimited pension is necessary to encourage people to establish plans. I think the history of it and all of the factors that went into that were recounted earlier and they would tend to indicate that and I think, secondly, some things may not be worth the price.

If we have to have these unlimited benefits to a few in order to get qualified plans, maybe we ought to think of a better way to go about it.

Mr. Savage suggests that what we are doing by putting limits is making progressive rates steeper in the area of private pension plans.

I think on the contrary what we are doing is trying at least a little bit to maintain the progressive rates. I think the present system, because of the greater benefits, as the Chairman pointed out, to higher-income people from a deferral, destroys this. This is particularly true since only 50 percent of the people who are now employed get any benefits from a private pension plan and——

Senator NELSON. Excuse me; you mean are covered or get benefits?

Professor HALPERIN. Are covered by private pension plans. And all of the evidence would indicate that 50 percent who are not covered are very, very heavily in the lower-paid side. So the low-paid people are paying the full tax burden in order to finance the pensions for the high-paid people and to finance retirements.

I can't see how you could justify that under any circumstances. I think if we are going to have limits, it is important that the limits be in terms of salary and that should be taken into account for purposes of the private pension plans.

Experience under H.R. 10 would indicate that we have a dollar limit on the size of the contribution or on the size of the benefit and that has the effect of reducing the benefits for the low-paid.

For example, if the top contribution under H.R. 10 is $2,500, if the owner of a business is making $100,000, he says that it has a 2½ percent contribution for himself and he makes a 2½ percent contribution on behalf of all of his employees. I don't think that was what it was intended to be. I think it was intended to be that the 10 percent contribution be the maximum and that $45,000 be the maximum salary that can be taken into account.

Now, I notice in the administration's latest bill, contrary to what they did last year, S. 1631 repeats what I think is the error of H.R. 10 and allows the $7,500 contribution to be considered as a percentage of whatever salary is being made rather than 15 percent of $50,000 of earnings.

I think that is a real serious mistake.

I think that across-the-board limits make sense and I agree with everybody else that in a perfect world there should not be a differentiation between different kinds of arrangements; however, assuming that that might not be achieveable, I think it is reasonable to look to see whether a plan is doing the job.

I would add, we give the special tax benefits to qualified plans not, I think, because we want to make sure that somebody making $100,000 a year is going to be able to live in retirement; but because we want people to establish retirement benefits in such a way so that it brings along the low-paid; so that it establishes retirement benefits for those people who otherwise would not have it.

I think it may be reasonable to look at individual plans to see if they are doing the job. If a plan is of the type that just benefits a few high-paid individuals, there is a reason to propose severe limits on that kind of plan. On the other hand, a plan that does have a great benefit for lower-paid and the rank and file employees is at least performing a social service and we are getting our money's worth out of that kind of plan.

There may be some feeling you don't have to be quite as harsh on that type of arrangement or at least I would think it would not be unreasonable to make that differentiation.

For the same reasons, I would oppose individual retirement savings. I think that the low paid will not start saving because of the tax deduction. If you are in the 14-percent bracket, you are not going to put $100 into a bank account because your tax goes down by $14. If you cannot afford to save $100 today, you are not going to be able to afford it in the future.

What we get from individual retirement accounts, as proposed in 1631, is increased pension benefits for higher paid and lower taxes for the higher paid with no benefit at all for the lower paid.

We lose sight completely of the purpose for the qualified pension plans, which is to encourage the higher paid to save in a way which benefits the lower paid. If you can save for yourself without bringing anyone else along, there is little justification for a tax benefit unless it is going to benefit the lower paid.

Senator NELSON. Mr. Berger?

Mr. BERGER. I have just some very brief comments on this, since I was primarily dealing with the problem of administration.

I think that it is worthwhile again to go back to the beginning and the beginning in this case of the private pension plan system, as far as I am concerned, is not to provide an incentive to encourage savings, but to provide a plan which would allow people to have some reasonable resources to provide for their old age and not be provided for at the public trough.

I don't think, therefore, it is to encourage savings, but to provide some standard of living for as many people as possible in the country.

Going on from that, I think that in terms of setting limits, I think that limits are necessary. Wherever the tax law provides a Federal subsidy through tax deferral for a public benefit, I think it is necessary to set standards, not in the context of allowing a person to continue the standard of living which he has achieved in his lifetime, but to provide him with some kind of minimum standard of livng that Congress decdes, in its wisdom, is reasonable for as many people as possible. So I would modify from my perspective Mr. Nolan's remarks to look back to what is the social purpose.

Is it to encourage savings? I say no; it is to provide retirement income.

Secondly, I say that the limits should be set in that context.

Senator NELSON. Let me skip back to the first question for a moment, Mr. Swartz.

As I recall, and correct me if I am wrong, you said that there were 50 full-time—did I understand that correctly—full-time experts in the national office and 400 in the Federal office?

Mr. SWARTZ. That is correct.

Senator NELSON. Are these 400 and 50 people exclusively devoting their time to pension questions?

Mr. SWARTZ. There are 400 man-years. Some of them devote half their time and others devote half their time. So there are probably more than 400 people, but they do it on the basis of man-years. There are 400 full man-years per year devoted to the specialty of pension trusts in the field.

Senator NELSON. 450 or 400?

Mr. SWARTZ. 400.

Senator NELSON. But you said there were 50.

Mr. SWARTZ. 450 total; 400 in the field and 50 in the national office.

Senator NELSON. Is that 400 man-years or 450 man-years?

Mr. SWARTZ. 400 man-years in the field and 50 full-time people in the national office.

Senator NELSON. In the national office, are they full time in the pension field?

Mr. Swartz. Yes.

Senator Nelson. If the functions they are now administering were administered by the Labor Department, they either would have no functions left in the Internal Revenue Service or they would have to be transferred, as has been suggested.

Mr. Swartz. If the tax functions were transferred over there, yes. There would have to be other phases, I presume, in connection with the Commissioner examining into various phases of the pension trust area, which would remain in IRS.

Senator Nelson. But what I am getting at is, those 400 man-years would not any longer be required by IRS if the functions were transferred from IRS to Labor; is that correct?

Mr. Swartz. If the function of examining into the deductions, and not just the qualification of the plans, but the function of whether or not the contribution is deductible and whether or not the plan qualifies for gift tax purposes, if the function of auditing the tax returns as to the correct amount of that deduction that the employer is entitled to, if all that was transferred, then, of course, they would save the entire 400 man-years, but I would presume that the function of examining the tax returns would not be transferred to the Department of Labor.

Senator Nelson. In looking at the various pending bills, including S. 4, Senator Bentsen's bill, and Senator Curtis' bill, do you have any estimate of how much additional personnel will be required to perform the functions now being performed in the Labor Department and in IRS respecting pension plans? How many additional will be required under these bills?

Mr. Swartz. No; I have never made a study. I would assume, however, that if the function were left with the Commissioner of the Internal Revenue Service, that the number of man-years would not have to be increased very much and that, while they were examining the other factors that the Commissioner has to look into in connection with the tax laws, to look at one or two more provisions, vesting provisions, wouldn't require any more time than they need now.

Senator Nelson. If a substantial number of the labor force presently not covered by private pension plans were to be covered by private pension plans, which is one of the objectives of the various pension proposal, and also the additional responsibility for vesting, funding, et cetera, which have been proposed were enacted, are you saying that IRS could perform these new duties with the same number of employees that are now there?

Mr. Swartz. I think what I am saying is that most of the large employers have plans at the present time and to amend those plans to provide for faster funding or faster vesting would not require any more man years to audit than they do today.

The plans, the new plans, that is, that are being submitted today to Internal Revenue Service for rulings as to their qualifications as new plans, they are usually the smaller corporations which have 25 employees or less.

Now, if there are more plans put into effect that are not existing now, to that extent, the Internal Revenue Service would have to devote more man-years if they are going to audit those additional employers; yes.

Senator Nelson. Mr. Nelson, do you have a comment on that?

Mr. NOLAN. I would suppose if the principal administration were not centralized in the IRS and if the Labor Department were to undertake to investigate the new rules with respect to the coverage and vesting and funding, that there would be a very large number of people who would have to be employed in the Labor Department in addition to those people already employed in the Internal Revenue Service, because I cannot conceive of a system in which the Internal Revenue Service does not continued to do essentially what they are doing today, even if additional requirements are set up in another department.

They simply have to inquire into the initial qualification of plans and audit the operation of the plans to assure that all of the tax requirements are satisfied. And I would be very much disturbed if a system were adopted, such as Mr. Berger suggested, whereby the Labor Department would certify to the IRS that a plant is qualified for tax purposes. We have not ever, with one minor exception, done that in the past.

We have not divided responsibility between two departments with respect to compliance with the tax system. The one exception in which we did it involved amortization of emergency facilities during World War II and during Korea, and that was not a satisfactory experiment at all. The decisions with respect to tax qualification and compliance with the tax system simply have to be made, in my view, by the Internal Revenue Service, and any division of responsibility in that respect would be a mistake, I feel.

Senator NELSON. Perhaps it was Mr. Berger, but somebody also suggested that you take the expertise presently in the Internal Revenue Service and transfer it to the Labor Department to perform these functions.

Mr. NOLAN. Well, I just really don't believe that that is feasible. I think the tax questions, the requirements that exist in the Internal Revenue Code for qualifications of plans and their continued operation ought to be investigated and monitored by the Internal Revenue Service and it is not a desirable system to divide responsibility in that respect and give those determinations to another department.

Senator NELSON. You would leave some functions to be administered by the Labor Department. The disclosure function is there now.

Mr. NOLAN. Yes.

Senator NELSON. What functions would you have in the Labor Department under those bills if one were adopted and what functions under the Internal Revenue Service?

Mr. NOLAN. I would continue to leave the disclosure and reporting requirements essentially with the Labor Department under the Disclosure Act, as it would be strengthened by these bills; but I would very much support the sanction system, which is adopted in S. 1631, of a penalty excise tax.

This is based on the private foundation provisions of the 1969 Reform Act. And the Labor Department would receive reports as to that.

I would hope that those reports could be correlated with reports that were presently submitted to the Internal Revenue Service so that some of the duplicative reporting that now exists would be eliminated; but that the Labor Department would continue those reports and, in the event of violations, would so advise the Internal Revenue Service, who would then undertake to apply the penalty sanctions.

Senator NELSON. Do the rest of you wish to comment on that issue? Would you leave it to the Labor Department or the Internal Revenue Service, or would you consolidate all of the functions in one?

Mr. MURDOCH. I would certainly not urge that anything having to do with collecting taxes be transferred out of the Treasury. I think that would be a mistake.

And if the price of an effective pension reform is that we have a dual administrative setup, then I think we will just have to pay that price. That is not too great a price to pay to have what seems to me to be the required reform; namely, something that insures the worker he will get his pension.

I think we have a couple of precedents here that we can look at. A recent one is the economic controls. It was apparently felt that the Internal Revenue Service people had the expertise and specialties which made them particularly well suited to enforce the economic control systems. But despite that, I don't think there was ever serious consideration given to trying to impose wage and price controls by tinkering with the tax law.

It would be the same as saying, if you violate a wage freeze, the penalty is not a rollback of wages or prices but the penalty is that you can't take a deduction or there will be an excise tax. In other words, I don't think because the expertise lies in the Treasury people, that we must have an amendment to the tax laws to bring to bear their expertise. They can be moved to the Labor Department very easily.

Senator NELSON. Does anybody else want to comment on it?

Mr. BERGER. I would like to make a couple of comments to bring together a few comments made by Mr. Savage and Mr. Nolan.

The effectiveness of the Internal Service has to be looked at in the context of to what end? Here the new legislation is to provide retirement benefits and not to collect taxes. The legislation is being thought of now not in the context of those plans that are doing their jobs, but in the context of those plans that are not doing their jobs. I think the revocation of a tax exemption or an excise tax which is not payable to the fund of the beneficiaries then but to the Federal Government is not an effective sanction to do the job.

Now, in terms of dual administration, there are other precedents. For example, the tax law provides a special deduction to financial institutions for their bad-debt reserves because Congress thought it was desirable to encourage homebuilding and for other reasons. Now, the definition of the institutions, the nature of the animal, so to speak, entitled to the special benefits starts off by saying "The domestic building and loan association means such" and then it says, it means "either insured institution within the meaning of the National Housing Act, or subject by law to supervision and examination by a State or Federal authority having such supervision or such associations."

Now, the savings and loan associations are examined to see that they are carrying out the purposes for which they are organized by State regulators and Federal regulators.

In addition to that, there is a tax function which determines whether or not the deductions they are taking are within the tax limits. Here I think we are hung up on a case of the tail wagging the dog.

The primary purpose of this legislation is not tax oriented and its tax function should be restricted to the nature of the tax involvement.

Of primary concern in Mr. Murdoch's concern, as he mentioned, is that when we put in new standards here, we give the people covered by those plans a reasonable expectation, not that revenues will be properly collected; but that the plans will be operated, and not only just set up, but operated in a way to reasonably carry out the congressional intent.

Senator NELSON. Do any of the rest of you wish to comment?

Mr. SAVAGE. I would just add the point again that very many of the rules that are applicable to qualified pension plans are not dealt with by S. 4 and are not intended to be dealt with by S. 4 and that very many of the plans which received qualified tax treatment are not covered by S. 4. So that you cannot move all of your personnel over to the Labor Department because you still have a very extensive program that is not covered under the proposed rules and which would still have to be administered in the Internal Revenue Service.

Mr. BERGER. I think there is an answer to that, Mr. Chairman, and I would add it is correct that the present legislative proposals do not deal with that; but that doesn't mean it can't be dealt with. For example, it would be possible to vest the Department of Labor with the authority to determine which plans require which rules. For example, if it is felt that a plan because of a certain number of participants, well, that certain rules are not applicable to it, then it could deal with its tax aspects in a more limited way and with much more limited kind of administrative authority than is now required for all of the pension plans. I think these are judgments that can be made by the authority primarily vested with the job of doing this, with the job of carrying out this legislation.

Senator NELSON. If I can interrupt, if you end up with a tax question, it has to ultimately end up with the Internal Revenue Service.

Mr. BERGER. That is right. There will always be some tax questions, but not as many.

Mr. NOLAN. I don't want to turn my back, though, on 30 years of effective administration in this area by the Internal Revenue Service. It has not been my experience, and Mr. Savage testified that it was not his experience that the Service was tax-raising oriented in their approach to the pension plans. Their statutory mandates have been that the plans must be for the exclusive benefit of the employees, and that the plans must not discriminate in contributions or benefits in favor of high-paid employees. Now those very broad and basic standards, over a 30-year period the Internal Revenue Service has built up a vast network of rules and regulations which essentially are designed to protect lower-paid employees.

My experience has been that it has been an effective system for monitoring the operation of qualified plans that employers and employees alike have generally agreed with the effectiveness of that system. The courts have generally approved the rules and regulations adopted by the Service, all of which are built on the foundation of this very broad statutory mandate, which is clearly insufficient to do the job. But with that history of effective administration in the Internal Revenue Service, I see no reason when we are dealing with essentially the same kind of problems they have been dealing with during this period, for instance, coverage, vesting, and funding, I see no reason for not committing the administration in those areas to that department which has a proven record of effectiveness.

Senator NELSON. Anybody else wish to comment? In the administration bill, Senator Curtis has proposed a tax deduction for contributions to personal retirement plans which Professor Halperin—if I understood you correctly—opposes. Instead of a deduction, Senator Bentsen's bill provides for a tax credit for contributions for personal retirement. He argues that is more equitable because of the progressive nature of income tax.

Two questions. If you were to establish a personal retirement plan, do you support the deduction of the tax credit approach? And second, if you do establish one, would that tend to discourage self-employed persons from establishing H.R. 10 plans, which to some extent benefit their employees?

Professor HALPERIN. I think the one reason they put a very low limit on the contribution to individual plans, the $1,500 a year was to continue the incentive, in order to get the higher contribution, to have the self-employed person establish an employer plan. If the difference between the figures is very small, then I think that there will be a disincentive toward employer plans and people will go into their own retirement savings.

I think if you are going to have individual retirement savings, I think a credit is better. A 25-percent credit——

Senator NELSON. Twenty-five percent?

Professor HALPERIN. Yes, as proposed in Senator Bentsen's bill, it gives more favorable treatment to anybody in the 25 percent or lower bracket and the deduction would, of course, be less favorable treatment to people in the higher bracket. Therefore, I guess it would have a tendency to give the push towards the people we are interested in helping. I have my doubts as to whether that will make that much of a difference. There are a lot higher revenue estimates from the Treasury on the tax credit proposal than on the tax deduction proposal. I haven't seen any figures as to whether that is because they are estimating it in greater participation or just that the tax cost for the same participation is greater.

Senator NELSON. You are saying that the Treasury drain is greater for the credit than the deduction?

Professor HALPERIN. It is much higher for the credit than it is for the deduction. In part, one has to look at those figures a little carefully because most of the people who are going to get this tax benefit are not people who do not now save. They make that benefit available to people who now contribute voluntarily or compulsorily to employer plans. And so the great bulk of the people you are talking about are Federal employees, State employees.

Senator NELSON. I thought there was an offset in there. You only take the difference between that—whatever was being put into your own retirement plan—and, if you had $1,500 going into that, that didn't apply. Am I misinterpreting that?

Professor HALPERIN. That is correct, but they assume the contributions is 7 percent paid. If you are making $10,000 a year, for example, they assume the employer puts in $700 and if you are now putting in $700 on your own, you will now get a tax deduction for that $700 which you did not get before.

The Treasury thinks about 14 million people getting tax deductions on those plans. I have not seen them say how many of those people, though, are going to represent new savings as compared to people who now already contribute on non-tax deductible bases. I may be wrong about that, but I have not seen their figures. I think that is an area to concentrate on. That would give us a better idea whether this individual retirement plan is going to work at all and——

Senator NELSON. One more question. Who does the administration think is going to utilize this plan? Who do they think it is going to benefit?

Professor HALPERIN. Well, they say 70 percent, if I remember correctly, tax benefit goes to people earning less than $15,000 a year. They don't point out that that represents 90 percent of the taxpayers, and therefore 10 percent of the taxpayers are getting 30 percent of the benefits. And also, as I said, they don't break it down betwen new savings and old savings. They don't break it down between how much are people contributing who don't get tax deductions—and there may be equitable arguments about whether they should, particularly for the U.S. Government employees, who have no choice, but that is a different argument than talking about this as a way of increasing savings. They don't tell you how many new plans are going to be established. At least I have seen no figures.

Senator NELSON. Don't you think this proposal is beneficial at least to the family farm? Most farmers don't have an employer.

Professor HALPERIN. The farmer?

Senator NELSON. The farmer who runs his own farm.

Professor HALPERIN. Well, he would establish a plan under H.R. 10 today.

Senator NELSON. Well, if he tries to save $1,500, he now pays a tax on it.

Professor HALPERIN. He could establish a plan as an employer, if he is self-employed, and he could establish the plan as an employer and contribute $2,500. This is for people who are employees.

Senator NELSON. Just employees, and not anybody who is self-employed?

Professor HALPERIN. Right.

Senator NELSON. It is not usable by self-employed persons?

Professor HALPERIN. Well, it is. He would have the advantage of using that and not bringing his employees along with him, which he would have to do if he used H.R. 10 and he would have to limit himself to $1,500 as opposed to $2,500 or some higher limit.

Senator NELSON. So if he were self-employed without any employees he could get $2,500 and wouldn't need this?

Professor HALPERIN. Right.

Senator NELSON. If he does have employees, he may take $1,500 and not include his employees?

Professor HALPERIN. Right.

Senator NELSON. Mr. Nolan?

Mr. Nolan. I want to speak to this because this was an idea which I was very interested in when I was in the Treasury Department and I would certainly not agree with some of Professor Halperin's judgments about the utilization of this. The study that we did in the Treasury in 1970 and 1971, looking at the Canadian experience and talking with various groups, institutional groups, convinced us that this would be widely utilized. Now that is not to say that it can't be improved. I think it probably could be, but I think it is an excellent idea for giving people an opportunity to want to save for their retirement an opportunity to do so. And the new saving versus old saving argument doesn't seem to me to be very persuasive because if amounts are put into one of these plans, there are restrictions on withdrawals. They are in effect committed to retirement at that point. It seems to me that is a desirable policy and that we should encourage people who are willing to do so to commit some of their savings to their postworking years. So we achieve that advantage even if we do nothing more than convert existing savings into retirement savings.

On the matter of incentive, as long as the amount of this benefit is held at a fairly low level, as it is now in all of the proposals, it seems to me clear that a substantial incentive will continue to remain for adoption of qualified plans covering employees because the ordinary individual, who is a high bracket taxpayer, is not going to get enough benefit out of a deduction of $1,500 per year as compared to what he could get out of a qualified plan.

On the deduction versus credit argument, it seems to me that allowing a credit is a desirable improvement on the original proposal in that it will give lower paid employees clearly a larger incentive to adopt this. And the Treasury estimates reflecting large revenue losses, take that into account, but there is a matter of equity; insofar as high paid employees are concerned, if you allow them only a credit at the time they go in and thus in effect limit the value of the deduction to them. There is a corresponding proposal when they draw the money out to limit the tax bracket, the marginal rate of tax on which they pay that amount. And it seems to me at least in theory if you are going to limit their deduction at the time they go in, that you should correspondingly limit the marginal rate they pay on that benefit when they take it out of the plan. It would seem to me a desirable possibility might be allowed to allow parties to take either a deduction or credit when they go in, whichever favors them the most, and then to take them under the progressive rate structure when they come out. So that people who were higher bracket taxpayers and are going to pay a relatively marginal rate when they draw the amount out would have gotten a corresponding reduction when they went in.

Senator Nelson. Presumably, this isn't designed to benefit solely higher income people anyway.

Mr. Nolan. Well, to the extent a person is an employee whose employer does not have a plan, I see no reason why he, as a highly paid employee, shouldn't have the same opportunity to create some fund for his own retirement as the lower paid employee would. This is designed for corporate employees whose employer has not installed the plan, which is a very common circumstance among small retail businesses and small service establishments, and it seems to me that even though he is a high paid employee, if his employer hasn't chosen to install the plan he ought to have the same opportunity to save funds for retirement as the low paid employee. It is an opportunity that is being granted to all corporate employees with the offset provision so that there is no duplication of benefits with respect to the qualified plan benefits.

And it seems to me it is a very desirable step forward and will in my judgment extend the coverage of the private system to a significant degree.

Senator NELSON. Would it be equitable to provide for a flat tax credit, the same for everybody and then when they withdraw the money on retirement, they pay a tax on the amount of the credit? If they are in a high tax bracket, they would be paying on the amount of credit they received.

Mr. NOLAN. Well, I would have to work out that arithmetic on that to see how it works out equitably. It seems to be more appropriate to tax the amounts as they come out of the plan as ordinary income subject to the progressive rate structure like any other income because the individual is getting the money at that time.

In order to do that, if he was a higher bracket, he should have been allowed the deduction when he came in. And I have no objection to giving the lower paid the credit. That seems to me fine. It does seem to me a matter of equity as far as the higher paid employee though——

Senator NELSON. So you would make it the option of the investor? Is that what you are saying?

Mr. NOLAN. Yes.

Senator NELSON. Does anybody else want to make a comment?

Mr. MURDOCH. Could I make a comment about a comment made by Professor Halperin? He suggested, as I understand it, there should be a limit on benefits and he cites the case of the over-$200,000 executive. As I understood it, his argument is there ought to be a limit on that because 50 percent of the taxpayers don't have protection under these plans. It seems to me that is beating the wrong dog. Most of the over-$200,000 executives that I know about are executives of the giants of American industry, and generally those industries have now and for a long time have had qualified pension plans, which do give coverage for the lower paid people. So I see no point in punishing an over-$200,000-a-year executive because some other employer in the restaurant or farm business hasn't established a pension plan. I don't see the tie-in there.

Senator NELSON. Did I understand your testimony about and hour or so ago? I thought you basically agreed with Mr. Nolan that you would set a limit?

Mr. MURDOCH. No sir, I said that I agreed with Mr. Nolan that there should be uniform rules for everyone. I think I would be on Mr. Savage's side on the proposition that there should be no limit. I think there are built-in limits, just in the economics of the situation.

Senator NELSON. I am glad I asked that, because I understood you to agree with Mr. Nolan.

Mr. MURDOCH. Not 100 percent. I agreed with him only on the idea of uniformity; whatever the rules are, they should be uniform.

Senator NELSON. But you would have no $7,500 or $10,000 or $15,000 limits, as proposed for the self-employed.

Mr. MURDOCH. That is correct. And the reason I feel strongly about that is because there is no carryover provision at least suggested so far and when you start imposing these limits, the $7,500 a year limit, if that is what it is going to be, everyone assumes that the minute a man opens his business at age 25 he is able to save $7,500 a year until he is 65. That doesn't follow at all. The result is that most people are not able to enter substantial savings programs until late in life and then they get no benefit for the years when they couldn't put the $7,500 away.

Senator NELSON. Any comment on that, Mr. Nolan?

Mr. NOLAN. No. I just feel that as long as the limits are at an appropriate level, I do believe that the function of the private financial system is to allow a person to continue his standard of living after retirement; that is, building on the social security base, and that ought to be the factor we take into account in setting a limit. And as long as the limits are reasonable in light of that objective, it is appropriate for everybody to be subject to those limits.

Senator NELSON. Any comment?

Professor HALPERIN. I think this does make sense to have, as Mr. Murdoch said, the limits in terms of benefits because if you have a limit in terms of contributions, the people who can start at age 25 or 30 will get obviously much more than the people who start at age 55 or 60. And if we have some kind of aim as to what is a reasonable pension, we are going to not overprotect the guy who starts early and have tool little for the person who starts too late. So I think you ought to start off with the assumption that the limit ought to be on the amount of money you can set aside for a retirement plan and the amount of benefit that can be accumulated.

Mr. SAVAGE. How do you work that in a profit-sharing plan?

Professor HALPERIN. I am not sure how you would handle increases in the value of a stock, but I think the primary point is once contributions or once the amount built up is over a particular amount for a particular individual, any further investing would have to become taxes, and be treated as if they were unqualified.

Senator NELSON. As to self-employed, couldn't you use averaging concept? That is to say, if he could only afford to put in less than $7,500 1 year—and I know it creates some complications, but couldn't you take care of the case for somebody who was able to set aside $4,000 but not the $7,500 1 year by averaging it out in subsequent years?

Professor HALPERIN. That kind of concept is in the law today for section 405(B) which is applicable for employees of tax-exempt institutions or universities—and that is my tax loophole. You can accumulate, in effect, credit for all of the years you skipped and make it up as you go along.

Mr. MURDOCH. Yes, I agree you could have an averaging concept or kind of carryover concept, but again we are back to this old bugaboo of complications. This sort of thing is what has made the Internal Revenue Code so thick. If you want to have a highly refined system, you are going to have to have a very complex system; that is what we would be getting into. Also, you would be getting into the problem that already arises when you ask a taxpayer to keep copies of old returns. Many of them don't. As I understand it, the Government destroys them after a while. So it is very difficult to find them.

Senator NELSON. Old tax returns?

Mr. MURDOCH. Am I right? Individual returns are destroyed?

Mr. SWARTZ. Yes.

Mr. MURDOCH. By the Government, yes.

Senator NELSON. For which year?

Mr. SWARTZ. I think they still keep them for 3 years.

Senator NELSON. Did anybody else wish to comment on any other point?

It is 12:35 and I would be glad to stay——

Mr. BERGER. One comment on the 30 years' experience, Senator. I would like the record, for the sake of completeness, to reflect, as indicated on page 124 of the testimony printed for today, that the overwhelming bulk of the Service's activities, in administering existing tax law is in examining plan documents, so that this great expertise at the local level and the national level, historically, has been spent in the original qualification of the plans and the amendments thereto, but not so much in the followup in determining whether a plan is qualified or operates properly in its operations.

Senator NELSON. You are quoting from what?

Mr. BERGER. This is in the testimony of today, and it is a citation to the Senate Committee on Labor and Public Welfare's report, Senate Report 92-637 and furthermore——

Senator NELSON. Who are you quoting?

Mr. BERGER. I beg your pardon?

Senator NELSON. Who are you quoting?

Mr. BERGER. I was quoting this Senate committee report.

Senator NELSON. What page?

Mr. BERGER. This is page 124 of the testimony printed for today and that is consistent with my experience of the operation of the Internal Revenue Service in pension plans. And those cases of audits, audits over funding questions, are more prevalent in my experience than over other questions where you do get into audit questions on discrimination to some extent. I think that the expertise we are talking about can be transferred insofar as it would be necessary to deal with the new provisions of the law.

Senator NELSON. I appreciate your taking the time to come here and testify. It is now 12:35. You were asked to comment on two specific questions, however, since you all are experts in the field, the committee would appreciate any other comments you would like to submit in writing for the record on any of the pending legislation. The only reason we haven't been able to conduct extensive hearings is that we had some compulsion to get this legislation out by mid-July. We really ought to have had half a dozen or more days more. But if you wish to submit a statement on any aspect or several aspects of any one of the pending pieces of legislation for the record, we would appreciate having it, along with your statements from today because we would like to have the benefit of your expertise.

[The prepared statements of the panelists and supplementary material submitted by Messrs. Nolan, Berger, and Murdock, follow. Hearing continues on page 826.]

SUPPLEMENTARY STATEMENT OF JOHN S. NOLAN

At the conclusion of the first panel discussion on Private Pension Plan Reform before this Subcommittee on May 31, 1973, Chairman Gaylord Nelson invited the panelists to submit supplementary papers. He suggested that such papers discuss any of the issues before the Subcommittee other than those dealt with by the Panel that day. I am deeply concerned with two specific matters, and accordingly I submit the following additional views.

INTRODUCTION

The private pension system is based on voluntary action. Such action may be initiated by the employer, or may result from collective bargaining, but it always remains wholly voluntary and discretionary action, to which the employer must agree. The terms and conditions of the plan, the employer's annual contribution, the level of benefits, and the administration of the funds are all major elements of the collective bargaining process between employer and employees. Existing plans generally represent a combination of rights and liabilities tailored to the needs and demands of the parties, reflecting that flexibility which is the essence of the private system, and which distinguishes it from the social security system.

It is essential to the survival and well-being of the private system in the future that legislation providing additional standards for the system be designed to do no more than establish basic standards for fairness. Undue regulation will deprive the system of its essential flexibility. The basic standards should provide fairness to both employees and employer -- and thus should constitute standards which contribute to the welfare of the economy as a whole by giving due consideration to the interests of all the parties involved against the background of how the plans came into existence.

Such basic standards of fairness should be established in light of the major importance of encouraging the maintenance of existing plans, the extension of greater benefits under such plans as productivity increases permit, and the adoption of new plans to cover the high percentage of U.S. workers not presently participating in any plan. Since the adoption of plans and extension of benefits requires employer action, and frequently is dependent on employer initiative, it is essential that due regard be given to the interests of employers in framing these standards. In view of the major objective of the proponents of legislative change -- to provide greater protection to employees (an objective I share in fullest measure) -- it is particularly important that a proper balance between the interests of employers and the interests of employees be achieved. Two particular elements of the pending legislation require further consideration to assure that a proper balance has been attained.

Plan Termination Insurance -- Employer Liability

Section 405 of S.4 provides that the employer shall be liable to reimburse the insurance program for any benefits paid by the program to employees to the extent of 100% of a terminated plan's unfunded vested liabilities on the date of termination, except that the employer's liability shall not exceed 50% of the employer's net worth. The United States is given a lien on the employer's property for the payment of such liability, subject to the lien for federal tax liabilities.

The effect of this provision is to make the employer liable for benefit payments under the plan, including liability for vested benefits for service rendered before as well as after the effective date of the legislation. Since nearly all plans provide for full vesting of employee benefits on termination, the effect is to make the employer liable for all potential benefits based on service up to the time of termination. In past years, many employers have carefully avoided any assumption of corporate liability for benefits, negotiating the amount of annual contributions (and thus the extent of funding of past service liabilities), the level of benefits, and the general investment policies of the fund with representatives of their employees on the clear understanding that the employees' right were to recover their benefits from the fund, not from the employer's assets in the event of termination of the plan for any reason. The sudden imposition of huge unconditional liabilities on the employer by legislation requires the most critical examination.

The Committee report explains the provision in question as follows:

> "The Committee also recognized that some degree of employer liability was essential where the employer was not insolvent at the point of plan termination in order to preclude abuse by shifting the financial burden to the plan termination insurance program despite the fact that the employer had available funds to continue funding the plan."

The Committee goes on to recognize the "potentially enormous liabilities" that might be imposed on employers and accordingly concludes that the employer's liability will be limited to 50% of the employer's "net worth" at the time of plan termination. Sen. Rep. 93-127, 93d Cong., 1st Sess. 26 (1973).

Aside from the fact that "net worth" is an extremely vague concept, and that one wonders why 50% is the proper limit as opposed to 25%, 66-2/3%, or any other portion of net worth, there is the basic question whether so drastic a remedy is really necessary to prevent the abuse described. There is a preliminary question whether the imposition of such liability, particularly insofar as it is based on service prior to the legislation, will withstand constitutional attack as a taking of property without just compensation, or without due process of law, contrary to the Fifth Amendment. It is possible that the constitutional problem is obviated by the fact that the plan termination insurance provisions will not become effective for three years after the legislation is enacted, thus giving existing employers an opportunity to terminate their plans and avoid imposition of corporate liability upon them. Many employers, however, could not terminate their plans simply to avoid corporate liability because of commitments under their union contracts, or under the terms of the plan. Even if they could, it would be the most undesirable possible result for existing plans to be terminated simply to avoid the effect of this statutory provision; and the value of imposing absolute corporate liability as an element of the termination insurance proposal should be weighed against the danger that it may cause a significant number of plan terminations within the three-year period. In any event, there is a clear possibility that the provision is unconstitutional. See Nichols v. Coolidge, 274 U.S. 531 (1927).

Returning to the basic question stated above, the remedy is indeed drastic. As previously stated, it would override the contractual rights of many employers obtained in intense collective bargaining over the years, in consideration of which in part employers have agreed to existing funding obligations and benefit levels under their plans. The unfunded past service liability of many plans will represent a major part of the employer's net worth, and in some could well exceed the 50% of net worth limitation under S.4. Depending in part on the effect such imposition of liability will have on financial accounting standards, it could create major disruptions under existing bond-indentures, credit agreements, preferred stock issues, and contractual arrangements which depend on a specified ratio of assets to liabilities or similar factors. More important, perhaps, the imposition of such liability could drastically prejudice the opportunity of employers to obtain additional credit or equity financing in the future, with serious adverse effects on capital investment and productivity, reducing the competitiveness of U.S. industry in world markets, including our domestic market.

Some idea of the potential magnitude of the liability may be obtained from the fact that the liability of the civil service retirement system for unfunded vested benefits at the present time is in the neighborhood of $63.5 billion, while the annual contribution (employer and employee) to the fund is about $5.3 billion. The total pension plan contributions of all corporate employers at the present time are roughly $14 billion.

The potential magnitude of the employer's liability is growing in most plans in gigantic jumps as current attitudes demand changes in existing pension plans. Thus, unfunded vested benefits increase substantially as changes are made to base benefits on final average rather than career average pay; to permit early retirement without actuarial reduction; to provide special benefits in event of plant shutdown (immediate pensions without actuarial reduction and with special supplements to age 62); to increase benefits by escalation clauses based on cost of living increases or other factors; and other such currently popular amendments. Few persons fully understand the enormous cost of pension plans to the employer if all the benefit rights of the existing work force are considered, and thus the gigantic potential corporate liability in question. As previously stated, the imposition of such a liability could drastically reduce the ability of U.S. business to obtain capital and thus to compete in the world market.

This danger to capital investment exists because institutional lenders, such as banks, insurance companies, and others, as well as the capital markets in general, pay attention to liquidation value of a business. Loan agreements contain a variety of special protections to the lender in event of plant shutdowns, bankruptcy, or other such events. The Government's lien, previously described, could frustrate traditional arrangements. If a U.S. company were suddenly made unconditionally liable for major obligations in event of full or partial termination of its activities, which liability would eliminate a substantial part of its net worth, the obtaining of future capital could possibly become much more difficult.

The abuse of concern is the possibility that employers, once covered by the insurance program, could otherwise simply terminate the plan and shift the burden to the program. Even the proposed liability of the employer will not prevent the unscrupulous employer from promising an unduly high level of benefits; if the business goes well, the employer will provide for the benefits; if it does not, the employer will leave it to the creditors to fight over the assets, and the insurance program may well end up bearing the burden of the employees' benefits. There are, on the other hand, natural constraints against the abuse in question. A solvent employer terminating a plan will create severe employee and union hostility unless there are sound business reasons for the termination. If there are such reasons, the abuse really does not exist. As previously stated, a plan deemed "qualified" for tax purposes must provide for full vesting of employee rights on a termination, thus depriving the employer of the advantage of forfeitability in causing employees to remain in his employ.

I submit that every effort should be made to give the employer an alternative to corporate liability for unfunded past service vested benefits. This opportunity should be given, under specified conditions, to all corporate employors, even those already subject to corporate liability under the terms of their plan. In this fashion, the termination insurance program could work to the benefit of both

BEST COPY AVAILABLE

parties, employer and employees. Employees would obtain insurance protection against loss of their benefits. Employers could obtain through the program insurance protection against catastrophic losses attributable to plan terminations necessitated by good business reasons. Employees would be assured of retirement income. Employers would be relieved of the spectre of a gigantic contingent liability, thus preserving to them full access to the capital market -- to the substantial benefit of the economy as a whole.

Accordingly, I recommend that employers have three basic options with respect to corporate liability for benefit payments in connection with the proposed insurance program:

1. An employer willing to pledge 50% of net worth (as provided in S.4) as security for the payment of benefits would pay the normal premium contemplated by S.4 and be subject only to the general funding requirements elsewhere provided in the bill (in general, normal service cost, interest on unfunded liability, and funding to amortize unfunded liabilities over a 30-year period).

2. An employer not now subject to corporate liability under the terms of the plan would be obligated to reimburse the insurance program for benefit payments only to the extent of 15% thereof if the following conditions were satisfied as of the date of termination:

   a. The employer has elected to pay 150% of the normal premium contemplated by S.4 for the period the insurance program has covered the employer's plan;

   b. At least one-third of all vested benefits of the employees covered by the terminated plan are funded by the time of termination;

BEST COPY AVAILABLE

c. The employer has been funding the unfunded liability of the plan at least ratably over a period not to exceed 20 years (in addition to normal service cost and interest on unfunded liability); the employer has been funding increases in unfunded liability attributable to additional benefits provided after the plan becomes covered by the insurance program over a period not to exceed 10 years; and the employer has made at least three annual payments on this schedule by the time the termination occurs; and

d. Business reasons exist for the termination, and the termination is attributable to such reasons as opposed to an attempt by the employer to shift the financial burden of the plan to the insurance program.

3. An employer already subject to corporate liability under the terms of the plan would be relieved of any such liability, and would be obligated to reimburse the insurance program for benefit payments only to the extent of 15% thereof, if the following conditions were satisfied as of the date of termination:

a. The employer has elected to pay 200% of the normal premium contemplated by S.4 for the period since the insurance program has covered the employer's plan;

b. At least one-half of all vested benefits of the employees covered by the terminated plan are funded by the time of termination;

c. The employer has been funding the unfunded liability of the plan at least ratably over a period not to exceed 15 years (in addition to normal service cost and interest on unfunded liability); the employer has been funding increases in unfunded liability after that time attributable to additional benefits provided after the plan becomes covered by the insurance program over a period not to exceed 10 years; and the employer has made at least three annual payments on this schedule by the time the termination occurs; and

d. Business reasons exist for the termination, and the termination is attributable to such reasons as opposed to an attempt by the

> employer to shift the financial burden of the plan to the insurance program.

I submit that this system would be much fairer to employers and would clearly avoid any constitutional problem. Corporations which may have made substantial concessions over the years to avoid corporate liability are at least given some opportunity to retain the benefits of their bargain. Employers on which corporate liability is not imposed would remain co-insurers of employee benefits to the extent of 15% thereof. Abuses would not occur because of this obligation and because of the substantially more burdensome funding commitments they must assume, and must have carried out for at least three full years.

It would be necessary to amend §404 of the Internal Revenue Code to permit employers to deduct all amounts contributed under the more rapid fu.iding schedules set forth above.

It might be useful to consider limiting benefit payments to employees from the insurance program to 85% of the amounts they otherwise would have received under the plan, consistent with the employer's co-insurance obligation. Insurance generally operates more efficiently when there is some risk of loss to all beneficiaries; such a limitation would create an incentive for both employer and employees to cooperate to prevent terminations, to keep operations going, and to avoid a call on the insurance program.

In any event, the specific proposals outlined above would make the plan termination insurance proposals more acceptable by giving employers as well as employees the opportunity to obtain protection against the catastrophic effects of a termination.

Fiduciary Responsibility -- Liability For Breach

A second matter requiring more careful attention is the liability of a fiduciary for breach of any of the responsibility provisions to be added to the Welfare and Pension Plans Disclosure Act. Thus, for example, section 510 of S.4 adds the so-called federal prudent man standard of conduct for fiduciaries and a series of express prohibitions to prevent self-dealing and similar transactions. The term "fiduciary" is very broadly defined to include any person who exercises any power of control, management, or disposition with respect to *** (the fund), or has authority or responsibility to do so" (section 502). Section 510 also provides that --

> "Any fiduciary who breaches any of the responsibilities, obligations, or duties imposed on fiduciaries by this Act 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 incurred to such fiduciary through use of assets of the fund."

Exculpatory provisions are outlawed. Co-fiduciaries are made subject to certain duties of preventing any of their co-fiduciaries from committing a breach of responsibility, and of compelling them to redress such a breach.

The remedies for enforcement of these fiduciary obligations are extremely broad. Civil actions in federal or state courts without regard to diversity of citizenship or amount involved are authorized, and class actions are expressly permitted. The only constraint is that the court may allow reasonable attorneys fees and costs to any party and may require the plaintiff to post security for payment of such amounts. Such suits may be brought to redress any breach, presumably even if the employee or class is not actually harmed because the plan is overfunded and there is no apparent risk their benefits will not be paid.

This is strong medicine indeed. The question is whether the potential consequences of all these new measures taken together have been fully weighed, and whether the risks they create (and the resulting deterrent to innovative investment and energetic plan management) are necessary to meet the potential abuses at which they are directed.

A new framework of law is being created. Uniform fiduciary standards throughout the United States are desirable. There is, however, no existing federal common law from which a uniform prudent man standard may be derived. Although the Committee report states that this standard is adopted from "existing trust law" (with modifications), the prudent man concept today varies from state to state. Further, it has often been the case that when responsibilities to the United

States Government are created, the courts tend to enlarge the areas of responsibility. Some fiduciaries, accustomed to operating under the standards generally prevailing in their state for many years, could be surprised by adoption by the federal courts of a more severe rule. The parameters of the new rules are yet to be defined.

The broad definition of "fiduciary" will include many individuals. These individuals, as well as all corporate fiduciaries, are made liable for any losses to the fund resulting from a breach by them of any of their responsibilities, obligations, or duties under the Act, including the new federal prudent man standard, without regard to whether their conduct involves negligence, bad faith, wilful or knowing actions, or similar considerations. There is no limitation on their total liability -- either in dollar amount or in terms of only those losses reasonably foreseeable as a consequence of their breach. The Committee report states only that these provisions are intended to codify rules developed under the law of trusts. Again, however, this is only a pious hope; there is no existing federal law of trusts, and rules vary from state to state. Much more explanation is required.

Unless this system is developed with the utmost care, fiduciaries will avoid exercising initiative, judgment, individual responsibility, or similar subjective attention to individual plan management. The essential element of the private system -- flexibility -- will be compromised. Undue conservatism will be encouraged -- to the detriment of the employees, the employer, and the economy as a whole. The spectre of class actions, similar to the "stockholder" suits which have often become little more than legalized blackmail against corporate management, is particularly troublesome as a potential cause of such atrophy. See Eisen v. Carlisle & Jacquelin, ____F.2d ____ (2d Cir. 1973), 41 Law Week 2586.

Faced with a very similar problem of fixing responsibility on managers of private foundations for sound investment, regular income distribution to charity, absence of self-dealing, and other duties, the Tax Réform Act of 1969 adopted a different approach -- one which has been extremely effective. That Act provides a series of excise tax penalties for violation of the statutory standards applicable to any foundation manager who participates in the violation, knowing that it is a violation of such standard, unless such action is not wilful and is due to reasonable cause. In the case of investments, the standard provides that amounts must not be invested "so as to jeopardize the carrying out by the organization" of its stated purposes. The excise tax penalty for a "manager" violating this standard under the conditions previously stated is 5% of the amount of jeopardizing investment.

This system would be more efficient in enforcing the duties and responsibilities of "fiduciaries" created by the new pension legislation and would not create the same danger of stagnation as the potentially more catastrophic liabilities of the present provisions of S.4.

Accordingly, I strongly recommend that the fiduciary responsibility provisions be developed in the same manner as the private foundation rules governing conduct of foundation managers -- particularly the investment standard. The obligations should be enforced by a system of penalty excise taxes, applicable where the fiduciary knowingly violates any statutory standard, unless such action is not wilful and is due to reasonable cause.

If such a system is not adopted, the proposed provisions for liability of fiduciaries for breach of any of their responsibilities, obligations, or duties should contain reasonable limits. Fiduciaries should be liable only for breaches which they know to be violations (subject to a provision that they will be presumed to have reasonable knowledge of statutory requirements), unless such actions are not wilful and are due to reasonable cause. Their liability should be limited to losses reasonably foreseeable as a consequence of their actions. Their liability should be limited to losses which might reasonably result in an actual loss of benefits to participants in the plan. Their liability for any single breach or group of related breaches should not in any case exceed 50% of their net worth and in the case of an individual should in no event exceed $100,000. Class actions should in all events be expressly prohibited, rather than authorized. The other sanctions in the bill are surely adequate without creating the dangers of such actions. At the very minimum, class actions should be permitted only on a preliminary finding by the court that the rights of the plan beneficiaries are not likely to be adequately enforced in the absence of such an action.

CONCLUSION

The foregoing recommendations whereby employers meeting specified rigid funding standards would not be subject to corporate liability for employee benefits, and whereby the liability of fiduciaries in carrying out their responsibilities would be more carefully defined, would contribute greatly to the continued vitality of the private pension system even as plan termination insurance and extensive fiduciary responsibility obligations are imposed. They will facilitate growth of the system, liberalization of benefits, and better management of plans reflecting that necessary degree of judgment, initiative, and well-balanced investment which should remain the special function of private as opposed to public action in the matter of employee retirement benefit plans.

STATEMENT OF JOHN S. NOLAN
MILLER & CHEVALIER, WASHINGTON, D.C.
BEFORE THE SUBCOMMITTEE ON PRIVATE PENSION PLANS
COMMITTEE ON FINANCE, UNITED STATES SENATE
May 31, 1973

ADMINISTRATION OF NEW PENSION PLAN REQUIREMENTS LIMITATIONS ON CONTRIBUTIONS OR BENEFITS

The Internal Revenue Code provides special tax benefits for "qualified" pension, profit-sharing, and stock bonus plans -- plans which in general benefit employees of the particular employer on a broad basis, without discrimination in coverage or benefits in favor of higher-paid employees. The employer is entitled to an immediate deduction for amounts set aside ("funded") for employees under such a plan. The earnings on the amounts set aside for the employee, including earnings on additional amounts which he voluntarily sets aside as "employee contributions" out of his earnings, are not currently taxable to him. The employee does not incur tax on the amounts set aside for him by his employer, on his share of the earnings on such amounts, and on earnings on amounts which he himself voluntarily sets aside, until the time such amounts are subsequently made available to him individually in cash or other property. Appreciation in the value of employer securities which the employee receives is not taxable to him even then; he is not taxed until he sells such securities. Amounts received as a lump sum distribution on termination of employment or death are taxable as long-term capital gains to the extent they consist of earnings on the amounts set aside, or appreciation in value of securities in the employee's account. Transfers of an employee's interest in such a plan by gift or at death are not subject to Federal gift or estate tax except to the extent attributable to voluntary "employee contributions".

These substantial-tax benefits are granted to induce private savings, particularly for retirement, and they are an essential element in our system of providing post-retirement security for our citizens. They permit the development of private plans tailored to the needs of particular groups of workers -- that is, they permit necessary flexibility through private rather than public action. They provide investment discretion to such groups, and also the greater efficiency of decentralized administration of savings plans by the interested parties themselves. They build on the income floor provided by the Social Security System. They give the individual the independence and dignity that proceeds from the provision by him for his own future out of his own earnings during his lifetime.

These substantial tax benefits have been an effective inducement to the adoption of qualified plans -- some 30 million persons are now covered by such plans. This rapid growth has highlighted some major problems in the development of employee benefit plans -- coverage of employees, vesting, funding, the treatment of self-employed persons, and other matters. The major legislative proposals now under study by this Subcommittee (S.4; S.1179; S.1631 and S.1557) deal in varying degrees with these problems; all, however, provide minimum coverage, vesting, and funding requirements, as well as improved, uniform fiduciary responsibility and disclosure and reporting provisions. They differ completely on the matter of responsibility for the administration of these new provisions -- S.4 provides that they shall be administered by the Department of Labor, and S.1179 and S.1631 provide generally that they shall be administered by the Treasury Department. This is a most important issue which deserves the Subcommittee's closest attention.

Administration of New Requirements

The development of our existing, extensive private system over the past 30 years has been under the supervision, almost solely, of the Internal Revenue Service. Working with the barest and broadest form of statutory standards -- such as requirements that the amounts set aside be used "for the exclusive benefit of employees", and that contributions or benefits not discriminate in favor of persons who are officers, shareholders, or highly compensated employees -- the Service has been an effective overseer of a system that now covers, as previously stated, some 30 million persons in the United States. The Service has steadfastly developed and enforced such rules as requirements that plans be fully vested on termination, that vesting requirements be included in plans of smaller employers to insure that the prohibited non-discrimination in favor of highly-paid employees does not occur, and that at the minimum the employer fund each year current service liabilities plus the interest due on unfunded past service liabilities.

These are merely examples of literally hundreds of other detailed rules and requirements built by the Service only on the bare, broad statutory standards previously described. These rules have generally been accepted by employers and employees alike, and by the courts, as fair and reasonable, and as having contributed immensely to the development of the highly effective private pension system which exists in the United States today.

During the past 30 years, the Internal Revenue Service has intensively reviewed the organization or adoption of substantially every qualified plan in the U.S., and has monitored the subsequent operation of a high percentage of such plans. The Service has developed and applied extensive rules as to the necessary coverage of the plan to insure non-discriminatory coverage of the employee group; the Service has required inclusion of various provisions to protect the rights and benefits of lower-paid employees; and the Service has required inclusion of provisions to prevent diversion of the fund to any purpose other than the exclusive benefit of the employee group (so-called "prohibited transactions"). The practical necessity of an employer obtaining a "determination letter" from the Service approving the plan, so as to assure the favorable tax benefits, has given the Service the opportunity to enforce effectively its extensive network of regulations and rulings.

To accomplish these objectives, the Service over such 30-year period has developed a cadre of personnel highly skilled in the operation of private pension plans. These personnel are to a large extent decentralized into district offices. They are complemented by a group of experts, including qualified actuaries, in the National Office of the Service who deal with the most complex of the problems presented. These personnel are not only involved in the approval of plans when first created but also in the regular monitoring of plan operations under the Service's extensive audit and compliance programs.

The Service has collected extensive files and data on the operation of particular plans, and through its computer system Master File has developed a special Employees Plan Master File system which produces invaluable information in the tax audit of employee benefit plans.

The problems which exist in the existing private pension system -- lack of adequate vesting and funding,

BEST COPY AVAILABLE

absence of uniform fiduciary standards, and insufficient reporting and disclosure -- are attributable to the absence of sufficiently comprehensive statutory requirements for the development of the system, not to inadequate supervision by the Service. Tax men would generally agree that the treatment of employee benefit plans by the Service reflects a history of administration over the years in which the Service has been most aggressive in insuring that plans are operated for the exclusive benefit of employees, without discrimination in favor of higher-paid personnel. The Service has thereby guided the development and operation of employee benefit plans to an extraordinary degree. Now that legislative proposals are being considered to provide the necessary statutory requirements, it seems highly inadvisable to commit their administration to any agency other than that department -- the Internal Revenue Service -- which has the proven background, experience, personnel, and demonstrated fortitude to enforce them effectively.

I recommend strongly, based on my own experience, for the reasons just outlined, that administration of new requirements governing coverage, vesting and funding be committed solely to the Treasury Department. These particular requirements are matters with which the Internal Revenue Service has had extensive experience in the past and which are best enforced in the existing framework of grant or denial of the favorable tax treatment. (Improvement in the existing system of tax sanctions is necessary to insure that the burden of denial of these favorable benefits does not fall unduly on innocent employee-participants who are not responsible for the failure to satisfy statutory requirements, but this is a widely recognized and separate problem which can and should also be solved in connection with the new legislative action in this area.)

Otherwise, we will have an overlapping and duplicating system of administration which will be highly inefficient with unnecessary cost to both the Government and industry. It will still be essential for the Internal Revenue Service to pass on the qualification of plans and audit their operations to insure that the favorable tax benefits are justified. This discretion cannot be committed to another department of government; with one minor exception, it never has been so delegated in the history of the administration of our tax system, and division of responsibility in such administration would be extremely unwise.

Thus, the Service would necessarily continue to concern itself with coverage, vesting, and funding to insure the organization and operation of plans on a basis that does not discriminate in favor of higher-paid employees, and that is for the exclusive benefit of employees. The Labor Depar ment would attempt to enforce coverage, vesting, and funding requirements under different statutory provisions. Conflicts would surely develop. An employer satisfying Labor Department requirements would not readily accept Internal Revenue Service refusal to approve his plan, and he would not readily conform it to Service requirements, as is generally the practice today. The Labor Department, required to obtain a court order to enforce its administration on S.4, would urge the Service to extend the tax requirements without adequate statutory foundation to take advantage of the self-enforcing feature of the tax system. Two separate investigative staffs would be necessary, and employers and plan trustees would be subject to two sets of audits. The extent of potential duplication is already well documented in Summary of Proposals For Private Pension Plan Reform, prepared for this Subcommittee by the Staff of the Joint Committee on Internal Revenue Taxation (see pp. 12-14), and it need not be repeated here.

With respect to uniform fiduciary standards and improved reporting and disclosure requirements, I would recommend continuation of the dual administration that presently exists but with much closer integration of requirements and sanctions than any of the pending bills provide. The Labor Department has been administering the Welfare and Pension Plans Disclosure Act, which would be greatly strengthened by all of the pending bills, and some duplication in reporting and disclosure already exists as between Internal Revenue Service and Labor Department requirements. This seems wholly unnecessary and in all events should not be intensified.

The purpose of the prohibited transaction rules of the Internal Revenue Code and the fiduciary standards rules of the above-referenced Disclosure Act, as it would be amended, are essentially the same. They should be integrated into a single set of requirements, with lessons learned from the self-dealing and investment restriction provisions of the Tax Reform Act of 1969. These latter provisions serve essentially the same purposes for charitable organizations. Enforcement should be by penalty excise taxes similar to those provided under the Tax Reform Act provisions, improved with the benefit of hindsight as to the operation of those provisions over the last three years. The effectiveness of this system is now proven. Provisions in S.4 contemplating enforcement by class actions on behalf of employees should in all events be abandoned as highly inefficient and an unnecessary burden on our judicial system. See, for example, Eisen v. Carlisle and Jacquelin, ____F.2d____ (2d Cir. 1973), 41 Law Week 2586, in which the United States Court of Appeals for the Second Circuit is highly critical of class actions.

Similarly, the Internal Revenue Service requires extensive reporting, and disclosure to plan participants, for many of the same purposes that these are required, or to be required, under the Disclosure Act. The agencies could be required to develop a single set of reports, serving both their purposes, and to integrate their enforcement activities.

There simply is no merit in two separate systems for achieving essentially the same objectives in the development and operation of private pension plans. The existing Internal Revenue Service system must be continued. Private pension plans are adopted by employees, and benefits under existing plans are extended, in large measure because of the favorable tax advantages, and the Service must carefully monitor the plans to insure that the objectives of such benefits are being served. Efficiency of government would seem to require that additional statutory requirements, of the same nature as requirements already being imposed by the Internal Revenue Service and designed to serve the same general objectives, also be administered principally by the Service.

Limitations on Contributions or Benefits

The major tax advantages of qualified plans have already been described (pp. 1-2). The heart of these benefits is that a plan participant may defer tax on employer contributions which are funded for his benefit, and on the earnings on such contributions and on additional voluntary contributions which the employee may make under the plan, until he draws them down in cash or other property individually at a later time. This tax deferral is a substantial tax benefit, and the question arises whether the benefits to any individual participant under the qualified plan system should be subject to some over-all limit.

In the case of corporate employees, the only limitations on contributions or benefits for employees are -- (1) contributions or benefits must not discriminate in favor of higher paid employees, that is, in general, they must bear a uniform relationship to total compensation; (2) the employer may not deduct, in general, contributions in excess of certain limits (25% of current compensation of plan beneficiaries where both a pension and profit-sharing plan exist); and (3) in the case of Subchapter S "small business" corporations, shareholder-employees (owning more than 5% of the stock) must include in income amounts contributed on their behalf in excess of $2500 (or 10% of compensation, if less). Except for Subchapter S corporations, these rules do not in practice serve to limit contributions or benefits on behalf of individual highly paid employees to any substantial extent, and accordingly retirement annuities on behalf of corporate executives exceeding $100,000 per year are not uncommon.

In the case of self-employed persons, deductible contributions are presently limited to $2,500 per year (or 10% of earned income, if less)(which is also effectively the result for shareholder-employees of Subchapter S corporations, as set forth above). As a consequence of this limitation, self-employed persons have increasingly organized themselves into so-called "professional corporations" pursuant to special provisions of state laws permitting professional persons to incorporate under conditions whereby the professional responsibility of the lawyer, doctor, accountant or other member of a profession to the client or patient is preserved. This development has served to circumvent the limitations on contributions on behalf of self-employed persons which are contained in the tax law. See Summary of Proposals For Private Pension Plan Reform, supra, at p. 30.

The special limitations applicable to self-employed persons and shareholder-employees of Subchapter S corporations reflect the fact that the non-discrimination standard is not adequate to prevent excessive tax benefits to owner-employees under the qualified plan provisions. As previously indicated, the result of such limitations, however, is to deny to such persons the same benefits as may be realized by corporate employees, and accordingly the professional corporations have been organized. In recognition of this difference in treatment, the Administration bill proposes to increase the limit on deductible contributions for self-employed persons and shareholder-employees of Subchapter S corporations to $7,500 (or 15% of earned income, if less). It is apparent, however, that this will not eliminate the difference in treatment -- it will simply reduce its scope. The incentive for operation through professional corporations will continue to exist to obtain the greater tax benefits available to corporate employees.

The Administration pension bill (S.1631) also proposes that contributions to a money purchase pension plan in excess of 20% of current compensation of an employee for whom such contributions are made be includible currently in the employee's income. This is presumably designed to reach the case in which owners of small closely-held corporations, including professional corporations, seek to set aside a substantial portion of their compensation under a vested plan under conditions whereby there is not sufficient assurance that the plan will be non-discriminatory in its actual operation. Benefits under a defined benefit aggregate funded plan would not be affected by this limitation.

There is no basis for difference in treatment of corporate employees and self-employed persons under the qualified plan provisions. In each case, the plan must be non-discriminatory as to contributions or benefits as between high-paid and low-paid employees. Differences should not arise by reference to the form of business organization utilized, or the existence of ethical considerations which make operation in corporate form less appropriate. There should be complete equality of treatment in the application of the qualified plan provisions with respect to all earned income.

Equality of treatment may be achieved by removing all special limitations on the treatment of self-employed persons and shareholder-employees of Subchapter S corporations. It may also be achieved by extending the same limitations to all corporate plans. It may be partially achieved by extending such limitations to closely-held corporations, including professional corporations, but this merely moves the point of difference in treatment, or discrimination, to high-paid employees of closely-held corporations versus high-paid employees of publicly-held corporations, an equally unsatisfactory result.

The analysis points up the question whether limitations are appropriate to any extent, and if so, for what reason.

The essential public policy underlying the qualified plan provisions is to encourage personal saving, particularly for retirement, out of earned income under employer-sponsored plans which are not discriminatory. Employer-sponsorship of non-discriminatory plans assures reasonably wide coverage and efficient operation. It is not necessary to achieve these objectives, however, to permit tax deferral benefits to individual participants which are unduly large or permit the funding of post-retirement income beyond what is reasonably needed for maintaining the individual's standard of living after he ceases work. The qualified plan provisions are not designed to sponsor wealth accumulation beyond what is appropriate to maintain such a standard. The realization by some individuals of excessively large tax benefits through the qualified plan system undermines public confidence in the integrity and fairness of our income tax system.

Accordingly, while I recommend strongly that the Congress increase the limitations for self-employed persons and shareholder-employees of Subchapter S corporations, I recommend that a uniform limitation be applied to all qualified plans, including those of all corporations. In the case of defined benefit plans, the limitation should be in terms of benefits under the plan. In the case of money purchase pension plans or profit-sharing plans, the limitation should be somewhat higher than the Administration has recommended for self-employed plans and should contain provisions for automatic increase as inflation occurs.

As an example, benefits under a defined benefit pension plan might be limited to 2% for each year of service based on final average compensation, except that the amount of final average compensation to be taken into account for this purpose would not exceed $100,000. Thus, the annual retirement benefit for a participant with 25 years of service whose final average compensation was $100,000 or more would be limited to $50,000 (in terms of a single life annuity at normal retirement age). If the participant had 30 years service, the maximum would be $60,000. Additional benefits attributable to employee contributions would be permitted.

In the case of a money purchase pension plan, the maximum annual deductible employer contribution would be at the rate of 10% of compensation taking into account a maximum amount of compensation for this purpose of $100,000. In the case of a profit-sharing or stock bonus plan, such maximum would be at the rate of 10% on compensation up to $100,000 per year, or at higher rates up to 15% on lower maximum compensation amounts ($66,667 for 15% rate), so as to permit a maximum annual deductible employer contribution for any participant of $10,000 per year. Using a 6-1/2% earnings assumption, this would produce a single life annuity for a male retiring at age 65 for whom maximum contributions of $10,000 per year had been made for 25 years of about $50,000.

The $100,000 amount or other maximum compensation base should be automatically adjusted upward in steps of $10,000 each time the cost of living index rises an additional 10% over its base at the time such new limitations are adopted.

Those limits are reasonable enough to assure that sufficient incentive remains for voluntary adoption of qualified plans by employers. My experience tells me that officers of publicly-held corporations, owner-employees of closely-held corporations, and self-employed persons will be persuaded sufficiently even under these limits to adopt nondiscriminatory qualified pension and profit-sharing plans for themselves and their employees -- as much as they would do so under present law.

If such persons wish to defer a larger portion of their current compensation to post-retirement years, they will remain entirely free to do so under non-qualified plans, which do not provide the same substantial tax advantages and which may be adopted for individual employees, or higher-paid groups, without regard to any non-discrimination requirement. Deferred compensation contracts, phantom stock plans, restricted property arrangements, and non-qualified stock option plans provide a variety of means for the higher paid executive to defer receipt of his compensation, but without the extraordinary tax benefits which are granted to qualified plans.

Such an over-all limitation is more appropriate in light of the 50% maximum tax rate on earned income which became fully effective in 1972. High-bracket earners no longer require the same protection from high marginal rates under the progressive rate structure to achieve a reasonable degree of lifetime averaging of their compensation.

I would couple these limitations with a restriction generally applicable to all qualified plans preventing withdrawal of alienation of interests attributable to employer contributions until age 59-1/2. I would also require withdrawals to begin by age 70-1/2 on the same basis as is presently required for self-employed plans. These requirements are consistent with the public policy underlying the qualified plan provisions of encouraging retirement savings and help prevent undue tax advantage.

Conclusion

The development of a comprehensive statutory pattern of minimum requirements for tax-sponsored employee benefit plans is urgently needed. The administration of such provisions falls more appropriately within the expertise of the Internal Revenue Service because of its long experience in the area and because of the self-enforcing effects of a tax sanction system. In addition to the key issues of coverage, vesting, and funding, the Congress should liberalize the treatment of self-employed persons, but Congress should apply the same higher uniform limits to contributions or benefits for all qualified plan participants, including participants in all corporate plans.

* * *

LAW OFFICES
MURDOCH, LONGOBARDI, SCHWARTZ & WALSH
PROFESSIONAL ASSOCIATION
9TH FLOOR BANK OF DELAWARE BUILDING
300 DELAWARE AVENUE
WILMINGTON, DELAWARE 19899
(302) 658 8661

CONVERSE MURDOCH
JOSEPH J LONGOBARDI
MURRAY M SCHWARTZ
PETER J WALSH

ROBERT E SCHLUSSER
DANIEL A DURKIN
PETER J SHANLEY
HAROLD F MEASLEY, JR
ROBERT L THOMAS
JOHN A PARKINS, JR

MAIL P O BOX 949

The Honorable Gaylord Nelson
Chairman
Subcommittee on Private Pension Plans
Committee on Finance
United States Senate
Washington, D. C.

Re: Panel Discussion on Private Pension Plan Reform Held May 31, 1973

Dear Senator Nelson:

I was privileged to be one of the panelists before your Subcommittee on May 31, 1973. At the conclusion of that day's hearing, you stated that any panelist could submit written comments about papers and statements submitted by the other panelists. During the course of the hearing, I made several comments about certain statements of other panelists. I do not believe it is necessary for me to repeat all of those statements in this letter - it being sufficient that my oral comments were picked up in the transcript. However, I do want to put in writing a few comments. The name and page citations are respectively to the last name of the panelist and to the page in the committee print of the testimony to be received from our panel.

Halperin, Pages 1 and 5: Professor Halperin and other panelists have suggested that the purpose of the favorable tax treatment accorded qualified deferred compensation plans is to "encourage plans for lower paid individuals who are the ones unlikely to save on their own."

The basic rules in the tax law having to do with the requirement that plans not discriminate in favor of officers-shareholders, supervisors or highly compensated employees had their origin in the Revenue Act of 1942. The Ways and Means Committee[1] and Finance Committee[2] reports regarding the 1942 amendments with respect to deferred compensation plans indicate that the Congressional intent was to cause management to extend

[1] H.R. Rep. No. 2333, 77th Cong., 1st Sess. (1942) 1942-2 C.B. 372.

[2] S. Rep. No. 1631, 77th Cong., 2d Sess. (1942) 1942-2 C.B. 504.

BEST COPY AVAILABLE

the benefits of pension plans beyond the management group and into the rank and file groups. See 1942-2 C.B. 413, 450, 541 and 606.

In 1942 Congress did not find an absence of private pension plans and decide to encourage them by favoring some sort of a 'blue collar welfare plan" with a grudging concession that certain highly paid employees could be given coverage. That was not the situation. On the contrary, the situation was that the Congress believed that then existing pension plans were in some cases designed to benefit only management groups. Congress wanted the benefits, then being enjoyed by management groups, to be extended to others. It is important to note the distinction between a purpose to encourage deferred compensation plans for lower paid employees to the exclusion of higher paid employees versus a purpose to insure that benefits available to higher paid employees are made available on a comparable basis to lower paid employees.

If it is erroneously assumed that the first was the sole purpose of Congress, one can then construct a plausible argument for the proposition that anything given to the highly compensated employee is a concession not necessarily in keeping with Congressional purpose. If on the other hand it is the second purpose which Congress had in mind (i.e., to extend the benefits of plans for top management to the rank and file workers), it is inconsistent with that purpose to now legislate discrimination _against_ highly compensated employees.

Nolan, Page 3: Mr. Nolan in his statement opines: "* * * The provisions [regarding qualified deferred compensation plans] are designed to encourage personal saving to build on the Social Security system base so that the individual may fund a post-retirement income to maintain his existing general standard of living after he ceases to work. The qualified plan system is not designated to provide tax advantages for wealth accumulation beyond his post-retirement income need." Implicit in that statement is an assumption that the tax rules regarding qualified deferred compensation plans were meant to discriminate in favor of lower paid employees. There is nothing in legislative history which I can find which supports that proposition. The entire thrust of the law is in the other direction, i.e., to avoid discrimination in favor of highly compensated employees. Avoiding discrimination in favor of highly compensated employees does not require discrimination in favor of lower paid employees.

If one assumes that the purpose behind the qualified deferred compensation tax rules is to establish some sort of a blue collar post-retirement welfare plan, it is an easy step from that assumption to a recommendation that dollar limits be placed on pension benefits available under qualified plans. While there

BEST COPY AVAILABLE

can be presentable arguments made in favor of that proposition, I do not believe that they can be supported on the basis of legislative history. Except for seeing to compliance with the tax rules regarding reasonableness of compensation and absence of discrimination in favor of highly compensated employees in qualified plans, I do not believe that it is proper to use the tax laws to impose ceilings on compensation. There may be justification for imposing compensation limitations in the name of economic controls during certain limited periods, but I do not believe there is justification for imposition of nearly permanent limitations in the guise of raising revenue.

Halperin, Page 9: Professor Halperin states that there should be limitations imposed on the amount of pension benefits available for highly compensated executives because 50% of the working population is excluded from coverage under private retirement systems. In my opinion, this argument involves "beating the wrong dog". It seems to be based on the assumption that it is the employers who pay high salaries to top executives who are responsible for the exclusion of 50% of the working force from the private pension system. I know of no statistics which would bear out that assumption. My own observation has been that the executives who receive salaries of the magnitude mentioned by Professor Halperin are likely to be top executives of the giants of American industry which have for many years maintained good pension programs for all of their employees. I do not believe that imposing dollar limitations on the pensions available to the presidents of the five hundred largest corporations in America is going to do one bit of good for the workers who are presently not covered under private retirement systems. Those uncovered workers are likely to be employees in agricultural enterprises or the restaurant and hotel industry. Such enterprises and industries are not noted for paying executive compensation in the ranges mentioned by Professor Halperin.

In fact, imposition of rules requiring discrimination against higher paid employees and officers may seriously inhibit the spread of private pension plan coverage to those workers not now covered.

Halperin, Pages 10-11: Professor Halperin suggests that if there is a need for special limitations on deferred compensation plan benefits, the limitations should be dependent on the ownership interest of a participant. Professor Halperin states in part on this point: "* * * It may be noted that closely held businesses are the ones most likely to have pension plans which benefit only a few highly paid people." No authority is cited for that statement and it can be assumed that it is based on hypothesis.

If there are any statistics supporting the proposition, I submit that they are bound to be misleading. I can demonstrate the fallacy of any supporting statistics by examples. Assume that a large manufacturing corporation has 5,000 employees, each with an average annual pay of $10,000 or a total payroll of $50,000,000. Assume the same company has a president making $250,000 per year and other officers with aggregate compensation of $500,000 per year. Assume further that the corporation contributes 10% of each officer and employee's cash compensation towards a pension benefit. The result will be that of the amount going into the fund, $5,000,000 will be earmarked for the rank and file employees and $75,000 will be for the benefit of executives. Thus of the total company contribution, only 1.5% is earmarked for the benefit of officers and the balance for the benefit of the rank and file.

Compare that situation with a small closely held business in which the owner-employee is making $25,000 a year and he has one other employee (not an owner) to whom he is paying $10,000. Assume again that the small business contributes 10% of both employees' compensation towards a pension benefit. The result here is that of the total pension plan contribution, 71.4% is earmarked for the owner-employee and the balance for the non-owner-employee.

It would be bizarre to point to the mentioned statistics as justification for enactment of a law decreeing that the top executives in the first example (i.e., the manufacturing corporation with 5,000 rank and file employees) will not have any special limitations imposed with respect to their pension benefits, but that in the second example the owner-employee earning ten percent of the pay of the top executive in the first example will be subjected to special limitations solely because he is an owner-employee.

In my written statements as well as in my oral presentation to the Subcommittee, I stressed my belief that employees (including owner-employees) of small and closely held businesses are in particular need of liberal treatment with respect to deferred compensation plans. If there is to be any difference in treatment as between owner-employees of closely held businesses and executives of large, publicly held corporations, all arguments point towards more liberal treatment for the employees of closely held businesses.

Respectfully submitted,

Converse Murdoch

CM:jwl
cc: John Nolan, Esq.
Harold T. Schwartz, C.P.A.
Prof. Daniel Halperin
Paul Berger, Esq.
Carroll Savage, Esq.

CM:5/23/73

STATEMENT OF CONVERSE MURDOCH OF WILMINGTON, DELAWARE BEFORE THE PENSION SUBCOMMITTEE OF THE SENATE FINANCE COMMITTEE IN CONNECTION WITH HEARINGS ON PRIVATE PENSION LEGISLATION.

Pensions, Profit Sharing and Deferred Compensation

Need For A Fair System

May 31, 1973

Tax reform is the subject of much discussion at all levels - from neighborhood bars to the highest councils of government. Throughout these discussions, there is one recurring theme - there is a crying need to have a system which is fair - or just as important, appears to most of the citizens as fair.

Some persons in government honestly believe that tax cheating by rank and file taxpayers and preparation of false returns by some alleged tax experts are matters which can be traced to nothing more than a corrupt and criminal motive. They believe these "antisocial" tendencies can be stopped by threats of fines and imprisonment and by flattering speeches about the glory of our "voluntary" self-assessment system.

I believe the spread of tax "cheating" by the rank and file citizens must be recognized as due in large part to two things. First, the tax laws applicable to the ordinary taxpayer have become so complicated that he feels frustrated by them and is ready to fight back by doing what he can to avoid them. Second, the more the average taxpayer hears about tax reform, the more he is convinced that the system is unfair. He believes that people of wealth can afford the help of experts to do tax planning and he sees nothing immoral in engaging in a little do-it-yourself planning by claiming an extra dependent. The worker who files a tax return and omits a few hundred dollars his wife earned as a babysitter is not doing so because he is a dangerous criminal type. He's more apt to be an otherwise solid citizen who was recently outraged to hear about some wealthy person, all of whose income completely escaped tax because he could enjoy the luxury of investing his wealth in municipal bonds. I'm not condoning this sort of tax cheating. I'm merely saying that much of this sort of thing is not done by the persons we ordinarily think of as criminal types, and, accordingly, it's not going to be stopped by imposing more and more criminal penalties. Much of the petty tax cheating represents in the mind of the perpetrator nothing more than his protest against an unfair system.

• Unless something is done soon to make our income tax system both simpler and more fair, we are going to see more, not less, petty tax cheating. Accordingly, I believe any move in the field of tax legislation must be tested against a basic criteria, i.e., does the change lead to a fairer system. No longer can the sole test be: "Can we afford the loss of revenue which will follow from a particular legislative move?" Now the question must be, "Can we afford to risk the erosion of respect for our tax system which can be traced to the continuation of what many citizens believe (rightly or wrongly) to be unfair discriminations in our tax laws?"

The Tax Burdens on Earned Income

Throughout most of the history of our present federal income tax system, the recipients of earned (as opposed to unearned) income have been the least favored group of taxpayers. Not even the recently enacted 50% maximum federal income tax rate on earned income has done much to change that situation. The 50% maximum rate only applies to a tiny percentage of the millions of taxpayers who are dependent on earned income and who regularly give up a substantial part of their earned income through federal, state and local income, wage and social security taxes.

A person who starts with no inherited wealth and must depend on earned income faces a staggering burden of taxes, living expenses, life insurance premiums, education costs, etc. It is a very serious problem for him to lay aside from after-tax income sufficient savings to see him through periods when his earned income may suddenly be cut off by illness, death or retirement. If he also happens to be self-employed, the present tax laws put an additional hurdle in the way of his achieving even a modest level of financial security. The law severely limits his ability to establish a tax qualified deferred compensation plan. The maximum deductions under so-called Keogh plans are 10% of earned income but in no event more than $2,500 per year. There is no provision for a carry-over of unused deductions and there is no provision permitting a person with the prospect of only ten more earning years a greater deduction limit than the person who can look forward to forty more earning

CM:5/23/73

years. The law gives no recognition to the fact that for many persons dependent on earned income a meaningful plan of saving for retirement must be postponed until the relatively short period between completion of paying staggeringly high costs for education of children and the time of retirement.

The present law gives no recognition to the fact that retirement and consequent loss of earnings may not occur at a time planned for over many years. It may occur suddenly and prematurely through death or disability.

The Tax Burdens on Unearned Income

The taxpayer who can live on the income from inherited wealth faces few of the financial problems faced by the worker dependent on earned income. That much most people are willing to accept stoically - that's life. However, more and more people are becoming resentful about the fact that the tax laws seem designed to widen the financial gap between recipients of earned and unearned income. With even the most rudimentary tax and financial planning, a man receiving fifty thousand dollars a year of income from investments can minimize or entirely eliminate his income taxes. However, for the person receiving a like income from work as a sole proprietor, the prospects of meaningful reduction of taxes and the resulting increased ability to save for planned or unplanned retirement are remote.

The recipient of unearned income can create trusts for family members, he can purchase real estate producing high tax-free cash flow, he can shift his investments into municipal bonds - the list goes on and on. Not so with his neighbor who works to produce his income. Assuming after paying for maintenance of a home, education of children and insurance against an early death or disability that the worker has anything left to save, he is told that the maximum he can lay aside (and pay tax on later) is $2,500 per year.

The answer is not in taking away the tax "goodies" available to the person living on inherited wealth. Even if that were feasible, it would not make the system fair to the worker unless it enabled the latter to establish a meaningful retirement plan.

CM:5/23/73

Tax Reform and the Deferred Income Rules

Unlike most of the items usually included in the catalogue of tax preferences requiring review as part of tax reform, the advantages of tax qualified deferred compensation plans are pure and simple matters of timing income taxation. I'm not suggesting that timing of taxation is unimportant. However, it involves far different problems than those associated with most of the other areas under study. A dollar of municipal bond interest which escapes the income tax today, escapes it forever. Not so with a dollar of income deducted because it is saved for spending and taxation later.

A person living on unearned income has myriad opportunities to determine for himself the timing of the income taxation (if any) on his receipts. The only comparable and significant opportunity with respect to earned income is found in the qualified deferred compensation area.

Unlike many of the items now being reviewed as part of the tax reform studies, the deferred compensation items involve limited tax breaks for savings as opposed to expenditures. At a time when inflation and outflow of U. S. capital are looked on as serious problems, one would assume that a tax rule which encourages savings within this country would be viewed with favor.

Special Problems of the Self-Employed and Employees of Closely Held Businesses

All persons dependent on earned income are at a financial and tax disadvantage compared to those living on invested wealth. Within the group dependent on earned income, those who are self-employed or who work for small or closely held businesses are subjected to even further tax discrimination.

The self-employed person or the individual working for a small or closely held business faces special financial problems. His income is likely to stop if he or a principal owner of the business becomes disabled or dies. Usually any program of savings for planned or unplanned retirement involves an immediate and direct reduction of his spendable income - this is so whether or not the plan involves an income tax break.

CM: 5/23/73

In a large organization, it is feasible for the employer to establish non-qualified, unfunded, deferred compensation plans which provide meaningful financial security for the employees and owners. Such is not possible in a small organization. For example, in a law firm with a hundred partners, it is possible to establish an unfunded retirement plan. This is because each of one hundred partners now active can afford a small decrease in current compensation to provide retirement payments for from ten to twenty retired partners. Also, such a firm is in the nature of a continuing institution and thus can give good assurances that when the active partners reach retirement status, there will be money available to "pay them back" for their earlier contributions to the retirement pay of their predecessors.

Such a plan is unworkable in a two-lawyer firm. It's not fair or feasible for the older of two partners to ask the younger to sign a contract guaranteeing that when the older man retires, the younger one will bear the burden of meaningful retirement benefits.

Within the group consisting of the self-employed and those employed by small or closely held business, there is a further tax discrimination against the self-employed. Not only do they miss out on such tax goodies as stock options and king-size group life insurance coverage, but they are put under an unreasonably low ceiling when it comes to deductible contributions to retirement plans. Under existing law the limit is 10% of earnings, but in no event more than $2,500 per year. There is no consideration given to the plight of the person who for one reason or another can't save for retirement until comparatively late in his working life. There is no carry over of unused deductions. A sixty year old has the same limits imposed on him as does a thirty year old person. Likewise, a thirty year old person with nothing but earned income and no savings ability has the same limits as a thirty year old who has both earned and unearned income and who, accordingly, can start saving earlier.

Under existing law, the only clearly defined tax discrimination against closely held businesses (as contrasted with large or publicly-owned businesses) is found in Code § 1379. That is the section which in effect places Keogh limits on the pension and profit sharing plans of Sub-Chapter S corporations. In my view, this provision has discouraged small businesses from electing Sub-Chapter S status. It also involves an unwarranted further discrimination against closely held businesses with respect to which there is a special need to encourage meaningful pension and profit sharing plans. I urge the Subcommittee

CM:5/23/73

to recommend the repeal of the discriminatory features of § 1379.

Professional Corporations

In every jurisdiction in the United States (including the District of Columbia by virtue of action by Congress) licensed professional persons may now practice in a corporate form. This means that now professional persons have the opportunity to achieve the same tax and non-tax advantages which non-professionals have enjoyed for at least sixty years.

At one time the idea of practicing a profession in a corporate form seemed a shocking break with tradition. Now, however, the fact of professional incorporation has gained wide acceptance and is no longer looked on as an aberration.

I don't remember hearing anyone who ever expressed disgust with the idea of professional incorporation who pointed out even a single concrete case in which a patient or client was harmed by the fact that his lawyer or doctor incorporated. A competent and honest lawyer does not become incompetent or crooked by virtue of incorporating his practice. The converse is also true - an incompetent or crooked lawyer does not become less so by virtue of practicing as a sole proprietor or as a member of a partnership.

There are those who urge that the tax laws should be changed so as to put persons employed by professional corporations at a tax disadvantage compared with those employed by other corporations. They tend to overlook the fact that the adoption of professional incorporation statutes did not give away anything to professionals. The only effect of such laws was to give professionals in private practice an opportunity to use their own earned income in an attempt to provide for themselves the security which for years had been enjoyed by non-professionals and professionals employed by government, educational institutions, banks, exempt organizations, manufacturing corporations or any of a host of other corporate entities.

CM:5/23/73

Deductions for Employee Contributions Under Deferred Compensation Plans

The administration proposals for reform in the deferred compensation area (as embodied in S. 1 6 31) include a provision for limited deductions for voluntary contributions under retirement plans. I believe this is a move in the right direction, if for no other reason than to give a signal to the taxpayers that their government is interested in giving them a greater opportunity to save for their retirement years.

I assume that whatever dollar limits are imposed in this area will be based on revenue considerations. I hope that those who prepare estimates of revenue costs in connection with such proposals will not proceed on the assumption that all (or even a sizeable number) of taxpayers will rush to save and deduct up to the maximum limitations. Most taxpayers have a limited ability to increase their rate of savings, with or without a tax incentive. It is worth a substantial temporary loss of revenue to convince the average taxpayer that we are moving towards a fairer system.

It is a very rare person who sees an empty parking space and rushes out to buy a car to put in it. Likewise, most individual taxpayers are not inclined to rush out and spend or save a dollar just because they are told "it's deductible". If the ordinary taxpayer is inclined to spend or save a dollar for non-tax reasons, he may do it more readily if the move is coupled with a tax break. However, the presence or absence of a tax advantage is rarely the critical factor in the ordinary person's decision on a financial matter.

Conclusion

If for no other reason than moving towards fair tax treatment for persons dependent on earned income, there should be a considerable relaxing of the tax rules applicable in the deferred compensation area - and particularly for plans of the self-employed and those associated with small and closely held businesses.

CM:5/25/73

PAPER ACCOMPANYING STATEMENT OF CONVERSE MURDOCH OF WILMINGTON, DELAWARE BEFORE THE PENSION SUBCOMMITTEE OF THE SENATE FINANCE COMMITTEE IN CONNECTION WITH HEARINGS ON PRIVATE PENSION LEGISLATION

Pensions, Profit Sharing and Deferred Compensation

SUMMARY

May 31, 1973

Much of the creeping disrespect for our present tax system can be traced to the fact that many persons believe that the present system is unfair. Any proposal in connection with tax reform should be first tested in terms of (1) will it tend towards a fairer system and (2) will it appear to most persons to be a move towards a fairer system.

For years recipients of earned income have been the least favored group of income tax payers. A person dependent on earned income is at an obvious financial disadvantage versus a person with a like amount of unearned income. Unlike a person living on the income from wealth, a person dependent on earned income must make all of his plans on the assumption that his source of income is bound to disappear - certainly by virtue of death and, likely, by virtue of planned or unplanned retirement. These obvious disadvantages of earned income are further aggravated by our present income tax system.

The recipient of unearned income has available many ways to reduce or eliminate his income tax liabilities. The person dependent on earned income has no effective way to escape income tax liability. One of the very few tax "breaks" available to the recipient of earned income is in the area of qualified deferred compensation plans. Even this break involves nothing more than a forward averaging. Many of the tax breaks available to persons living on income from property involve complete and permanent escape from the income tax. This is not so in the case of qualified pension and profit sharing plans.

Within the group consisting of persons dependent on earned income, general financial problems and the income tax burden are particularly onerous for those who are self-employed or employed in small or closely held businesses. Persons employed by large organizations have a measure of financial security which comes from the sheer size of their employer - a person who is self-employed or who works in a small business

CM: 5/25/73

does not have even that measure of security. He must build his own security by savings out of income. This makes particularly unfair the provision of Code § 1379, which in effect imposes "Keogh limits" on deferred compensation plans of closely held corporations which elect Sub-Chapter S treatment.

All American jurisdictions have enacted laws permitting professionals in private practice to try for tax equality with all other taxpayers who depend on earned income and who are employed by corporations. Professional corporations are real. They have now spread to the point where they can no longer be considered revolutionary breaks with tradition or aberrations.

The adoption of a provision, such as that in S. 1631, permitting all recipients of earned income larger tax deductions for amounts saved for retirement would at least be a move in the right direction. If it accomplished nothing else, it would be a signal to the rank and file taxpayer that Congress is interested in moving towards an income tax system which is fair to the person living on earned income.

CM:5/25/73

REFORM OF THE PRESENT SYSTEM OF TAXING DEFERRED COMPENSATION

Most statements on tax reform seem to proceed from the basic premise that there is a crying need for a tax system which is fair - or, probably just as important, appears to most citizens to be fair. Once a sizeable bloc of taxpayers become convinced that a tax system is unfair, no amount of threats of imprisonment or flattering speeches about the grandeur of our so-called "voluntary" self-assessment system are going to keep the system free of evasion and save it from eventual disintegration. There has recently been a great deal of publicity about the growing problems caused by inept or crooked preparers of tax returns. I'm not prepared to make a brief for professional or amateur preparers of false tax returns. However, I do think legislators and administrators should start looking for the root causes of this situation.

During the recent Presidential election campaign, one of the candidates, in talking about tax reform, pointed out that the rank and file worker in his audience couldn't deduct the cost of the bologna sandwich in his lunch pail while the corporate executive could deduct the cost of his three-martini business lunch. I don't believe that a rank and file worker hearing that comment is going to attempt to deduct the cost of his bologna sandwich in his next tax return. However, he is likely to think about what he perceives to be an obvious unfairness in the system when he has to decide whether to report the baby-sitting fees his wife receives.

I believe Congress and the Administration should first test every proposal for tax reform in terms of: Will the adoption of the proposal lead to a fairer system and will it appear to the bulk of the taxpayers as being a move towards fairness?

More and more persons are suggesting that we achieve greater fairness in our system of taxing earned income by permitting more recipients of earned income to defer taxation of that part of their earned income which is saved for future expenditure. President Nixon's proposal, as embodied in H.R. 12272, is but one of these proposals. Others have gone even farther in their proposals. Regardless of which proposal is being considered, a frequent response from those who urge rejection of (or delay in considering) the proposal is: "We can't afford the resulting loss of revenue."

No responsible advocate of tax reform can ignore the revenue effects of any proposal. However, we are now reaching the point where one can ask in all seriousness: "Can we any longer afford the unfairness and complexities which are a part of our present system?"

In considering the need for reform in the deferred compensation area, we should consider the effects of the present system on recipients of earned income and secondly on various types of earned income.

The Present Burden on Recipients of Earned Income

For over fifty years persons dependent on earned income have been the least favored group. The exceptions to that generalization are few and far between.[1] Yet, I can't recall any person in or out of government who ever said with a straight face that earned income is dirty while unearned income is clean; that earned income is bad for the economy while unearned income is good; or that persons dependent on earned income are contributing less to the nation than those who enjoy unearned income. Very few tax technicians seem outraged by the ever-increasing income taxation of earned income while they observe the simultaneous introduction of more and more relief provisions

[1] E.g., there was a limited earned income credit available under the Revenue Acts of 1924, 1926 and 1928, it was eliminated in the 1932 Act, it was reenacted as part of the 1934 Act but was finally repealed by the 1943 Act when the high individual income tax rates necessitated by World War II began to take hold. The Tax Reform Act of 1969 introduced what is now a 50% maximum tax on earned income. However, that provision has no significance to the great bulk of recipients of earned income since it has an effect only after taxable income passes a level of $52,000 in the case of a married taxpayer filing jointly. For the year 1969, less than 1% of individual returns showing taxable income involved adjusted gross income from all sources of over $50,000.

BEST COPY AVAILABLE

for recipients of unearned income. To appreciate the unfairness of the system, one has only to compare the income tax and economic plight and prospects of two hypothetical individuals, aged thirty, whom we can identify as W (for worker) and H (for heir). Both are married and have children ages six and four.

The Tax Outlook For The Recipient of Earned Income

W has no hope of receiving any inherited wealth from any source. He has completed his education (paid for at top rates with no discounts or tax deductions) and has been licensed to practice aeronautical engineering. He has worked five years in the U. S. space program with his salary subjected to federal, state and local income and wage taxes.[2] W has decided to become an independent consultant and to operate as a sole proprietor. He anticipates that with any breaks, he will net $20,000 during his first year as a consultant and that his net income will increase on an average of $2,500 per year until his age 42, when he expects to peak out at $50,000 per year. W realizes that out of his fully taxed compensation, he must pay all of the costs of running a household. He also realizes that if he should die before his children are educated and self-supporting, his widow and children will be faced with a staggering financial problem which can only be met (and then only in part) through life insurance, the premiums on which must be paid for out of after-tax dollars. It suddenly comes to W that there is an even graver possibility facing him - suppose his income stops, not because he dies, but because he is disabled by a disease which requires expensive treatment. W finds that insurance against loss of income furnishes only limited benefits, is expensive and the costs of it are by and large not deductible in computing his taxable income.

[2] In considering the effects of taxation on recipients of earned income, it is often forgotten that recipients of earned income not only bear high federal income taxes but they must also pay ever-increasing federal social security taxes and state and local income and wage taxes. Persons dependent on earned income are also likely to be those who have a high percentage of their savings invested in their own residences with the result that local real estate taxes are to them a substantial burden. Attached is a schedule showing the combined federal, state and local income tax burden in certain localities selected at random.

BEST COPY AVAILABLE

CM:5/25/73

Since in the eyes of those who administer scholarship aid programs W has a "good" income, W must plan for the four to eight year period when he must spend from five to ten thousand dollars per year per child to pay for the ever-spiraling costs of higher education. Those costs are not going to be deductible for tax purposes.

For the same reasons, W can anticipate that any charges to him for medical expenses (insurance, doctors, hospitals, drugs, etc.) will be billed to him at top rates because he has a good income. Yet unless these expenses are abnormally bunched in such a way as to permit limited deductions under the medical expense deduction rules, he must pay for these expenses out of after-tax dollars.

W's formal education, which put him in a position to earn his so-called "good" income, in all likelihood cost W or his father anywhere from forty to fifty thousand dollars - possibly much more. Despite the fact that as every second ticks by, W's working life is shortened, W is not given any deductions for depreciation or depletion in connection with the costs of getting the training necessary to earn his "good" income.

If we assume the present level of personal exemptions and tax rates and that W will claim the maximum standard deduction, W can look forward to the following adjusted gross income, federal income taxes, social security taxes and after-federal tax income:

Age	Adj. Gross Income	Fed. Inc. and S.S. Taxes	After Federal Tax Income
30	$20,000	$3,874	$16,126
35	32,500	7,784	24,716
40	45,000	13,004	31,996
45	50,000	15,424	34,576
50	50,000	15,424	34,576

CM:5/25/73

Between ages 30 and 50, W's adjusted gross income has increased by 150%. During the same interval, the costs for educating his children have undoubtedly risen even more dramatically, but his income after federal income taxes has risen by only 133%. Ever-spiraling inflation has further eroded his after-tax income. While H's adjusted gross income at age 45 is two and one-half times his income at age 30, his federal taxes have risen nearly four fold.

It is from his after-tax income that W must feed and house his family, pay for education of his children, pay life insurance premiums, pay health insurance premiums and start laying aside funds to give him some hope of living on other than social security or welfare payments when he voluntarily or involuntarily quits working. W is losing ground on the treadmill of economic life.

Under present law so long as he remains self-employed, the only income tax break available to him in meeting the problem of laying aside funds for his planned or unplanned retirement is found in the almost parsimonious provisions relating to so-called "Keogh plans". In essence, these provisions permit a deduction of 10% of gross income but with a maximum of $2,500 per year. The fact that these provisions are in the Internal Revenue Code does not mean that government has arranged things so that W will be able to save $2,500 per year starting at age 30. The presence of these provisions means only that if W is able to save ten percent of his income every year after taking care of all of the other financial demands associated with raising a family, he can deduct up to a maximum of $2,500 per year.

The stark reality of life is that most persons in W's situation are not able to "save" even the limited amounts contemplated under Keogh plans until they approach their few peak earning years and then usually only after their children have completed their formal education. Yet, the tax law permits no "catch up" in the form of deductions in excess of $2,500 in recognition of the fact that for years W could not, or did not, save the maximum amounts. The tax law makes no allowance for the fact that when he first became able to start saving for retirement, his effective tax rates were peaking while his remaining years for saving were rapidly diminishing .

CM: 5/25/73

The Tax Outlook For The Recipient of Inherited Wealth

Let's look at the tax and financial prospects of H, the thirty year old person who has just received an after-tax bequest of one million dollars. It should be noted that in all likelihood H's million dollar bequest is the net of a larger bequest which has been reduced as it passed through the death tax mill. Nonetheless, the death taxes were paid with money not produced by H. He can still count himself fortunate to have been "born right" despite his protestations about the confiscatory death tax system.

If H does nothing more than invest his entire million dollar inheritance in fully taxable bank certificates of deposit yielding 5%, he and his family can look forward to a very comfortable existence with an after federal tax spendable income of approximately $35,440 per year as long as H lives.[3] H is not troubled by the spectre of a disabling illness - his income will continue whether or not he works. Accordingly, H feels no compulsion to save from his taxable income to provide for the day when he can't work.

W must have a tax domicile where he works. Often this means being required to help feed the seemingly insatiable appetite of state and local taxing authorities, who are in turn faced with the ever-spiraling costs of supplying public services in urban and suburban areas. H, on the other hand, can pick his tax domicile which can be one with a minimum of state or local taxes. In this regard, H need only worry about telling someone where to mail the checks.

Even the prospect of death does not pose a serious income tax problem for H. With only the bare minimum of pre-death estate planning (viz., creating a marital deduction trust for Mrs. H), H can assure that his widow and children will have an investment base of approximately $873,500 during Mrs. H's widowhood. After the deaths of both Mr. and Mrs. H, their children will each receive inheritances of $353,500. With just slightly more pre-death estate planning, the after-tax inheritances of Mrs. H and their children can be raised dramatically. With such an assured future for his family, H can forgo the payment of large life insurance premiums out of after-tax earnings.

[3] The same as W's after federal taxes income starting at age 45 but adjusted upward to reflect the fact that H pays no federal social security taxes.

CM:5/25/73

With an inheritance of one million dollars, H can easily afford to secure the help of advisers who can further brighten his tax and financial picture.

H can put $100,000 into each of two trusts for the benefit of his children. Immediately, H removes $10,000 per year of income taxed at his marginal rates of roughly 46% and puts it into the hands of his children where it bears an effective federal income tax of 9% - an annual tax savings of roughly $3,700.[4] More to the point - H can go to sleep each night knowing that no matter what happens to him, his children are assured of an education and probably a secure start in a business or professional career.

Next H can sell $200,000 of the certificates of deposit and purchase tax free municipal bonds yielding 5% or more. This produces a further annual tax savings of $3,900.

H can take another $100,000 and purchase an equity in an apartment house producing a tax free annual cash flow of $5,000 - with an additional annual tax savings of $1,640.

With very little effort and no loss of income to the family unit, H has reduced the family's annual federal income tax bill by $9,240.

One could go on and on with further refinements in H's financial planning, each producing further tax savings. The point is that none of those mentioned are available to W who is dependent on his own personal efforts to support himself and his family.

Even if it were politically feasible to eliminate each of the recited tax advantages enjoyed by H, we would still not have gotten appreciably closer to a fair tax system unless somehow the extra revenue secured from H and his family could all be earmarked to give immediate tax rélief to W. That seems most unlikely.

[4] This move will involve a federal gift tax of approximately $5,580. However, this gift tax "cost" is more than recovered by two years of income tax savings. More to the point, by paying $5,580 of gift tax, he has eliminated $65,786 of eventual federal estate taxes otherwise payable on the gift and the gift tax.

CM:5/25/73

Accordingly, we are faced with the question, should tax reform aimed at producing fairness as between those working for earned income and those enjoying unearned income include some income tax relief for persons dependent on earned income. I respectfully submit that the answer to that question should be affirmative.

The Qualified Deferred Compensation Rules and Their Relation to Reform in Taxing Earned Income

The so-called tax breaks enjoyed by persons participating in qualified pension and profit sharing plans are vastly different from most of the other items which are usually mentioned as loopholes or tax subsidies.

Any income which is not currently subjected to income taxation because it is saved as part of a qualified deferred compensation plan is destined to eventually be picked up as gross income by the recipient at the time the savings are drawn down. By virtue of a provision enacted as a part of the Tax Reform Act of 1969, even the limited slippage in taxation caused by treating lump sum distributions as long term capital gains has been largely eliminated. It is true that one of the selling points for establishment of a deferred compensation plan is that it enables the participant to move marginal income from high rates applicable during active working years to lower income tax rates likely to be applicable during post-retirement periods. However, no one seems shocked that for many years and for the foreseeable future the same effect has been (and will be) achieved by persons living on unearned income. An investor can decide to realize capital gains in years of low income or losses; he can sell on the installment basis and spread his gain into low rate years; he can invest in stocks paying little or no dividends and select the years to "cash in" by selling his appreciated securities; he can bunch deductions into years when he chooses to realize gains - the list goes on and on. Yet, even a severely limited spreading of income by a person dependent on earned income is looked on with disfavor by some.

A dollar of tax free municipal bond interest escapes the federal income tax forever. A dollar of the excluded half of long term capital gain is not taxed when realized or at any future time. Every dollar that goes into a qualified deferred compensation plan is destined to someday be a part of some person's gross income. True, personal exemptions and deductions

CM:5/25/73

may provide a tax umbrella for some part of the pay out. However, the same exemptions and deductions are available with respect to all other gross income (earned and unearned) of the same magnitude.

The deductions and exemptions associated with qualified deferred compensation plans are unique in another important respect. They are practically the only ones associated with taxpayer savings rather than with expenditures. At a time when many persons in and out of government seem concerned with the need to slow down inflation and to encourage capital accumulation in the United States, it seems anomalous to talk about discouraging the spread of plans designed to encourage saving while giving tax breaks to plans involving spending.

The Special Problems of The Self-Employed and Employees of Closely Held Businesses

At the present time self-employed persons are singled out for particularly restrictive rules in connection with their rights to establish qualified deferred compensation plans. Probably the most unfair of these restrictive rules is that which limits the individuals deductible contribution to $2,500 or 10% of income, whichever is the lesser. This imposes a particularly unfair hardship on the self-employed individual who for much of his working life was unable to contribute to a retirement plan and who is placed under this unreasonably low ceiling during the relatively few years when he has completed paying for his children's education and is experiencing peak earnings.

The individual who is employed by a small closely held business corporation is also faced with special problems in establishing and continuing a qualified deferred compensation plan. Generally, the tax law does not discriminate against deferred compensation plans established by small businesses. The one glaring exception to that generalization is found in Code § 1379 which in effect places Keogh limitations on the pension and profit sharing plans of Sub-Chapter S corporations I respectfully urge that this Subcommittee propose the repeal of § 1379.

CM:5 /25/73

It has been suggested that the rules in the deferred compensation area should be made more stringent for small and closely held businesses than for large or publicly held corporations. Various reasons are advanced in support of this proposal. I believe that a fair analysis of the situation will show that the employees of small and closely held businesses do not deserve worse tax treatment than their fellow taxpayers who work for big corporations, governments or exempt organizations. To the contrary, those who are employed in small businesses have a greater need for favorable tax treatment for their deferred compensation plans.

In the case of an employee of a closely held business who also is the owner, any increase in amounts going into a deferred compensation plan represents a direct reduction of funds otherwise available for current payment to the owner in the form of cash compensation or dividends. Hence, there is a practical limitation on amounts which the owner can afford to put into his retirement savings plan. He must still hold out of the plan amounts needed to support him and his family and to take care of the capital needs of the business. On the other hand, an increase in the deferred compensation benefits to executives of large, publicly-held corporations, to government employees or to college professors is not usually coupled with a direct reduction of what would otherwise be current cash income.

Some people believe that in closely held businesses the only limit on the owner's ability to salt away money in a deferred compensation plan is the limit of his own greed, whereas in a corporation with non-management, public shareholders, it is the latter who put limits on deferred compensation plan contributions. It has been my observation that neither of those assumptions is valid. I have yet to see any minority stockholder proposals to limit deferred compensation plans for publicly owned companies which have gotten off the ground. I am not suggesting that deferred compensation plans of the large, publicly-held corporations which I have seen are too generous. I'm only stating that I have seen nothing to indicate that there is more need for tax law imposed limitations for plans of small employers than there is for plans of large employers.

Another stated reason for suggesting tougher rules for small businesses is that their owners are more inclined to "do in" the rank and file employees in matters of eligibility, vesting and funding. My observations do not support that charge. To the contrary, my experience has been that deferred compensation plans for small business are likely to have more generous eligibility, vesting and funding provisions than those of large businesses, governments and exempt organizations. This may be due in part to the fact that IRS agents seem to take a harder line in qualifying plans of small businesses. Regardless of the reason, the fact is that small business plans I have seen tend towards the generous side in matters of eligibility, vesting and funding for the rank and file employees.

-If there are to be any distinctions between small and large businesses, it would seem that fairness dictates more lenient rules for the small and closely held business.

In a closely held business, the death or disability of a principal employee (particularly in a personal service business) often marks the end of the business. Accordingly, there is a greater need for a plan which is funded quickly. In a large organization, the death or disability of even a top executive may temporarily slow down the operation but it seldom kills it.

In a large organization, payments of compensation after the retirement (due to disability or age) or death of an employee can be handled in whole or in part under a non-qualified, unfunded deferred compensation plan. That is not a workable alternative in a small organization. For example, in a law firm with one hundred partners, it is possible to provide in the partnership agreement that the younger, active partners will continue to pay something to the retired older partners. This sort of unfunded self-insured pension plan can work because at any one time one hundred active partners will each be taking a small drop in take home pay to support ten to twenty retired partners. However, in a two-lawyer firm, it is not fair or feasible for the older partner to ask the younger partner to enter into an agreement obligating the younger person to make meaningful retirement payments to the older man. In such a situation, there is only one form of tax deferred compensation plan which will work,viz., one that permits each partner during his working life to lay aside funds which he will spend (and on which he will pay income taxes) during his retirement period.

CM: 5/25/73

The employee of a closely held business without publicly traded stock has no real opportunity to receive meaningful compensation under stock option or restricted stock plans. His coverage under group insurance programs is usually miniscule compared with that which can be acquired under an insurance program adopted by the large publicly-held corporations.

Professional Corporations

At the present time all fifty states (and Congress for the District of Columbia) have enacted statutes permitting persons engaged in the practice of a profession to conduct such practices through professional corporations. There is no question about the fact that one of the main reasons for the enactment of such laws was a desire on the part of legislators to afford professional persons an opportunity to achieve some measure of tax equity for themselves. It is important to note that such laws do not give public funds to professionals. They merely give a professional person the opportunity to use some of his own income in a way which lets him approach tax parity with his fellow professionals who work for public corporations, the government or exempt organizations. The fact that one of the reasons for forming a professional corporation can be traced to an unfairness in the tax law does not mean that a professional corporation is any less real than any other corporation.

Aside from the fact that professional employees of professional corporations are generally made personally liable for professional acts, professional corporations have all of the attributes of any other corporation. Even the mentioned difference is more theoretical than real. If a plumber who practices his skills through a controlled corporation botches a job, he can be held personally liable for his negligence just as is true of a surgeon who practices through a professional corporation.

When it first occurred, the practice of one of the so-called "learned" professions through a corporation represented a break with long tradition. However, today the concept of professional incorporation has spread to such an extent that a professional corporation is no longer an oddity. More important, I have yet to hear of a single instance in which a client or patient received bad advice or treatment which could be traced to the fact that his lawyer or doctor was incorporated.

CM:5/25/73

A competent and honest lawyer does not become incompetent or crooked by virtue of incorporation.

Despite all of this, there are somc persons who still agonize about the trend towards incorporation of professionals. I don't recall hearing any person who opposed the idea of professional incorporation who could point to a single concrete instance in which the fact of incorporation led to a bad result for the professional or his clients.

The gist of the complaints against the spread of professional incorporation seems to run like this: 1. A professional who incorporates his practice gets a better tax break than one who doesn't. 2. One who doesn't incorporate has little chance of gaining tax equality with corporate employees. 3. Ergo, all professionals who incorporate should be thrown back into the tax situation of the self-employed. This is an almost classic example of a dog in the manger attitude.

No one has ever satisfactorily explained to me why as an attorney in private practice I am entitled to less tax equity than my fellow attorneys who work for manufacturing corporations, governments or universities.

With every United States jurisdiction now permitting professional incorporation, there is no professional person in the country who is by law suffering tax discrimination in relation to his fellow professionals. Any remaining discrimination in this area is the result of the voluntary act of the affected professional and not a result of any prohibitions imposed by Congress or the state legislatures.

This argument often brings the response from the unincorporated professional: "Why should I be forced to incorporate to get tax equity?" That response furnishes an excellent argument for the proposition that the tax benefits for the deferred compensation plans of the self-employed should be raised to the level of those available for corporate employees. However, that response does not support the argument that incorporated professionals' benefit plans should be dragged down to the level of present discriminatory rules applicable to the self-employed.

It's surprising to me that it is usually lawyers (not other professionals) who ask the question as to why one should be forced to incorporate to gain equity. Because of their training, one would assume lawyers, of all people, would be less inclined to think of incorporation as an abhorrent act.

CM:5/25/73

They are usually in a position to do much of the work of incorporation for themselves so they can't even complain about the legal fee^s^ involved.

If we assume that one of the aims of any tax reform program is to approach tax equity, it seems to me to be wrong to seriously consider imposing special discriminatory rules on professional corporations - or on any small business.

Deduction For Employee Contributions Under Deferred Compensation Plans

From time to time commentators have suggested that the present tax rules in the deferred compensation area are unfair to taxpayers who voluntarily or involuntarily contribute under retirement plans. A good example of such a situation is the U. S. Civil Service Retirement System. I seriously question whether under modern concepts, the civil servant's so-called "contribution" is in legal or practical contemplation a true employee contribution. I don't believe it is possible for any one covered under the system to elect not to make the contribution. I believe it would be more realistic to treat this contribution as what it really is, i.e., a reduction in pay to finance a retirement system. I believe that the taxation of this particular form of employee contribution could be handled in either of two ways, by changing the law regarding civil service pay and treating what is now called an employee contribution as a reduction in pay or by amending the tax laws to permit a deduction for such "contributions". Either way, the result will be much the same for the employee. However, if the relief comes through the amendment to the tax laws, members of Congress may be hard pressed for an explanation if they fail to give like relief to persons who are not employees of the federal government.

The administration proposals for tax reform in the deferred compensation area (as embodied in S. 1631) include provision for limited deduction for taxpayer contributions under retirement plans. I think this proposal has much to recommend it. I have doubts that many taxpayers will have the savings abilities or inclination to use the provisions, but despite that reservation, I think the idea of giving more and more taxpayers the opportunity to achieve tax equality with their neighbors is all to the good.

CM:5/25/73

I realize that revenue considerations are uppermost in the minds of the tax technicians who propose various limits on deductions for contributions under retirement plans. I don't know how those responsible come up with revenue loss estimates based on various assumed levels of limitations on deductions under qualified retirement systems. I hope it isn't done by assuming that all (or even a large percentage) of taxpayers will contribute the maximum deductible amount. Most taxpayers have trouble saving money whether or not there is a tax incentive associated with the savings.

Much will have been accomplished in terms of convincing the public of the fairness of the system if Congress offers more people an opportunity to increase their savings for retirement. If for no other reason than that, I urge a deduction for contributions under retirement plans for all recipients of earned income who are not adequately provided for under employer sponsored retirement plans.

Conclusion

I do not urge that there be legislation aimed at further limiting deferred compensation plans for large employers. I do urge that in considering the tax rules in this area every effort should be made to raise the benefits available to employees of closely held businesses towards those now available for employees of large employers (taxable, governmental or tax exempt). To do otherwise would be contrary to what I see as one of the principal aims of tax reform - to strive towards a fair and equitable tax system.

For years the person dependent on earned income - and particularly the self-employed and those employed by closely held businesses - have been the least favored of all taxpayers. For Congress to legislate further discrimination against them would be a step backward, not a step in the direction of tax reform.

BEST COPY AVAILABLE

Combined Federal Income (Including Self-Employment) Tax and State and Local Income Taxes at Various Assumed Levels of Adjusted Gross Income in Randomly Selected Locales.

(Note: For ease of calculation, it is assumed that other income is offset by deductions and exemptions other than the deductible state and local income taxes. Accordingly, the latter are federal tax effected. It is also assumed that the taxpayer is filing a joint return).

Adj. Gross Income (in thousands)	Atlanta, Ga.	Cleveland, Ohio	Chicago, Ill.	Minneapolis, Minn.	Montgomery Co., Md.	Portland, Oregon	Richmond, Va.	San Francisco, Calif.	Wilmington, Del.
10	2885	2753	2815	3271	3135	3158	2909	2768	3139
20	4645	4740	4740	5968	5395	5597	5050	4884	5543
30	10049	9293	9202	11004	10062	10385	9662	9677	10354
50	19594	18799	18549	21277	19754	20269	19252	19784	20544
75	32844	31862	31362	35652	33192	34019	32471	33659	34982
100	46094	44924	44174	50027	46629	47769	45689	47534	49494

ARNOLD & PORTER

1229 NINETEENTH STREET, N. W.
WASHINGTON, D. C. 20036

TELEPHONE (202) 872-6700
CABLE "ARFOPO"
TELEX 89-2733

THURMAN ARNOLD (1891-1969)
PAUL A PORTER
MILTON V FREEMAN
NORMAN DIAMOND
WILLIAM L MCGOVERN
CAROLYN E AGGER
G DUANE VIETH
REED MILLER
ABE KRASH
WILLIAM D ROGERS
S HOWELL HILL
JULIUS M GREISMAN
EDGAR H BRENNER
DENNIS G LYONS
STUART J LAND
ROBERT E HERZSTEIN
JAMES R MCALEE
MITCHELL ROGOVIN
WALTER J. ROCKLER
CLIFFORD L ALEXANDER, JR
WERNER KRONSTEIN
PAUL S. BERGER
JAMES F. FITZPATRICK
MELVIN C. GARBOW
BRUCE L MONTGOMERY
JOHN D. HAWKE, JR
MURRAY H. BRING
DANIEL A REZNECK
GERALD H. STERN
MELVIN SPAETH
DAVID R. RENTOFF
DAVID H LLOYD
RICHARD S. EWING
PETER K BLEAKLEY
ALEXANDER E. BENNETT
RICHARD J WERTHEIMER
HARRY HUGE
JACK L. LIPSON

JEROME I CHAPMAN
MYRON P CURZAN
JAMES A. DOBKIN
STEPHEN L. HESTER
MICHAEL N. SOHN
BROOKSLEY LANDAU
JEFFREY D. BAUMAN
PATRICK F. J. MACRORY
ANDREW S. KRULWICH
IRVIN B. NATHAN
ROBERT H WINTER
NANCY K. MINTZ
NORTON F. TENNILLE, JR.
ROBERT D. ROSENBAUM
J. BRADWAY BUTLER
FREDERICK B. ABRAMSON
RICHARD L. HUBBARD
KENNETH A. LETZLER
DOUGLAS G. ROBINSON
STEPHEN M. SACKS
THOMAS J. MCGREW
MARK J. SPOONER
G PHILIP NOWAK
DAVID BONDERMAN
STEVEN P. LOCKMAN
JEFFREY A. BURT
CARY H. SHERMAN
JUDITH N STEIN
SIMON LAZARUS III
IRVING B. YOSKOWITZ
RONALD G. NATHAN
GARY G. GERLACH
LANNY J DAVIS

PAUL S RYERSON
THOMAS D. NURMI
JOHN H. FEDDERS

MARTIN RIGER
OF COUNSEL

The Honorable Gaylord Nelson
Chairman, Subcommittee on
  Private Pension Plans
United States Senate
Washington, D. C. 20510

Dear Senator Nelson:

In accordance with your request of June 20, 1973, enclosed is a memorandum we have prepared on the constitutionality of granting prior service credit for vesting. As you will see, we have concluded that vested benefit credits may validly be given to workers for all service performed prior to the effective date of any new law establishing mandatory vesting requirements.

Please let us know if we can be of further assistance.

Sincerely,

Paul S. Berger

Enclosure

BEST COPY AVAILABLE

ARNOLD & PORTER

July 10, 1973

MEMORANDUM

RE: Constitutionality of Granting Prior Service Credit for Vesting

We have been asked to prepare a memorandum on the constitutionality of granting prior service credit for vesting under the private pension bill which will be considered by the Senate Finance Committee in executive session on July 11, 12 and 13. It is the conclusion of this memorandum that a long line of Supreme Court cases upholds the power of Congress under the Commerce clause to impair or even destroy pre-existing contracts, and that, therefore, the proposed vesting provisions are constitutional.

I. Pending Proposals for Private Pension Plan Reforms -- A Discussion of the Relevant Provisions

As a threshold matter we interpret the relevant provisions of at least one bill pending before the

Senate.[1] S. 4 provides in § 201-202 for deferred graded vesting for all employees who have been in covered service under a registered private pension plan for a period of eight years, no more than three of which need be continuous. The bill provides for additional vesting on a yearly basis until the fifteenth year of service, at which time the employee will have achieved full vesting. Moreover, S. 4 allows an employee to include as years of covered service time spent under a plan prior to the effective date of the legislation. Thus, an employee who had worked for fifteen years under a plan prior to the effective date of the legislation (the effective date, as provided in the statute, will be three years from the date of enactment unless the Secretary provides an additional five-year deferral; such a deferral would be justified if the application of the normal effective date would cause "serious economic injury,"

[1] This is for the purposes of analysis only. Senator Bentsen in S. 1179 has proposed retroactive credit for employees 45 and older, a provision similar to one contained in the predecessor to S. 4. The administration bill, S. 1631, provides for no retroactive credit.

as defined by the Act § 216) would acquire full deferred rights without a further day's work. On the other hand, however, a fifteen-year veteran who left the company a day before the statute's effective date would have no vested rights beyond what the plan itself might have included. S. Rep. No. 127, 93d Cong., 1st Sess. 20 (1973).

Constitutional objections might focus on the Committee's own language, found on page 20 of the report:

> "This Committee has endorsed a major innovation which provides for retrospective credit in accrued benefits attributable to service rendered prior to the effective date of the vesting provisions." (Emphasis supplied.)

It might be argued that giving such retrospective[1] credit violates the following constitutional provisions -- Article 1, Section 10 which forbids a state from impairing the obligations of contract, and the Fifth Amendment to the Constitution which forbids the

[1] This memorandum uses "retrospective" and "retroactive" interchangeably throughout.

taking of private property for public uses without due process and just compensation.

II. This Memorandum's Alternative Theories

Such constitutional objections may be overcome in two quite different ways. First, this memorandum will show that, "it is the operation of the statute which determines its character." Winfree v. N. Pacific Railway Co., 227 U.S. 296 (1913). Whatever language the Committee may have used, this statute, including the vesting provision questioned here, operates prospectively. Second, this memorandum will demonstrate that even if the statute is retrospective in operation, "a statute is not void merely because it is retrospective." Curtis v. Whitney, 13 Wall 68 (1871). In the exercise of its commerce power, Congress may render pre-existing contracts either "unenforceable" or may impair their value. Louisville and Nashville R.R. v. Mottley, 219 U.S. 467 (1911).

III. The Statute is Prospective in Operation

The argument that the statute is prospective in operation would proceed as follows:

a. The statute covers only active employees who retire subsequent to the effective date of the Act; it thus tampers not at all with the previously closed issues of benefits for former employees.

b. The statute does not require that any money be spent immediately in direct consequence of a past transaction. All it does is to require employers to use a different standard in calculating future retirement benefits from what they used in the past. In McShain v. D.C., 205 F.2d 882, 884 (D.C. Cir.) cert. denied 346 U.S. 900 (1953), for example, a contractor had made construction contracts with the District prior to the passage of a sales tax. He argued that it would be a retroactive -- *i.e.*, unconstitutional -- application of the new tax to apply it to purchases made under the pre-existing contracts. In rejecting this theory, the courts said that a

> ". . . statute is not necessarily objectionable as being retroactive if antecedent facts affect its operation."

And in Brewing Corporation of America v. Cleveland Trust Co., 185 F.2d 482 (6th Cir. 1950) the court rejected a similar claim of unconstitutionality where the challenged statute -- a Price Control Act -- was passed after the making of the contract, but before delivery of the item in question. "Federal regulation of future action based upon rights previously acquired by the person regulated is not prohibited by the Constitution." Id. at 484. Although the defendant had contracted to sell his product at one price, he was forced to accept a lower price after the Price Control Act rolled back prices to an earlier date.

c. It is worth noting at this point that courts will construe a statute as operating prospectively unless the legislature, by clear intent, commands a retrospective application. Thus, when Congress changed the law relating to wrongful death actions against railroads, the Court failed to find such Congressional intent and refused to apply the new legislation to accidents preceding the date of enactment. Winfree v. N. Pacific, supra. As we have seen, there is a clear intent in S. 4 that antecedent facts be taken into account in determining future benefits. The question is whether the vesting provision is more like changing the rules before a contract is completely fulfilled or changing the rules before the action for wrongful death occurs. It might be argued that the former is closer to S. 4 than the latter: these contracts are ongoing like the ones in the circuit court cases discussed in (b); only if the vesting provision applied to workers whose affiliation with the company had already terminated would the wrongful death case be in point.

IV. Judicial Hostility to Retroactive Legislation

A retroactive statute is one which "takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past." Society for Propagation of the Gospel v. Wheeler, Fed. Cas. No. 13,156, 2 Gall. 105, 139; see also 73 Harv. L. Rev. 692 (1960). Given the fact that the legislation would require employers to pay retirement benefits to workers who might not otherwise have received them, based on work done before the enactment of the statute, it is at least possible that the court might consider S. 4 a retroactive statute. For this reason we proceed now to consider the legal issues involved in such statutes.

The commentators report that courts have generally been hostile to retrospective legislation on grounds both of policy and of constitutional interpretation. As to policy, the objections are basically three: a fear that retrospective legislation might be used to punish specific, closed and thus easily identifiable transactions; a sense that people should be able to plan and conclude their legal affairs with some degree of certainty and predictability; and an underlying notion that retroactive legislation flies in the face of the ancient common law distinction which allowed courts retrospective authority but denied it to legislatures.[1/] Harv. L. Rev., supra. These theories are incorporated into the constitution by Article 1, Section 10:

[1/] Some of these policy considerations would clearly seem lacking here. Were this an attempt to single out certain industries, or to render business unpredictable, it is unlikely that Congress would have proceeded so meticulously to establish standards for evaluating the plight of individual employers and to allow temporary escape hatches through grace periods for effective date. (See § 216 of S. 4; S. 1179 contains provisions which reflect a sensitivity to possible hardship situations).

> "No State shall . . . pass any . . . Law impairing the Obligation of Contracts. . . ."

and by Amendment 5 to the Constitution

> "No person . . . shall be deprived of life, liberty, or property without due process of law; nor shall property be taken for public use, without just compensation."

V. The Contracts Clause

It seems well settled that the contracts clause does not operate against the Federal Government. Where Congress' power to act is constitutionally assured -- as here with the commerce or, in other cases with the war (Lichter v. United States, 334 U.S. 742 (1948)) or with the currency power (Norman v. B. & O.R. Co., 294 U.S. 240, 307-308 (1935)) -- contracts, "however expressed . . . have a congenital infirmity . . . parties cannot remove their transactions from the reach of dominant constitutional power by making contracts about them." Norman v. B. & O.R. Co., supra.

VI. The Fifth Amendment

The vesting provision, if immune from Article 1, Section 10, must still survive a Fifth Amendment challenge.

There are two major elements to any potential Fifth Amendment challenge to the retroactive vesting provision: (1) taking the employers' property for public use without just compensation; and (2) depriving the employers of property without due process of law.

First, employers might claim that the vesting provision takes their property for public use without just compensation. By requiring them to pay unanticipated retirement benefits, they may argue, Congress is, in effect, taking their property -- money -- for public use -- to provide for pensioners and thereby keep commerce moving -- without just compensation. In Lynch v. United States, 292 U.S. 571 (1934), the court struck down a statute that attempted to abrogate war-risk insurance policies issued by the government to premium-paying private citizens. The court there said that the "Fifth Amendment commands that property be not taken without making just compensation."

Lynch is clearly distinguishable from the instant situation. Lynch involved contracts between the Federal government and private citizens. In a very real sense, cancelling those contracts produced a "taking" of the property of private citizens -- the petitioners had made premium payments for more than a decade -- by the government. The courts have insisted that the compensation requirement applies only to just such a "direct appropriation" of property. On the other hand, the courts have not recognized a compensation requirement in the case of "consequential injuries resulting from the exercise of lawful powers. It has never been supposed to have any bearing upon or to inhibit laws that indirectly work harm and loss to individuals. A new tariff, an embargo, a draft, or a war may initially bring upon individuals great losses; may indeed render valuable property valueless. They may destroy the worth of contracts." Knox v. Lee, 12 Wall 457, 484 (1872).

Thus, for example, where the government -- having taken the entire output of a steel mill -- prevented another company from receiving steel that it had a contractual right to receive from the steel producer, the Court held the government was not required to compensate the customer for the loss it suffered as a result of the government's taking of the steel from the steel company.

> "The contract in question was property within the meaning of the Fifth Amendment . . . and if taken for public use the Government would be liable. But destruction of, or injury to, property is frequently accomplished without a 'taking' in the constitutional sense . . . . There are many laws and government operations which injuriously affect the value of or destroy property. . . . Contracts in this respect do not differ from other kinds of property." Omnia Commercial Co. v. United States, 261 U.S. 502 (1923).

Certainly, the vesting provision is more like Omnia than Lynch. In the performance of a valid Congressional operation -- regulating interstate private pension plans -- it is "indirectly" working loss to individual employers. There is no direct appropriation or taking of private property for public use requiring compensation.

> "When a widely diffused public interest has become enmeshed in a network of multitudinous private arrangements, the authority of the state 'to safeguard the vital interests of its people' is not to be gainsaid by abstracting one such arrangement from its public context and treating it as though it were an isolated private contract constitutionally immune from impairment." East N.Y. Bank v. Hahn, 326 U.S. 230, 232 (1945).

The due process argument would be similar, both in content and in outcome. Employers might argue first that requiring them to pay higher retirement benefits based on prior service credit will produce labor costs higher than they contracted for and will thus amount to a deprivation of property -- the money necessary to pay the increment. Second, they would claim that, as the contracts were negotiated before enactment and thus without notice of the change, the provision is fundamentally unfair and violates due process.

The case law runs strongly against this reasoning. The guarantee of due process demands only that the law shall not be unreasonable, arbitrary or capricious and that the means selected shall have a real and substantial relation to the object sought to be obtained. Nebbia v. New York, 291 U.S. 502 (1934). In measuring allegedly retroactive statutes by this standard, the Court has been quite deferential to Congressional findings. See Norman v. B. & O.R. Co., supra, Louisville and Nashville R.R. v. Mottley, 219 U.S. 467 (1911). This language from the Second Circuit, upholding the Portal-to-Portal Act against charges of retroactivity (see infra, p. 18) accurately characterizes the nature of the Court's inquiry into the reasonableness of the statute:

BEST COPY AVAILABLE

> "This is not to say, of course, that Congress may exercise its commerce power in discriminatory or arbitary manner . . . . Faced with what it reasonably considered a situation relating to commerce that called for legislative action, Congress, after a thorough investigation, enacted the Portal-to-Portal Act. . . . Clearly the Act did not violate the Fifth Amendment insofar as it may have withdrawn from private individuals . . . any rights they may said to have had which rested upon private contracts they have made." Battaglia v. General Motors Corp., 169 F.2d 254 (2d Cir.), cert. denied, 335 U.S. 887 (1948).

Where Congress makes findings that legislative action is called for under one of its powers, then, the Courts have not subjected the ensuing legislation to a rigorous due process test.

Where an employer argued that the overtime provisions of the 1938 Fair Labor Standards Act would interfere with pre-existing contracts and force him to pay more in labor costs than he had anticipated, the Court upheld the statute with the following words:

> "Substandard laboring conditions were deemed by Congress to be injurious to the commerce . . . If overtime pay may have this effect upon commerce, private contracts made before or after the passage of the legislation regulating overtime cannot take the overtime transactions from 'the reach of dominant constitutional power.'" Overnight Motor Transportation Co. v. Missell, 316 U.S. 572, 576 (1942).

BEST COPY AVAILABLE

Similarly, exercising its currency powers, Congress declared in 1933 that all private contracts requiring payment in gold were against public policy; it ordered such contracts discharged dollar for dollar, rather than in gold. The court sustained the statute with words similar to those above about Congress' power to regulate those areas falling within its constitutional control. Norman v. B. & O.R. Co., supra.

Certainly here, given Congress' intensive investigation into the pension area, the specificity of the findings of proposed S. 4 and the Labor and Public Welfare Committee's expressed concern about the impact of the vesting provisions, it would seem highly unlikely that the courts would declare the statute "arbitary and capricious."[1] We quote below from the statute and the Committee report to indicate both the depth of the Congressional study and the studied effort at equity.

> "The Congress finds that private pension and other employee benefit plans . . . have become firmly rooted into our economic and social structure; that their operational scope and economic impact is interstate . . . ; and that it is therefore desirable . . . in the interest of the free flow of commerce, that minimum standards be prescribed to assure

[1] The extensive investigations of the Senate Finance Committee should further enhance the bill!s acceptability.

> that private pension and employee benefit plans be equitable in character and financially sound and properly administered." S. 4, 93d Cong., 1st Sess. § 2a (1973).
>
> "This additional increment of cost appears, therefore, to be tolerable by the vast majority of plans that would be subject to the vesting provisions of S. 4 and is greatly outweighed by the much larger number of workers who will be rewarded for their labors by retrospective vesting." S. Rep. No. 127, 93d Cong., 1st Sess. 20 (1973) [the above related to a proposal liberalizing the requirement for retrospective vesting; a fortiori, Congress must have conducted a similar balancing for the basic provision.]

To reiterate, insofar as someone challenging this statute maintained that he had rights under a contract -- namely, not to pay retirement benefits to workers who did not work for a specified number of years, as specified in the contract -- it would appear very unlikley that the taking of this "right" amounts to a due process violation.[1]

[1] An employer might argue that the due process clause also protects his "liberty" -- here, his "liberty to contract." Insofar as that liberty covers the provisions of a specific contract, it is clear that pre-existing contracts cannot hamper or restrict to any extent the exercise of the commerce power. Louisville and Nashville R.R. v. Mottley, supra. A fortiori, the liberty to enter into such a contract could not blunt valid Congressional legislation. Addyston Pipe & Steel Co. v. United States, 175 U.S. 211, 229 (1899).

Still, the analysis may not be complete without a consideration of the following argument. In challenging the vesting provision, an employer might say that in minimum wage legislation, all the statute did was to require that each future contract be constructed according to the minimum wage statute. The statute did not require that employees who had worked for the company in past years at less than the new minimum wage be compensated for such low pay employment by being given a bonus of some increment above the minimum wage for some period of years following enactment of the statute. This is what the vesting provision does, they might argue, by giving employees who happened to be working at the time the statute was passed credit in future years for work they did in past years.[1/]

It is our conclusion that while this argument does identify a difference between minimum wage legislation as enacted by Congress and the vesting provision,

[1/] We note the possibility of an equal protection argument here by workers not given retrospective credit, but we think the law is too clear in this area of economic regulation to regard such a claim as more than frivilous. See Williamson v. Lee Optical, 348 U.S. 483 (1955).

it does not suggest a distinction that has influenced the courts. In several cases, including the two which we cite, infra, the courts have been willing completely to abbrogate provisions of contracts and produce windfall profits in order to give force to congressional enactment.

In Louisville and Nashville R.R. v. Mottley, 219 U.S. 467 (1911), a contract to furnish transportation free of charge -- valid when made and based upon adequate consideration -- was held unenforceable when Congress later, in the exercise of its Commerce power, made it unlawful for railroads to provide such transportation. The fact that this free transportation was in fact compensation for an injury inflicted by the railroad did not sway the court and the railroad thus reaped a windfall profit. And, in a perhaps even more analagous situation, where Congress had passed the Portal-to-Portal Act to overrule a Supreme Court interpretation of the Fair Labor Standards Act that Congress viewed as too favorable to employees, the Second Circuit upheld the statute even though, in so doing, it deprived plaintiff-employees of millions of dollars in what the circuit acknowledged might be thought of as "contract rights." In other words, the court said that the employees' right not to be deprived of the overtime pay promised to them by the Supreme Court's interpretation of the statute under which their contract had been drawn could not block the constitutionality of the Portal-to-Portal Act:

> "It is the fact that here Congress was exercising its commerce power, which, we think primarily serves to distinguish the cases relied upon by appellants [employees]. The Joliffe, Ettor, Forbes Pioneer Boatline, and Coombes cases [citations omitted] all dealt with state statutes or constitutional provisions repealing prior state laws. And in Lynch v. United States, supra, appellants' only case dealing with a congressional statute, the principle that the reservation of sovereign powers is read into contracts was, we think, expressly recognized: the court there pointed out that, 'the Solicitor General does not suggest either in brief or argument that there were supervening conditions which authorized Congress to abbrogate these contracts in the exercise of the police or any other power.'" Battaglia v. General Motors Corp., 169 F.2d 254 (2d Cir.), cert. denied, 335 U.S. 887 (1948).

Finally, in at least one case, Wickard v. Filburn, 317 U.S. 111 (1942), there is a suggestion that if Congress provides some remedial provisions to ease the blow of the "retrospective" legislation, then the due process argument will have even less validity. There, while changing the law relating to the growing of wheat in the middle of the harvest season, Congress allowed the farmers to do various alternative things with their land and with their harvest which would enable them to avoid harsh economic losses. It would seem that the provision in S. 4 for (a) alternative vesting systems which are of an equal effect with the statutory one or (b) the provision of an additional five-year deferral period where imposition of the statutory retrospective credit immediately would cause serious economic harm would get similar favorable comment from the cou:'t and undermine an employer's due process objections.

STATEMENT OF PAUL S..BERGER

for a Panel Discussion on Private
Pension Plan Reform

Before

THE SENATE FINANCE SUBCOMMITTEE ON
PRIVATE PENSION PLANS

Honorable Gaylord Nelson, Chairman

2227 Dirksen Senate Office Building   May 31, 1973

I appreciate the opportunity to participate in this morning's discussion of a subject so important as the landmark legislation before this Subcommittee. Despite Social Security, and despite the explosive growth of private pension plans, American working people are not yet assured of the basic economic security that should be their birthright. As a practicing tax lawyer, working frequently with health, welfare, and pension plans, particularly those established under collective bargaining agreements, I have become aware of the importance of these plans to the general well-being of the American worker and his family. I have no doubt that the pension reform statute which emerges from this Congress will contribute importantly to securing this goal -- if effective machinery is provided for its administration and enforcement. But, just as surely, without the proper machinery to effectuate its goals, the new law will disappoint the people's high expectations.

As noted by Senator Nelson in his remarks at the opening of these Subcommittee hearings, the subject of the private pension system and its needs have been exhaustively studied by various committees of Congress, as well as by the Executive Branch during several administrations. These studies have produced somewhat of a consensus "that certain legislated minimum standards are necessary to strengthen the private pension system." While there remain differences to be resolved with respect to these standards, my testimony will not deal with these substantive issues. Hopefully, however, an examination of the problems of administration can contribute to a resolution of some of the outstanding differences.

The prospective administration of the various pending bills has received less attention than the issue merits, perhaps because of the unusual complexity of the substantive provisions of the bills. In itself, none of the three bills faces up to the considerable challenge of assuring effective administration. This morning I would like to focus on this question, to outline provisions which seem to me to be necessary to make the regulatory scheme work, and to suggest appropriate modifications in the existing proposals.

The Administration and Senator Bentsen are correct to prescribe a system of tax incentives to encourage compliance with the new federal standards. On the other hand, I do not believe that tax remedies should be the only or principal means of enforcing these new standards and I do not believe that the Internal Revenue Service should be the primary administrative home for the legislation. In this respect I differ with the Administration's bill, S. 1631, and Senator Bentsen's bill, S. 1179. Furthermore, I share the concerns voiced by some critics of S. 4 -- the proposal introduced by Senators Williams and Javits. These critics, who include the Senate Finance Committee in the Report it issued last year on the predecessor of S. 4, have argued: that to house pension reform in the Labor Department as that bill proposes, might without further action require funds to satisfy different and conflicting requirements under different statutes; could fail to take advantage of the priceless expertise built up over the years by IRS in its administration of existing pension requirements; could create two parallel bureaucracies with similarly-trained staffs duplicating much of each other's work; and that it would impose on the vast number of private interests affected by the legislation extremely burdensome and expensive requirements of processing and dealing with two regulators, rather than one. I would, however, solve these problems in a different manner than most of these critics, who favor IRS administration of the new law.

My specific recommendations to the Subcommittee are these:

First, Congress should with this legislation establish one set of minimum federal standards that covered pension plans must meet, which standards must determine both whether a plan is entitled to approval by Labor, and whether it merits favorable tax treatment -- by IRS;

Second, the legislation should provide for both the traditional tax sanctions in S. 1179 and S. 1631, and regulatory sanctions and remedies similar to those established by S. 4;

Third, primary administrative responsibility should be located outside the Internal Revenue Service, in the Department of Labor as proposed by S. 4;

Fourth, consideration should be given to the transfer of IRS pension experts to the Department of Labor;

Fifth, coordination should be assured and duplication minimized by instituting a certification procedure whereby Labor would certify to IRS that particular plans were in compliance with federal standards and therefore entitled to favorable tax treatment.

The Mission of The Internal Revenue Service

These conclusions are based on a sense of the prerequisites necessary to make the new pension reform law work. They are also based on a concern that the Internal Revenue Service continue its generally superior administration of the revenue laws. Administering this new legislation will be a classic regulatory task. But the mission of the Internal Revenue Service is, has been, and should remain, not the conduct of regulation, but raising revenue for the government. Its devotion to this mission should not be diluted by the imposition of regulatory activities such as will be necessary to make this legislation work.[1]

The complexity of the tax law is well known by this Committee as it has become also well known to the American public.[2] It is generally accepted that, in our time, simplification (together with other tax reforms) of the tax system is a major legislative target. In the context of the pending pension reform legislation, it is essential to keep in mind that much of the complexity of the tax law derives from its use "to achieve goals entirely unrelated to the raising of the revenue."[3] Congress should not use this opportunity to add to this complexity, especially when to do so will reduce the opportunity for achievement of the goals of the legislation. The pending legislation has as its principal object the development of a legislative framework to provide increased assurances

[1] Cf. Joseph H. Guttentag, Letters to the Editor, New York Times, Thursday, November 11, 1971.

[2] See, e.g., A Report on Complexity and the Income Tax, Committee on Tax Policy, New York State Bar Association, Tax Section, 27 Tax L. Rev. 325 (1972).

[3] Id. at 345. See also, Surrey, Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail, 34 Law & Contemp. Prob. 673, 684 (1969).

that a desired social goal will be attained. Aware of the object of the legislation, the major conclusion should easily follow.[1] Congress should invest the primary responsibility for the laws' administration in the Department of Labor, an agency whose mission is totally consistent with the objects and needs of the legislation.

Of course, regulatory purposes are often achieved in whole or in part through the use of incentives written into the Internal Revenue Code, and that in particular, the regulatory purposes of pension legislation have been and should continue to make use of the tax incentive strategy. Professor Surrey has recently criticized the use of tax incentives to promote various non-revenue social objectives; he has shown that in many cases tax subsidies are inefficient.[2] Whether or not that particular criticism applies here, as a practical matter tax incentives seem to me to be the price that must be paid

[1] The remaining inquiries should deal with the questions of how the administration might be accomplished effectively, efficiently, and with a minimum of duplication and other undesirable burdens. Those subsidiary questions will be dealt with at some length hereafter.

[2] Surrey, "Tax Incentives as a Device for Implementing Government Policy: A Comparison With Direct Government Expenditures," 83 Harv. L. Rev. 705 (1970).

BEST COPY AVAILABLE

for the continuity and growth of a private pension plan system. This price, I believe, is justified for a system which benefits those who could not or would not otherwise save enough to provide for their welfare after retirement.[1] However, although the use of the Internal Revenue Code for this non-tax objective may be justified, it does not follow that the Internal Revenue Code should be the repository of the entire law or that the Service need be or should be used to perform regulatory functions or operations incident to the proper administration of the law.

To make this particular regulatory scheme work will require administrative tasks ranging beyond ordinary tax administration. Normally in tax administration the sole aim is to determine whether or not the taxpayer is in compliance with particular legal standards. Where, as here, such determinations are not in themselves sufficient to promote the regulatory aims of a given statutory scheme, primary regulatory responsibility should not rest with the IRS.

[1] Whether the instant subsidy is wholly directed to this valid end is a central issue vis-a-vis the second question this panel has been asked to consider -- concerning the appropriate limitations on deductions on contributions to pension plans. This issue is briefly discussed below at p. 38.

BEST COPY AVAILABLE

IRS officials approach their job with a mandate very different from that which guides officials in agencies created to promote social or regulatory goals. The revenue official's task is to maximize the revenue of the United States Government. He is directed by law to give priority to that objective and to construe narrowly exemptions, exclusions, and deductions from citizens' tax obligations. Quite the reverse is the attitude with which a regulatory official must view his role. For example, the Social Security Act, whose mission is kindred to the legislation before this Committee, is, as the courts have repeatedly emphasized:

> "to be construed, wherever possible, to the benefit of the plaintiff who seeks its aid. Instead of a strict interpretation, it must receive a liberal construction if the beneficial results for the people are to be obtained." Cancel v. Gardner, 268 F. Supp. 206, 208 (D. Puerto Rico 1967). See also Social Security Board v. Nierotko, 327 U.S. 358, 364 (1946); Celebrezze v. Kilbarn, 322 F.2d 166, 168 (5th Cir. 1963); Pearson v. Gardner, 267 F. Supp. 498, 503 (W.D. Ark. 1967); Blankenship v. Celebrezze, 232 F. Supp. 229, 232 (S.D. W.Va. 1964).

This is the type of mandate which must guide administration of pension reform. It is not the type of approach to which IRS procedures, practices, and traditions are hospitable.

As tax practitioners well know, the Internal Revenue is under-staffed as it is and hard put to manage the massive job of revenue collection and administration. Indeed, the Service's burgeoning work load has recently obliged it to adopt greatly more formalized procedures restricting "oral advice to tax payers." Rev. Proc. 72-3, 1972-1 Cum. Bull. 698, 705. Within the last several months, the technical staff of the IRS, including its Pension Branch, have been urged to strictly follow the published restriction against oral advice. To impose such a procedural straitjacket on relations between the agency administering the new pension legislation and the individuals and organizations subject to its jurisdiction would be impossible; to attempt to do so would stultify the humane purposes of the law.[1/]

Indeed, strains on the agency's resources have dangerously confined its capacity to administer existing pension standards embodied in Sections 401-407 of

[1/] Section 306 of S.4 directs that "technical assistance shall be provided to all parties concerned in the efforts "to provide greater retirement protection for individuals . . . ."

the Internal Revenue Code. As recounted by the recent study made by the General Accounting Office for the Senate Labor Subcommittee concerning the activities of all federal agencies dealing with private pension plans.

> "IRS has conducted little investigative or audit activity to ensure that private pension plans are operated in compliance with the tax laws or IRS regulations. This has been due, in part, to the large number of requests for IRS to make advance determinations of the tax status of proposed pension plans. According to an IRS official, these determinations have taken so much time that they have prevented IRS from establishing an effective audit program. In 1969 a total of 156,779 determinations were made." 1/

The Administrative Prerequisites of Pension Reform

Bearing in mind the appropriate institutional limits of the IRS, we can turn to the other side of the coin -- the administrative prerequisites necessary to realize the promise of pension reform. To make this analysis on a systematic basis, we should again begin at the beginning -- by looking to the purposes of the substantive standards Congress is in the process of establishing.

1/ Senate Subcommittee on Labor, Interim Report of Activities of the Private Welfare and Pension Plan Study, 1971 S. Rep. No. 92-634, 92d Cong., 1st Sess. 97 (Feb. 22 1972).

Only then is it possible to design a proper home for their administration. Second, we have to distinguish three questions which have often been confused in the discussion of whether Labor or the Treasury should administer the new pension law. The first question is, what should be the regulatory standards applicable to pension plans generally. The second question is, what kinds of sanctions and remedies should be provided in the statute to make the regulatory scheme work. The final question then would be, how should administrative responsibility be allocated among various agencies. Though plainly related, these issues are in principle quite distinct. Just because tax benefits or sanctions are included in the package passed by Congress, it need not necessarily follow that the IRS must be the primary administrator of the law. We need not, and indeed must not, be restricted in our choice of regulatory tools by our choice of an agency to house the law -- or vice versa.

The Overall Regulating Standards

In large measure, the pending bills have been drafted in a "tail wagging the dog" manner and the proposed revisions would be made in the labor law or in the tax law depending upon the view of whether the provisions should be administered by the Labor Department or by the Treasury. In the case of S. 4, this approach would result in two sets of standards, administrators and rules without any apparent justification in substance. There is no reason why this problem cannot be easily corrected.

Congress must, in the legislation which emerges from the present session to govern the administration of private pension plans, establish a single set of legislative standards. These standards must specify the minimum requirements needed for a pension plan to comply with national policy for the retirement needs of our work force. These standards should determine both whether a given plan is entitled to favorable tax treatment and whether it is to receive the approval of the Department of Labor.

From this starting point, the legislation could move more easily into sanctions, remedies, and incentives in light of the universal standards adopted. From there, a division of responsibilities among or between agencies of government should be made in light of their respective missions and ability to carry out legislative purpose.

Implementing the Heart of the Legislation -- Vesting and Funding

The heart of the new legislation, as it is the heart of all three of the proposals before the Subcommittee, will be minimum requirements for "vesting" and "funding" which, under S. 4, all pension plans will have to meet in order to be "registered" with the Secretary of Labor, and, under S. 1179 and S. 1631, plans will have to meet in order to qualify for the three tax benefits now accorded qualifying plans under the Internal Revenue Code.[1/] The broad purpose of these provisions is not simply to set out the circumstances under which taxpayers may defer, deduct or exclude from their tax-returns, sums which would otherwise be owed to the United States. The provisions are aimed at ensuring that sums of money will reach the American working man, when the

[1/] These benefits are: the right on the part of an employer to deduct contributions made to the plan; the right on the part of the employee to defer taxation for the contribution until his pension is distributed; and the right of the plan itself to be exempt from taxation on its income.

time comes for his retirement, so that he can continue to live in self-reliant dignity.

This is the aim which must infuse administration of the law. Though its achievement can and should be enforced in part through the use of traditional tax incentives, this social objective requires much broader supervision than the IRS has been able to provide in its administration of existing pension standards in the Internal Revenue Code. It requires more varied enforcement tools and a more active regulatory posture than the IRS can or should reasonably be expected ever to employ.

The first task imposed on the administrator of the law, whatever version eventually clears the Congress and the White House, will be the analysis of plans to see whether, on their face, they comply with the dictates of the law. In the first instance at least, this demanding and highly technical task will be substantially identical to that performed by IRS officials in their administration of the less stringent and somewhat less (but still) complex provisions of existing law.[1]

It is obvious that the perspective from which this task is performed will be a most important determinant of whether pension reform will succeed. This means not only that skill and diligence must be shown by officials in examining those plans presented to them, but these officials in their examinations and consultations, should have in mind the overriding purposes of the statutory standards. If virtually all pension plans conform on their face to the dictates and the purposes of the law, then it is clear that we will be a long way toward securing the objectives of the law. If many plans do not conform, then the law will be a failure.

Because of the importance of this facet of the administration of the law, it seems a terrible mistake to discard, as S. 4 appears to have done with respect

[1] Present law does not require advance IRS approval of plans, but as a practical matter all proposed plans or amendments seek such approval. Examining plan documents pursuant to such requests constitutes the overwhelming bulk of the Service's activities in administering §§ 401-07 See Senate Committee on Labor and Public Welfare, Interim Report of Activities of the Private Welfare and Pension Plan Study, 1971, S. Rep. No. 92-637, 92d Cong., 2d Sess. 97 (Feb. 22, 1972).

to its new standards, the potent spur to initial compliance inherent in the traditional use of a tax incentive. As a practical matter, few plans will be adopted if contributions are not deductible to the employer and deferrable by the employee. Considerable expense and care will be invested in the preparation of plans to prevent any risk of incurring a massive tax liability sometime down the road. The same results may not obtain -- for certainly the same potent incentive to comply will be absent -- if exclusive reliance is placed on judicial remedies such as those provided by S. 4.

However, the administrative tasks incident to implementation of the new legislation will not end with the kind of documentary review which the IRS has traditionally performed in the pension area, and performed with distinction. The second task that will have to be performed in carrying out the basic vesting and funding provisions goes beyond the experience of the IRS under existing law. This task will be the preparation of new regulations to effectuate legislative intent. To be sure, regulation-writing is hardly unknown to the IRS, under the pension or other provisions of the Code. But the regulations required under the new law, especially if its vesting and funding provisions resemble those of S. 4 and S. 1179, should be of an altogether different character than those promulgated in conventional tax administration. The most important regulations promulgated under these bills will be purely legislative. They will require, in addition to expertise of the sort developed by the Service in its administration of existing pension standards, substantial sensitivity to labor-management relations and industry conditions. Many of these plans are the product of collective bargaining conducted by labor and management with the aid of labor lawyers, and in light of labor law principles. Moreover, the proposed legislation will have a substantial impact on collective bargaining itself. For example, under Part C of Title II of S. 4, the administering agency will acquire virtually unlimited legislative power to define the scope of the law. Section 216(a) of Part C authorizes the Secretary to "defer, in whole or in part, applicability" of the vesting requirements of the Act, for a period not to exceed five years; the standard for the exercise of this discretion involves a showing that compliance with the vesting requirements:

> 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.

Although Section 216(b) offers some guidelines as to the meaning of "substantial economic injury," the Secretary's determinations will not be significantly dissimilar to those made by Congress in originally framing the statute. These determinations should be made by the Labor Department which is familiar with the collective bargaining process, its requirements and the needs of the parties, as well as the dictates of the legislation.

Under Section 217, which prescribes the terms on which variances may be granted from the Act's funding provisions, the Secretary's discretion is in some respects broader than under Section 216. He may grant up to five consecutive waivers from the funding requirements if he "has reason to believe that such required payments . . . cannot be made. . .," as long as a waiver of such payment will not "adversely affect the interests of participants or beneficiaries of such plan . . . [or] impair the capability of the Pension Benefit Insurance Fund [established by Title IV of the bill]." Section 217(a)(1), (2). Under Section 217(d), the Secretary is instructed, notwithstanding the provisions of the legislation, to:

> prescribe alternative funding requirements for multiemployer plans which will give reasonable assurances that the plan's benefit commitments will be met.

No doubt such broad grants of discretionary -- in effect, legislative -- power are inherent in a regulatory scheme as ambitious as the one we have here under consideration. Similar grants of essentially unlimited power to prescribe the meaning of the law appear elsewhere in S. 4,[1] and throughout S. 1179 and S. 1631 as well.[2]

[1] See, *e.g.*, § 210(b)(2)(B), providing that if an amendment after the effective date of the new law "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 . . . ."

[2] See, *e.g.*, S. 1179, § 322(a), amending Internal Revenue Code § 401(a)(12)(B); § 323, amending Internal Revenue Code § 401 with the addition of subsection (j)(6) and subsection (k); S. 1631, § 2(a)(1)(B): "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."

Such determinations will often involve potentially drastic consequences for the health of large segments of the economy. Necessarily they will depend on judgments about the conditions in an industry, the needs of workers and employers, or the appropriate standards of fairness, which are not at all the kind of determinations which the Internal Revenue Service has customarily been charged with undertaking. It would be unfortunate if this tradition were now breached, at least if there is some other way efficiently to carry out the legislation.

This disadvantage associated with handing over administrative responsibility to the Treasury appears magnified when one considers the third task which will be imposed on the administrator of pension reform. This third task is enforcement -- discovering violations of the provisions and policies of the statute, and reacting to them. As we discussed briefly above, some -- indeed, much -- of this task will be discharged "automatically" in the initial process of reviewing plan documents for compliance with the statute. As we noted above, this critically important aspect of the enforcement function will be most

BEST COPY AVAILABLE

efficiently discharged if compliance is prerequisite to the acquisition of favorable tax treatment. However, enforcement cannot stop with examination of the substantive provisions of plan documents.

Some observers have contended, or assumed, that reliance on a tax strategy for enforcement is sufficient; they have characterized the tax as "self-enforcing." But this, it is clear, is a radical overstatement. The aims of this legislation go beyond securing initial compliance on the face of the document. Indeed, the principal reason why Congress has these bills under consideration is precisely because the promises undertaken by some pension plans have turned out to be hollow in practice, for one reason or another. Basic objectives of the new law will be to assure that paper promises are kept by plan administrators and employers, and, most important, to provide relief for beneficiaries when the promises are not kept.

To attain these ends, it is apparent that the traditional tax sanctions of existing law, and of S. 1179 and S. 1631, are not sufficient. For example, S. 1179

BEST COPY AVAILABLE

provides that to enforce its funding requirements (Section 324), Section 408 of the Internal Revenue Code shall be added to enable the Secretary, upon a determination that an employer has failed to make the required contributions, (1) to order the plan terminated, or (2) retroactively to include all deductions attributable to the plan in the income of the employer for the five previous taxable years, or (3) to take "such other action as he deems consistent with the purposes of such section." This limited array of remedies -- which are in any event broader than those offered to cope with similar situations by S. 1631 -- would constitute a blunt and often useless instrument. Wherever the employer would prefer to ignore the needs of beneficiaries and accept the loss of favored tax status, the administrator will be without means to promote the basic aim of the statute to assure relief to employees threatened with the loss of their pensions. The administrator will be helpless -- if disqualification from favored tax status is his only resort -- even where the employer has sufficient assets within his control to meet the terms of the statute or of the plan and make required payments to the beneficiaries.

Apart from such catastrophes -- which, it should not be forgotten, it is a central aim of this law to prevent and redress -- the proper implementation of this law will necessarily involve the administering agency deeply in the routine operations of unions, companies, and plans. The administrator will have to play a role of continuous oversight -- investigating, counseling, and pressuring -- to secure compliance or to provide relief. It is no insult to the capability of the Service to state the obvious -- that tax sanctions are often not at all a helpful aid in this type of regulatory work. Indeed, the Senate Finance Committee has made precisely the same observation in criticizing the use of loss of deductions and tax exemptions as a sanction for engaging in prohibited acts of self-dealing by administrators of private foundations:

> On occasion [such] sanctions are ineffective and tend to discourage the expenditure of enforcement effort. On the other hand, in many cases the sanctions are so great, in comparison to the offense involved, that they cause reluctance in enforcement . . . . Where the Internal Revenue Service does seek to apply sanctions in such circumstances the same factors encourage extensive litigation and a noticeable reluctance by the courts to uphold severe sanctions.

Senate Finance Committee, Report on the Tax Reform Act of 1969, S. Rep. No. 91-552, 91st Cong., 1st Sess. 28 (Nov. 21, 1969). The Committee's critique of disqualification from favorable tax treatment as a device for regulating private foundations applies with greater force to the pension plan regulation under the new law.

One partial response to this need for graduated and flexible sanctions would follow the solution adopted in 1969 to deal with abuses in private foundations. This would be to empower the Service to assess an array of penalty taxes covering specified categories of abuses for which disqualification would not be an appropriate response.[1] Such taxes could, for example, be authorized when an employer oı ɒlan administrator failed to comply with a lawful order to make required contributions or benefit payments; they could be increased if the delinquency persisted. They would not, of course, have to be assessed against the plan (which would ultimately

[1] The Tax Reform Act of 1969 authorized graduated penal taxes on various types of violations of the Code's phohibitions on self-dealing, and against speculative investments, and restrictions on the use of funds. I.R.C. §§ 4941, 4944, 4945.

harm its beneficiaries) but against the parties responsible for the violation. Indeed, the Administration has included in its bill just such a penalty tax to be imposed on interested persons engaging in self-dealing transactions with pension funds in contravention of the statute. See S. 1631, Section 6, adding to the Code a new Section 4971, imposing an "excise tax [of five percent of the amount involved] on prohibited transactions."

Provisions similar to those provided for the regulation of private foundations by the 1969 Tax Reform Act could be included in the instant legislation. Alternatively, and preferably, amounts in the nature of punitive damages payable to the fund or the beneficiary wronged, would be a useful complement to the sanctions in S. 4. The exclusive reliance in the present version of S. 4 on judicial remedies sought by the Secretary of Labor or by private civil claimants offers the advantage of flexibility in devising remedies. But it also promises delay and disinclination by recalcitrant offenders. Without a scheme of penalty taxes, or without the right to collect punitive damages or fines (not now provided for by S. 4), the administrator of the law will be without adequate means to compel swift respect for its provisions, when he finds a violation.

Administering Supplementary Provisions: Termination Insurance, Reporting and Disclosure, and Fiduciary Standards

Examination of the supplementary provisions of the legislation before the Committee reinforces the conclusion that active, expert regulation, beyond that to which the IRS is accustomed, will be necessary to make pension reform work. Indeed, while the bills conflict as to whether to include certain types of the programs that have been proposed to supplement vesting and funding requirements, they reflect little or no controversy as to where such programs should be administered, if Congress chooses to enact them.

Plan Termination Insurance

Plan termination insurance is provided for by S. 1179 and S. 4, but not by S. 1631 -- though Secretary Shultz stated in his testimony before the Subcommittee last week that the Administration is continuing to study this concept and is not irreversibly hostile to including it in the final legislation. It would seem incontrovertible that this program, if enacted, could not be administered by the IRS. S. 1179 would house it in a new Pension Guarantee Corporation. S. 4 follows the scheme of its other provisions and puts the program under the supervision of the Secretary of Labor. The latter seems clearly to be the superior option. If enacted, termination insurance should be coordinated with the other aspects of the regulatory scheme, especially with its funding component. There is no reason why this coordination should be complicated by an artificial interagency relationship, and no reason why administration of the insurance program itself should not be informed by the expertise acquired by the Labor Department in its administration of the entire legislative scheme -- if the legislation follows S. 4 in giving primary responsibility to the Department of Labor.

Fiduciary Standards, Reporting and Disclosure

Both S. 4 and the S. 1557, the Administration's companion bill to S. 1631, the only bills which provide for new fiduciary, reporting, and disclosure standards, assign these responsibilities to Labor, as they have been assigned under existing legislation. Despite the fact that the Labor Department has been criticized for some aspects of its treatment of these programs,[1] it remains clearly the proper place to house them. The remedy for the inadequacies found in the administration of these requirements by the Comptroller General is not to fragment administration of federal pension standards, but to strengthen the authority of the Labor Department to effectuate their aims, as the present legislation proposes to do, and as both the Comptroller General and the then-Secretary of Labor urged, when the Report was issued.[2]

[1] By the General Accounting Office, in a Report to Congress filed in 1967. Comptroller General of the United States, Review of Certain Activities Related to Administration and Enforcement of the Reporting and Bonding Provisions of the Welfare and Pension Plans Disclosure Act of 1959, in the Labor-Management Services Administration of the Department of Labor (March 1967).

[2] *Id*. at 2, 25-27.

Coordinating Labor and IRS Activities Under the Legislation

To be effective, the new law needs to be backed up by all three of the types of sanctions we have discussed -- disqualification from favorable tax treatment, standard judicial equitable remedies and damage awards, and either penalty taxes, administrative fines, or punitive damages. In addition, the law requires the active supervisory posture that only a genuine regulatory agency can provide. It requires expertise in industrial conditions and employment relationships. And it requires the priority and prestige within its administering agency that can only come if pension regulation is concentrated primarily in a single agency, and in one which can comfortably regard the law as harmonious with its own general mission, history, and constituency.

All these considerations seem to require that authority over the administration of federal pension standards be concentrated in the Department of Labor. None of the bills before the Subcommittee, not even S. 4, have gone as far in this direction as the new law will require.

The failure of the present proposals to provide the full complement of remedies and regulatory power to promote the aims of pension reform stems, perhaps in part, from the confusion referred to earlier between standards, sanctions, and administration. All the competing proposals apparently share an assumption that tax sanctions would be inappropriate in a bill to be administered primarily by the Labor Department, and, conversely, that judicial remedies would be inappropriate in a bill to be administered by the IRS. But these assumptions seem unjustified. If Administrative responsibility were concentrated in Labor, there is no reason why tax sanctions cannot be retained in the legislation.

As previously discussed, Congress should establish a set of standards applicable generally to private pension plans. Then the only difficulty created by a regulatory scheme based on this comprehensive array of standards, sanctions, remedies, and supervisory capacity on the part of the administering agency, would be the problem of coordination between Labor and IRS. It is not impossible to solve this problem. But it can only be solved if Congress seizes the occasion and dictates the solution itself, rather than passing the buck to the two agencies to attempt to work out through bargaining.

Further, Congress must specify that, since the Labor Department is to be the primary home for pension administration, it shall have the power to certify to the Internal Revenue Service that a particular plan meets federal statutory standards. There is precedent for making tax determinations based upon regulatory determinations of agencies other than the IRS. For example, Sections 851-55 of the Code define the tax status of regulated investment companies. Under Section 851(a)(1) the SEC determinates whether particular companies can qualify as regulated investment companies by determining whether they are to be registered under the Investment Company Act of 1940 as a "management company" or a "unit investment trust." Similarly, Section 1071 provides that the IRS treat as involuntary conversions of property under Section 1033 any sale or exchange of property certified by the FCC to be "necessary or appropriate to effectuate a change in policy by that agency." Section 1081 precludes taxation of transfers of corporate units of registered holding companies made "in obedience to an order of the Securities and Exchange Commission." Section 1101 forbids taxation when a bank holding company transfers property to a shareholder therein, when the Federal Reserve Board has certified that the transfer is "necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956." And Sections 1242-43 prescribe special tax treatment for companies operating under the Small Business Investment Act of 1958. If Congress provides such a structure for the new legislation, it will meet the administrative needs of pension reform, without creating insuperable interagency difficulties.

Objections to Labor Department Administration of Pension Reform

A number of critics have raised various objections to the concept of conferring primary administrative responsibility for the new pension law on the Department of Labor, as that concept is presently reflected in the provisions of S. 4. Many of these objections have substance, as applied to S. 4. However, each of the substantial difficulties with Labor Department primacy will be eliminated by the administrative framework outlined above.

Many critics of S. 4 have argued that turning the new legislation over to Labor will squander the expertise acquired by the IRS in its administration of existing pension standards in Sections 401-07 of the Internal Revenue Code. This, plainly, is a weighty objection. But it can be met. The way to avoid wasting the expertise of IRS' Pension Trust Branch is not to burden IRS with administrative duties which it is ill prepared to discharge. Much less is it to rob the new pension law of essential enforcement support. The proper solution is to consider transfer of these experts to Labor, where they would become a major part of the larger office devoted to pension plan administration. Numerous such transfers have been accomplished in recent years. Various units, for example, have been transferred from the United States Department of Agriculture; from the Food and Drug Administration, and from the United States Public Health Service to form the new Environmental Protection Agency. Similarly, bureaucratic relocations were part of the formation of the Department of Housing and Urban Development and the Department of Transportation. Such moves are underway right now, as the Nixon Administration dismantles the Office of Economic Opportunity and assigns its programs to older departments. There is no particular reason why such a transfer could not be arranged to make pension reform work as the American people expect it to.

A second set of objections to S. 4 expresses fears that employers and plan administrators will be subjected to the burden of complying with dual regulatory requirements, of filing dual reports, of meeting differences in coverage, and possibly even of coping with conflicting agency demands. Even without the consolidation of substantive standards and administration which is urged herein, much of the burden of dual administration could be eliminated by sensitive interagency cooperation. Even under present practice, Labor and IRS have attempted

BEST COPY AVAILABLE

with general success to coordinate overlapping requirements of existing law. For example, the Service has ruled that the information forms filed with Labor pursuant to the Welfare and Pension Plans Disclosure Act will partially satisfy the requirements of the Internal Revenue Code with regard to information that employers must furnish in claiming deductions under Section 404. Rev. Proc. 66-51, 1966-2 Cum. Bull. 1261.

However, as noted previously, it would be a disservice to the beneficiaries of this legislation, the taxpayers, and to regulated individuals and organizations, to leave the job of coordination to the two agencies involved. The proper way to solve the problem of dual requirements is to eliminate the problem here and now. Congress should set forth one set of substantive standards to guide pension regulation, making necessary modifications and deletions from the pertinent existing sections of the Internal Revenue Code in the process, and confer primary authority to administer this unified body of standards on one expert agency, the Department of Labor. In this event, fears about the chore of coping

BEST COPY AVAILABLE

with two sets of requirements and two sets of bureaucratic officials will, for virtually all intents and purposes, disappear.[1/]

Finally, the objection has been raised that Labor Department Administration of the legislation would forsake the valuable enforcement device of tax incentives. This objection is set out with particular cogency in the pamphlet summarizing the proposals for private pension plan reform prepared for the use of this Subcommittee by the staff of the Joint Committee on Internal Revenue Taxation:

> S. 4 would . . . adopt a fundamental change in the approach toward enforcing the pension provisions. For over three decades, withdrawal of the tax advantages associated with qualification has been the basic method of

[1/] For example, concern has been raised about conflict between the present S.4, which covers only plans with 25 or more participants, and the qualification standards in the Code, which extend to all plans. The proper way to deal with such problems is to give Labor authority to set standards for all plans, with authority to relax the generally applicable requirements in the case of plans below a certain size. The break-point of 25 participants would be a sensible distinction.

> enforcing the nondiscrimination rules of the Internal Revenue Code, which are designed to insure that pension plans are actually for the benefit of the rank and file employees. In general, this has been an effective tool since the withdrawal of qualification can result in the denial of deductions for employer contributions to the plan and the loss of exemption of the plan's earnings. The fact that such drastic penalties may be imposed for noncompliance provides a substantial inducement to meet the required tests for qualificiation. In contrast, under S. 4 the Labor Department would have to get a court order to enforce compliance where plans are not living up to these requirements. It is not clear how large an investigative staff would be required for this. In part this is because it is not clear whether employers would make changes voluntarily (as they do to avoid loss of tax deduction) or whether in the case of many of the requirements they would wait until an investigation is made by the Labor Department personnel. [1]

As stated previously, this criticism of S. 4 is justified. It would be folly not to use a tax incentive strategy as part of the enforcement program for the new provisions of the legislation. But this conclusion does not compel us to keep administrative responsibility for setting standards and invoking either tax sanctions or other necessary sanctions and regulatory devices in the

[1] Joint Committee On Revenue Citation Summary of Proposals for Private Pension Plan Reform 14 (Comm. Print, May 16, 1973).

Internal Revenue Service. This authority can and should be housed in Labor. Residual authority to determine primarily tax matters (an area to be worked out after adoption of general standards and after further study) would remain with IRS. But the basic responsibility for interpreting Congressional standards for pension plans, and applying them to determine whether individual plans qualify, should go to Labor.

Traditional tax incentives are necessary to make pension reform work, but they are not sufficient. Without a full complement of sanctions, remedies, and without active regulatory supervision, the aims of this legislation will not be wholly achieved. The proper institution to equip with this array of enforcement tools is that agency in our government whose main mission it is to regulate on behalf of the working man -- the Department of Labor.

Afterword: Limitations on Contributions and Deductions

This statement, as suggested in the invitation in Chairman Nelson's letter of May 18, concentrates on the first of the two questions with which this Panel will deal. A few words should be added, however, with regard to the second question -- whether and how Congress ought to set limitations on the amounts which can be contributed to qualifying pension plans of the various types included in the present Code provisions and in the proposals before us, and/or whether there should be similar limitations on deductions for such contributions. Answering this general question involves two sub-issues: first, whether there should be equality of treatment for all taxpayers, whether they are self-employed, or employed by large corporations, small corporations, or professional corporations; and, second, whether limitations should be set in order to confine the tax subsidy involved to individuals who would probably not be able or likely to set aside adequate retirement savings without the incentive -- that is to say, whether wealthy individuals deferring large amounts of income should be barred from making use of a subsidy except on a limited portion of the income deferred.

On the first of these two questions, there is no apparent reason why there should not be equlaity of tax treatment. If it is important to the society to encourage providing for retirement through tax subsidies, then it is important to encourage such provision for all individuals, whether or not they happen to work for a particular type of employer, or whether they are self-employed. With regard to the second question, whether there should be maximum limits on the sums of deferred income benefiting from tax subsidies, it seems that in principle at least, the answer is equally clear. There is no justification for a tax-break to help the wealthy save for their retirement -- when they would be able to provide for a secure and comfortable retirement without any assistance from the tax code. It is simply a device for taking money out of the pocket of the ordinary taxpayer and putting it in the already well-filled pocket of the rich man. Such wealth transfers serve no legitimate individual or social needs. Hence, in order to establish equality of treatment for variously employed taxpayers regarding the tax status of deferred income, Congress should revise downward the limits on contributions and deductions in areas where they are presently high, rather than revising upward these limits in areas where they are low.

STATEMENT TO THE COMMITTEE ON FINANCE

May 31, 1973

Daniel I. Halperin

This statement is principally concerned with the question of dollar limitations on benefits from qualified pension and profit sharing plans. Other matters will be mentioned very briefly in the second section of this paper.

The Need for Benefit Limits

The tax expenditure budget, prepared by the Treasury and Congressional staffs, shows nearly $4 billion per year as the cost of the special tax benefits to qualified plans. This outlay helps finance retirement benefits for only about 50% of the work force. Thus, while many, including a heavily disproportionate share of the lower paid, get no aid from the tax system in providing for their retirement, some people take advantage of the available tax benefits to build-up a retirement nest egg of well in excess of $1 million. It is my belief that the fairness of the tax law is severely compromised by this situation and in particular by the lack of limits on the benefits that can be received under qualified plans. I hope to demonstrate why I take this position.

Tax Benefits to Qualified Plans

Compensation paid to employees is generally deductible only if the employee will include the payment in income at approximately the same time. Thus under section 404 of the Internal Revenue Code if compensation is paid or accrued, on account of an employee under a plan deferring the receipt of compensation, the ordinary rules governing deductions do not apply and special rules are applicable. These rules essentially require that the deduction be taken in the year in which the amount is included in the income of the employee.

It may not be particularly difficult to arrange to defer the taxation of compensation to a later period, perhaps until after retirement, but in order to do so the employer must forego the tax deduction until the income is reported by the employee.* In other words if an employee earns $100,000 in 1972 and the employer insists on deducting the entire $100,000 currently the employee will have to include $100,000 in his income within a short time. If the employee insists on deferring tax on part of this compensation, to say 1980, then the deduction for this part will be delayed until 1980.

* The employee must also either be willing to take a forfeitable interest (such that his rights will be dependent on the performance of substantial future services) or to rely upon the credit of the employer. If he gets security for vested rights (for example, the employer makes deposits to a trust fund) then the employee will be immediately taxable even though distribution is delayed.

The one exception to this rule is for pension and profit-sharing plans that "qualify" under section 401 of the Internal Revenue Code. Contributions to such plans are deductible while taxation to the employee is delayed until actual distribution from the plan, most often after retirement.

Deferral of taxation until after retirement can of course have the effect of reducing the tax which will have to be paid in those cases where the worker will be in a lower tax bracket in his post-retirement years. This is a possibility wherever compensation is deferred. Under a qualified plan, however, there is an additional advantage which operates even when the tax bracket is not changed.

The mismatching of the employer deduction and the reporting of income enables the parties to increase the amount of money in private hands. For example, if a corporation which normally pays tax at the 48% rate earns $10,000, it can retain $5200 after tax. If instead of keeping the $10,000, the corporation paid it to Mr. Jones as compensation, Jones will be able to keep whatever portion is left after payment of taxes. If he is also in the 48% bracket, he retains $5200. The amount of money in private hands is unchanged by the corporation's decision to pay Jones an extra $10,000 in compensation.

On the other hand if the $10,000 were contributed to a qualified pension plan, the plan gets to keep the full $10,000, thus increasing the amount of money in private hands by $4800. The Treasury does not get this money until the plan distributes $10,000 to Jones (assuming Jones remains in the 48% bracket at the time of distribution).

Value of Tax Benefit Depends upon Tax Bracket

In essence the deferral of tax amounts to an interest free loan from the Treasury to the corporation or Jones. The amount of the loan depends on the tax brackets of the parties and if these differ upon whether one considers the special benefit to be allowance of the deduction or the deferral of the income.

At least in the case of vested benefits, it seems logical to look to the tax bracket of the employee in measuring the benefit from deferral, namely, the size of the interest free loan.

It is clear that for each dollar of retirement benefit purchased the higher the tax bracket, the greater the "loan." For example, assume at a given age it will take a set aside of $1000 per year, each year until retirement, to finance a life annuity of $5000. If the employee is in the 25% bracket, the Treasury's interest free loan is $250 per year; for the employee in the 50% bracket, the loan is twice as much or $500 per year.

Moreover, it is not "discriminatory" in favor of higher paid employees to provide a larger pension for such employees than for the lower paid as long as the ratio of pension to pay is not greater for the higher paid than it is for the lower paid. Thus, a plan providing all employees with a pension of 50% of pay would qualify for the special tax treatment. This would seem to magnify the favoritism to higher paid employees.

There is no limit on the size of the "loan" that would be made as long as the ratio of pension benefit to pay is maintained. For example, if an employee earning $250,000 were entitled to a 50% pension ($125,000) which cost $25,000 annually, he in effect gets a $12,500 annual loan if his marginal tax bracket was 50% or $17,500 annually if the maximum tax did not apply and he reached the 70% bracket.

Justification for Tax Benefits

What is the justification for the existence of these tax rules? Why should the tax system provide encouragement for saving for retirement, by not taxing such amounts until they are spent or are available for spending rather than when earned? It will be noted that this is inconsistent with the general assumption that the tax is on income not expenditures and with the lack of similar tax benefits for savings for other presumably worthwhile purposes.

A possible explanation is the extreme difficulty of planning adequately for retirement. People just can't think that far ahead and judge their needs; they are uncertain about how long they can work, how long they will live after retirement and what the cost of living will be at that stage. Moreover, we are disturbed when we see a substantial number, according to one estimate as much as one-quarter, of the elderly, including those who have worked hard all their lives, living in poverty and many more not able to maintain their previous standard of living.

These considerations have led, of course, to the adoption and constant efforts to improve our Social Security system which provides a basic level of benefits for most Americans.

However, Social Security alone will not replace pre-retirement income. For many people, it would seem unlikely that the gap will be closed out of personal savings (even if a tax-incentive to encourage savings were made available). The only hope in the absence of substantial Social Security increases is a private pension.

As mentioned above, the favorable treatment of pension plans under the Internal Revenue Code is limited to so-called qualified plans -- plans that do not discriminate in favor of stockholders, officers, supervisors or other highly compensated employees. This seems an implicit recognition that the purpose of the tax subsidy is to encourage plans for lower paid individuals who are the ones unlikely to save on their own.

The higher paid who may be expected to provide for their retirement, in any event, are encouraged to do so under tax-favored arrangements which benefit employees in general so that we will gain additional coverage of the low paid group. Unfortunately, we have failed to keep this goal sufficiently in mind in judging the success and failures of the private pension system.

The private pension system is not universal and the poor are more likely to be left out than the rich.

As the Treasury stated in its explanation of H.R. 12272 introduced in the last Congress:

> "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."

This is true for two reasons -- First many companies do not have retirement programs. Second, not all employees of companies who do have programs are covered by these programs.

An analysis of who is and who is not covered prepared by the Burea of Labor statistics in 1968 leads to one obvious conclusion. The uncovered one-half is heavily drawn from employees of small companies who tend to be at the lower end of the wage scale. For example, the survey shows that for companies where the average earnings of all employees in the company is less than $5000, the percentage of workers covered is 30%, while if the average earnings are over $10,000 the percentage rises to 78%. (See Bankers Trust, The Private Pension Controversy 30 (1973))

Method of Increasing Coverage

This Committee is considering restrictions on age and service requirements for membership in a plan and mandatory vesting after a specified period of service as means of increasing the coverage of the private pension system. Other possibilities may also be suggested.

Many plans exclude employees because they are paid on an hourly basis as opposed to a weekly salary. This should be prohibited for all companies, big or small. The Administration has recommended that employees in a bargaining unit be disregarded, in determining whether a plan discriminates in favor of the higher paid. It is claimed that unions often prefer other benefits to pensions and if this free choice is made there is no reason to limit the pension of employees outside the bargaining unit to the level desired by the union. This may cause particular difficulty when industry-wide bargaining is involved. It seems to me we have to know more about the effect this rule would have on the collective bargaining process before it can be adopted. In any event, it should be noted that under such a rule, there may be cases where the union voluntarily or otherwise, chooses to forego pensions and a plan is adopted covering only a few highly paid executives. Therefore, the operation of such a rule should be limited to those cases where a significant number of lower paid people will be in the plan.

Some plans exclude employees by requiring the employees to make contributions as a pre-condition to coverage or denying employer financed benefits if the employee chooses to withdraw his own contribution on termination of employment (the Civil Service Retirement System is guilty of the latter practice). Offering an employee the carrot of immediate recovery of his accumulated contributions upon pre-retirement separation from service, if he agrees to forego employer financed benefits is contrary to the whole purpose of the private pension program--encouraging savings for retirement and should be prohibited. Contributory plans have a long history and one hesitates to cavalierly advocate their prohibition but I would suggest that the burden of proof be put on those who advocate their retention. There may be something to the position that in certain instances employer financed benefits would be inadequate and the employee needs to be encouraged to save for his own retirement. Before buying this, however, one wants some assurance that employees at all income levels tend to participate and the result is not to leave a large number of lower paid without even an inadequate pension.

Another means by which the lower paid got relatively less benefits from a qualified plan is the practice of integrating such plans with Social Security. In general, this permits the employer to treat a portion of Social Security benefits as part of his plan and to reduce the benefits he pays accordingly.

For example, the benefit formula may be 50% of pay reduced by 83% of the primary Social Security benefit. For low income people this will mean little or no benefit from the private plan. For high income individuals the Social Security offset will have relatively little effect.

Integration would seem to play a proper role in insuring that the total retirement benefit (from Social Security and the private plan) does not exceed full replacement of pre-retirement earnings. On the other side of the coin it seems impossible to justify any special tax benefits for a plan which covers _only_ those employees earning in excess of the Social Security wage base. It seems therefore, that integration should not be allowed unless the total benefit after application of the integration formula will adequately replace pre-retirement earnings (say 70-80% of pay at lower levels).

Of course, even the adoption of these proposals will not give us anything close to 100% coverage. In particular, there will be no effect on employees who work for companies which do not have retirement programs. This has led the Administration to recommend that "employees who wish to save independently for their retirement or to supplement employer-financed pensions should be allowed to deduct on their income tax returns amounts set aside for these purposes."

The primary effect of this proposal will be tax reductions for employees, including all Federal employees earning less than about $21,000, who now contribute to employer sponsored programs. To this degree, it will result in no additional retirement coverage -- but produce considerable revenue loss to the Treasury.*/

Moreover, the large percentage of any new plans will undoubtedly be created by high income individuals and will merely involve the transfer of existing savings from one account to another. Canada has a similar program. The figures show then even 12 years after adoption of the program in 1969, only about 1.2% of all returns filed by persons earning less than $10,000 a year showed contributions while over 35% of those persons earning in excess of $25,000 were participating.

*/ It may be justifiable on equitable grounds to allow a tax deduction to those, such as federal employees, who are required to contribute to retirement programs as a condition of employment, but such proposals should not masquerade as a means of increasing coverage.

A tax credit in lieu of a deduction, as proposed by S.1179, will probably result in a less unequal distribution of benefits. Nevertheless, it seems unreasonable to expect many people who now cannot afford to put aside money, for retirement to save, for example, $500 per year merely because this would reduce their current tax bill by $125.

Most important provision of a tax incentive for individual savings would seem to lose sight of the theory behind qualified plans -- to encourage savings for retirement in a form which provides security for the low paid who would otherwise not be able to achieve it. When an individual establishes his own-retirement account, he provides only for himself. If there is to be a tax incentive for such savings, it should be limited to those who have need for government aid. It should not be available to the higher paid. Similar objections should be raised to the present exclusion for individual savings, available under section 403(b), to employees of tax exempt organizations and public schools and to qualified plans which permit an election on the part of the employee to participate or take cash currently.

Bringing vast numbers of low paid workers into the mainstream of private retirement programs is difficult if not impossible to accomplish. Thus, the Labor movement generally concentrates on Social Security urging that benefits be raised to the level where Social Security alone will assure the average wage earner that he could continue to live in his present manner after retirement. The private pension system would then function primarily for those with above average earnings.

If this is not to be done and a private pension is to be considered as a partner with Social Security in securing income maintenance, then it seems necessary to explore the feasibility and desirability of a compulsory private system. Tax incentives alone will not lure everyone into a voluntary system.

This is a long-term project but there are things which can be done in the meantime to increase the fairness of the private pension system and to get greater equity in the distribution of its tax benefits.

First, we should remove or lower the barriers to eligibility, discussed above, such as job classification, age, length of service, willingness to contribute and integration with Social Security.

Second, we should take steps (Vesting, Funding, insurance) to insure that those actually covered by private plans will get the benefits they expect and will not be disappointed.

Third, we should limit the presently available tax benefits to the higher paid.

Restrictions on Benefits

As stated above, there are no limitations to the benefits that can be accorded under a qualified retirement plan. For example, if the president of a large corporation earns $250,000 and the company provides a pension equal to 70% of pay, it can pay its president $175,000 a year from its qualified plan. Such a pension would require an accumulation in excess of $2 million. It is hard to see, particularly in light of severe restraints imposed on federal expenditures generally how we can justify a "tax expenditure" to help finance a pension of that size to one individual, particularly one who should be well able to provide for his own retirement.

Some might say that if you can provide a 70% pension to someone earning $10,000 a year, through a qualified retirement plan, equality of treatment requires that a man earning $250,000 also be allowed a pension equal to 70% of earnings. Even if I were to be tempted by this assertion in a situation where all workers are participating, I see no merit to it where 50% of the working population is excluded. Why should their tax burden be increased because of the extreme tax savings for those who receive such large pensions when the excluded 50% get nothing at all themselves. Moreover, it must be remembered that because the higher the tax bracket, the greater the interest free loan, a high paid individual is given more of a break than the low paid even when his pension is the same percentage of pay. Thus, he may still get as much help in relation to pay even when his pension is limited to a lower percentage of earnings.* This would seem to maintain enough of a carrot to encourage the establishment of private pension plans.

Others might suggest a tax deferred set-aside for retirement is necessary because otherwise the inordinately high tax rates make it impossible to build an adequate nest egg. I am not swayed very far by this argument but in any event I think it is precluded by the adoption of the 50% maximum tax on earned income.

Finally, it is essential to make very clear what is not being proposed. There is no suggestion that the amount of retirement benefits payable to an employee cannot be as high as an employer wants. If he wants to reward "excellence" by paying a pension of $175,000 or more a year, he can do so and such payment, as long as it represents reasonable compensation will be deductible when paid.

The issue is whether there should be a limit on the amount of benefits the Treasury should help finance through the special tax benefits to qualified plans.

No one would propose a direct expenditure towards the payment of such a pension and a tax expenditure is not any more justifiable.

* For example compare the following cases assuming a qualified pension can be based on only the first $50,000 of earnings and the plan calls for a 50% benefit.

Earnings	Benefit	Assumed Tax Bracket	Assumed Contribution	Interest Free Loan	Loan as % of Compensation
$ 20,000	$10,000	25%	$2000	$ 500	2-1/2%
$ 50,000	$25,000	50%	$5000	$2500	5%
$100,000	$25,000	50%	$5000	$2500	2-1/2%

BEST COPY AVAILABLE

To its credit, the Administration is clearly troubled by the tendency of the tax subsidy to private pension plans to unduly favor highly compensated individuals. Thus, the President suggests increasing the annual limit for deductible contributions on behalf of self-employed individuals to $7500 or 15% of income whichever is less because the "distinction in treatment [between self-employed persons and employees] is not based on any difference in reality." While the administration proposal narrows the distinction, a substantial difference remains. Why, if as the President acknowledges the difference is not based on reality, did the administration not propose either scrapping the limitations or applying them across the board? The answer seems obvious. They were unwilling to further open up the unwarranted tax advantage of an unlimited set-aside for retirement by making it available to the self-employed. Yet they were not brave enough to face the complaints of those whose tax benefits would be reduced if similar limits were placed on corporate plans. I believe it is essential to face these complaints.

The amount of the limits on benefits is essentially a value judgment but the limit should not be so small so as to eliminate the incentive to establish qualified plans. It may be noted that $50,000 is the maximum amount of earnings which can be taken into account under the administration's proposal relating to self-employed individuals. Limiting a pension payable from a qualified plan to 70 or 80% of this amount would seem reasonable, although the Committee may want to consider further restrictions.

The limitation is most easily and equitably stated in terms of a restriction on the amount that could be set aside on a tax deferred basis to provide a pension for any one individual. Once the vested amount set aside for any employee equalled this amount, any future vesting of contributions or earnings on the account would be currently taxable.

I recognize that there will be many people who will object to such an across the board limitation. Therefore, I would like to address myself to the question of whether there is any justification at all for a less universal limit.

As indicated above, the purpose of the special tax benefits to qualified plans is to secure coverage for low paid individuals. Therefore, it is reasonable to examine individual plans to see what proportion of the persons covered are low paid or what portion of the total dollar value of the benefits is allocated to the low paid. Low paid for this purpose might be defined as those earning less than the taxable wage base under Social Security.

If the benefits under the plan are predominantly for higher paid individuals there is little reason to encourage the plan as it then exists. It could be brought into line by limiting the benefits to the high paid to a specified dollar limit or more logically to that amount necessary to produce the required percentage benefit for the lower paid.

If neither of these proposals seem acceptable, it is not entirely unreasonable to impose limitations only on persons who are substantial owners of a business, although it should not depend upon the form of business organization. These persons are in essence saving their own money which would otherwise come to them as owners of the business. If individual savings for retirement are not deductible (or are deductible subject to severe limitations), it may seem

BEST COPY AVAILABLE

illogical to permit deductions for essentially individual savings just because the individual works for himself as an employee. The difference, of course, is that when the plan is established as an employer it may be necessary to provide coverage for employees but it may be noted that closely held businesses are the ones most likely to have pension plans which benefit only a few highly paid people.

Imposing limitations solely on professional corporations is illogical. It can only be justified if the HR 10 limits are to be kept and it is desired to remove the artificial stimulation to professional corporations because one feels such corporations are undesirable on public policy grounds.

Additional Considerations

Other Special Tax Benefits

This paper would not be complete without brief mention of the totally unwarranted special tax benefits for qualified plans - capital gain treatment and special averaging for lump sum distributions, estate tax exclusion and postponement of tax on appreciation of securities of the employer distributed by the plan.

The special treatment for lump sum distributions is a classic case of putting the cart before the horse. Special averaging is supposedly necessary to avoid the harsh results from bunching in one year income which was accumulated over many years. In actual fact, however, most lump sum distributions I know of are the result of a desire to take advantage of the special tax treatment.

It is senseless to encourage retired persons to take the entire amount accumulated for their retirement security in one year and risk its possible dissipation instead of spreading the receipt of the pension over their lifetime.

Bunching need not occur. Under the Code if an annuity contract is distributed, taxation is deferred until the annuity becomes payable. Similar rules can be adopted with respect to special types of government bonds or bank accounts. No special averaging procedure is necessary or desirable.

The Profit Sharing Council of America has argued that most lump sum distributions are relatively small. Moreover, since profit sharing is not necessarily intended to provide retirement income there is no reason to discourage lump-sum distributions. This testimony raises several questions. Since most of the justification for qualified plans is stated in terms of the need for retirement security does Congress intend to confer special tax benefits on profit sharing plans to the extent they are not for retirement purposes? Does the Council's argument extend to lump sum distributions from pension plans or to profit sharing plans without a fixed contribution formula, as is common in closely held businesses? Does the general ratio of lump sum distributions apply to benefits at retirement? Does it exist with respect, to intermediate benefits as opposed to the very small or very large?

It is also unwise, as well as being an unfair tax advantage, to have special incentives for distributions in the form of employer stock. It seems to me to be more logical to prohibit, or at least discourage, investments in employer stock under either a profit sharing or a pension plan. It may be noted that the special tax benefits are available only in the case of funded plans which provide more security for the employee than just the employer's promise. When the plan assets consist to a large extent of the stock of the employer, in many cases this does not appreciably increase the security the employee would have under an unfunded arrangement.

Vesting

I think the important point to emphasize in comparing S.4 and S.1631 is the similarity rather than the differences. For employees hired at age 31 or 32, 50% (11 years) and full vesting (16 years) are achieved at the same point under both proposals. S.4 achieves faster vesting than S.1631 for those who begin work at age 30 or younger, and takes longer for 50% vesting for those hired at 33 or older. It should also be noted that S.4 recognizes the possibility of alternative approaches to vesting. If a compromise is to be sought between the two proposals, I would suggest that 50% vesting be required at whichever of the following occurs first: 10 years of participation or 5 years of participation and age 45.

Administration

It seems to me to be most important to distinguish between the sanctions to be applied and the agency which will apply them. For example, loss of tax exemption is not a very good deterrent to so-called prohibited transactions. The kind of penalties proposed in S.1631 seem much better but as that bill recommends there is no reason why such penalties cannot be applied by the Internal Revenue Service. It would seem to me that it is even possible for more flexible penalties to be applied by the Service.

Vesting standards are best imposed as conditions for qualification. S.4 purports to apply vesting (and funding) requirements to non-qualified plans but I doubt if this will be very meaningful, at least in part due to the 25 employee requirement.

On the other hand, the suggested sanction for failure to fund suggested by S.1631, full vesting of accrued benefits, would not seem appropriate in all cases. A requirement that the employer assume liability at least up to the required funding may be better.

Statement by Harold T. Swartz
Before the Subcommittee
on Private Pension Plans
of the Committee on Finance
United States Senate

May 31, 1973

My name is Harold T. Swartz. Before my retirement from the Internal Revenue Service a little more than a year ago, I occupied the position of Assistant Commissioner (Technical) of the Internal Revenue Service. One of the functions of that office is to issue rulings and technical advice on the provisions of the Internal Revenue Code relating to pension, profit-sharing, stock bonus, and annuity plans. I have been involved with those provisions since 1942 when the tax laws pertaining to private retirement plans were substantially overhauled.

My comments will be limited generally to the administration and enforcement of the provisions in the Internal Revenue Code relating to employees' pension, annuity, and profit-sharing plans.

Under present law, section 401 of the Code sets forth the requirements for the qualification of these plans and the tax results of many other provisions of the Code depend on whether or not a particular plan meets the requirements of section 401.

For example:

1. Whether the income earned by a pension trust is exempt from taxation under section 501.

2. When the contributions by an employer are deductible under section 404.

3. When the beneficiary of an employee's trust is taxable on the contributions made to the trust on his behalf.

4. Whether the beneficiary of a plan is entitled to capital gain treatment (or the seven year averaging treatment) on total lump-sum distributions from a trust.

5. Whether a life insurance company may treat certain reserves as "pension plan reserves" under section 805(d).

6. Whether for estate tax purposes, the value of certain annuity or other payments are excluded from the gross estate under section 2039(c).

7. Whether, for gift tax purposes, an election by an employee to provide a survivor annuity to his beneficiary is an exempt gift under section 2517.

Thus, whether any agency of the Government other than the Treasury is granted enforcement authority over the vesting, funding, or other similar provisions of private retirement plans, the Commissioner of Internal Revenue will still have to examine into the qualification of all such plans under section 401 of the Internal Revenue Code in order to determine the tax results in all of the foregoing situations.

Prior to the pension trust legislation in the Revenue Act of 1942 there were a limited number of funded pension and profit-sharing plans in existence. While there were some large corporations that maintained pension trusts and group annuity plans for their rank and file employees, there had begun to be established a large number of plans which were designed to cover only the officers, and other highly compensated employees. There were no provisions in the tax laws at that time that prohibited favorable tax treatment to this type of plan.

After the 1942 Act, no longer could an employer maintain a funded deferred compensation plan that could continue to receive favorable tax treatment where it covered only a selected group of employees.

The 1942 Act provided that employee retirement plans, in order to qualify, had to cover a stated percentage of total employees or a classification of employees found by the Commissioner of Internal Revenue not to discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated employees.

Despite these situations, a large number of employers rushed to establish qualified deferred compensation plans for their employees. One of the reasons for their popularity was that contributions were deductible for excess-profits tax purposes. Another reason was that under the rules governing salary and wage restrictions then in effect, a contribution made to such a plan by an employer on behalf of an employee was not considered to be a prohibited increase in salary or wages.

One of the questions that Congress considered in 1942 was that of "vesting". During the hearings on the Bill many employers testified that a fast vesting requirement would be extremely costly, particularly in pension and annuity plans. They testified that this could very well discourage the establishment of plans and might compel cut-backs in benefits under existing plans. Apparently the Congress was impressed by this testimony because it did not provide in the 1942 Act for any requirement for vesting.

Upon enactment of the 1942 Act, the Commissioner of Internal Revenue was faced with the responsibility of administering and enforcing the deferred compensation provisions. Very few, if any, corporations wanted to establish a plan until the Commissioner had issued a ruling that its particular plan qualified under the new law.

As a result, the Commissioner set up a separate pension trust office within Internal Revenue to issue advance rulings on deferred compensation plans and to administer the provisions of the new law.

At the present time there are approximately 400 specialists in the field offices of the Internal Revenue Service and about 60 specialists in the National Office in Washington who devote their entire time to the administration and enforcement of these provisions of the Code.

Vesting

Under section 401(a)(7) of the Code, a qualified plan must provide that an employee's rights are to become vested upon termination of the plan or upon complete discontinuance of contributions thereunder. In addition the regulations require full vesting of benefits at the time an employee reaches normal retirement age.

While there are no other specific provisions in the Code with respect to vesting of benefits, the Internal Revenue Service has required fast vesting in many plans seeking qualification under section 401. This is particularly true of profit-sharing and stock bonus plans. Such plans usually provide that the nonvested portion of the credits in an employee's account are forfeited when an employee leaves the employer before retirement. These forfeited amounts are allocated among the accounts of the remaining participants. Since the officers and highly compensated employees tend to remain with the employer until retirement these allocations of nonvested forfeitures often result in final benefits discriminating in their favor.

It is the practice of the Internal Revenue Service to insist that in order to qualify, such plans contain vesting provisions adequate enough to prevent this.

With respect to pension and annuity plans, forfeitures may not be used to increase the benefits of remaining employees. These forfeitures, if any, must be used to reduce the employers' contribution or premium cost of the plan in the following years. In addition, the Internal Revenue Service has held that a pension plan, in certain instances, may not qualify under section 401 unless satisfactory vesting provisions are incorporated in the plan to prevent contributions or benefits from discriminating in favor of officers, shareholders, supervisors or highly compensated employees. Revenue Ruling number 71-263, published in the Internal Revenue Cumulative Bulletin for 1971, describes a plan that covered all employees but provided benefits only for employees who retired at age 65 with 15 years of service. The employees, other than officers etc., were workers who stayed on the job only a relative short time so that only the executive employees remained to receive any benefits. The Ruling holds that such a plan does not qualify under section 401. The Ruling indicates, however, that the plan might qualify if satisfactory provisions for vesting are provided.

Funding

With regard to funding, the Code contains no specific provisions relating to the funding of benefits, however, Treasury regulations and rulings require that contributions to a qualified pension or annuity plan must be funded to the extent of the current pension liabilities, plus interest on the unfunded past service cost.

The Service often checks the status of the funding of a plan during the course of an audit. While it is concerned also with a plan that may be overfunded because a contribution to an overfunded plan is not considered to be deductible as an ordinary and necessary expense, it at the same time enforces the rules regarding underfunding.

Termination

While there are no provisions in the Code that require plan termination insurance, there are regulations and rulings that are designed to protect employees in the event of termination of a plan.

Under existing law a plan, in order to qualify, must expressly provide that upon termination of the plan or upon complete discontinuance of contributions under the plan, the rights of each employee to benefits accrued to the date of such terminations, to the extent then funded, must become vested.

In the event a plan is terminated, or if contributions are curtailed, the Internal Revenue Service requires that certain information is to be filed so that a determination may be made as to the effect of the termination or curtailment on the prior qualification of the plan.

The regulations also contain provisions that are designed to benefit the lower paid participants in the event a plan is terminated within ten years after its establishment or where the current costs for the first ten years of the plan have not been fully funded.

Thus, the Internal Revenue Service has had considerable experience in enforcing existing rules pertaining to termination of plans.

Enforcement

While not required by the Code, almost all funded deferred compensation plans are submitted to the Internal Revenue Service for approval before they are put into effect. These plans are thoroughly examined by Internal Revenue pension specialists before a determination is made as to whether the plan qualifies under section 401. In addition, when a substantial amendment is made to the plan it is usually submitted to the Internal Revenue Service for a new determination letter.

After the plan has been established, the Internal Revenue Service, during the audit of the tax return of an employer, examines the continued qualification of the plan in operation.

There is an appeals procedure under which a taxpayer may request that a proposed disqualification of a plan, or a proposed disallowance of a contribution deduction, be submitted to the pension specialists in the National Office of the Internal Revenue Service for review. The taxpayer is entitled to file a brief and is entitled to be heard in conference in the National Office. The same procedures are available where a District Director proposes to revoke the exemption of a trust when he is of the opinion that the trust has entered into a prohibited transactions under section 503 of the Code.

Conclusion

The Internal Revenue Service has more than 400 pension experts in its field offices and more than 50 pension specialists and actuaries in its National Office in Washington. They all have had experience with the problems relating to vesting, funding, termination and qualification of pension, profit-sharing, stock bonus and annuity plans. The Internal Revenue Service has been administering and enforcing the existing provisions of the Internal Revenue Code relating to these plans for more than 30 years and will have to continue to do so.

During the first nine months of the fiscal year 1973, Internal Revenue agents have examined into more than 23,000 returns involving Code section 404 deductions and the employee plans pertaining thereto. In addition, they audited more than 9,000 Forms 990-P filed by trustees of pension and profit-sharing trusts.

A new Employees Plan Master File system has been adopted by the Internal Revenue Service which, starting with the taxable year 1971, will enable it to account for all plans, the employer entities adopting such plans, the trust funds involved, and the fiduciaries of such plans. The system will also provide data for statistical purposes, detection of non-filers and selection for audit examinatiohs.

It would seem logical and preferable, therefore, that any additional vesting, funding, and other similar provisions that may be required of these plans be enforced and administered through the Treasury Department.

PREPARED STATEMENT OF CARROLL J. SAVAGE, IVINS, PHILLIPS & BARKER WASHINGTON, D.C.

I. Administration and Enforcement of Retirement Plan Legislation

Speaking from the standpoint of a private practitioner representing employers, employees, and plan administrators in all aspects of the establishment and operation of private pension plans, including compliance with the various applicable regulatory statutes, it seems to me that certain assumptions may be generally agreed upon in approaching the question of administration and enforcement of any new legislative rules applicable to this area.

Historically, the institution of the private pension plan has grown in a remarkably short time to staggeringly large proportions with relatively little regulation.[1/] Even among those most insistent on new legislation to assure greater protection of employees through vesting, funding, termination insurance and fiduciary standards, most agree that a large proportion of the plans in existence today operate in a manner which would be substantially unaffected by many of the major legislative proposals now under consideration. Accordingly, a sound approach to new rules will be one which deals effectively with the deficiencies

BEST COPY AVAILABLE

which have been identified without unnecessarily regulating those plans which do not exhibit those deficiencies.

Most advocates of legislation agree that those persons who are not covered by any retirement plan at all or are covered only by a plan providing low benefits present a problem at least as pressing as that of the adequately covered worker who may lose expected benefits. Since approximately one-half of the labor force is still not covered by private retirement plans, regulation of the design and behavior of plans which today fall short of acceptable standards must be carried out in a way which does not have a tendency to discourage the continued improvement and expansion of private plan coverage.

Much has been written in the last few years on the history of the private pension movement and need not be repeated here. Until this time, the basic federal statutory rules bearing on the substantive content of pension plans have been found in section 401(a) of the Internal Revenue Code of 1954, and predecessor provisions, and have been administered by the Internal Revenue Service. Since 1958, the Department of Labor has been charged with administration of the Welfare and Pension Plans Disclosure Act, which deals principally with disclosure but also contains some limited provisions regulating the conduct of plan administrators.

The first issue presented here today, and one which I regard as of great importance, is whether any legislation which is enacted concerning eligibility, vesting, and funding in the private pension area should be administered by the Treasury Department through the Internal Revenue Service, which presently administers rules on these subjects, by the Department of Labor, or by both departments simultaneously. In addition, the question is posed as to the proper administering agency in the case of adoption of a termination insurance program or a portability program, neither of which currently exists in any form. Finally, although not directly posed by any conflicting approaches in pending legislation, the mode of enforcement of any new rules relating to fiduciary responsibility is, in my opinion, deserving of attention.

A. Eligibility, Vesting and Funding

The tax rules presently applicable to funded employee trusts which fail to meet the qualifications of section 401(a) of the Internal Revenue Code are so extremely adverse that it is safe to say that virtually all funded retirement arrangements are established to comply with these rules. The result of a failure of a plan to qualify is the taxation of employees on the full value of their accrued benefits as and when they become vested, without regard to whether the benefits are then payable,[2/] and the denial of a deduction to the contributing employer until the employee does become vested.[3/] In other words, if the plan provides for full and immediate vesting, the active employee is immediately taxed in full on his future retirement benefits as they accrue. If the plan contains no vesting, the employer, although making regular contributions, will obtain no tax deduction until the employee retires and receives his benefits. The situation in between, that of graduated deferred vesting as is found in most plans, is equally intolerable. Furthermore, the earnings of a trust under a nonqualified plan are fully taxable.[4/]

Because of these adverse consequences, I am aware of no instances in which funded retirement plans have been established in an intentional effort to circumvent the rules of section 401(a). Accordingly, it is fair to say that these rules have been to a large extent self-enforcing. In my opinion, cooperative compliance would not be likely to continue at as high a level if the statutory requirements were enforced only through court orders without automatic sanctions. In such instances, there is an all too frequent tendency to comply with aspects of the legislation which are considered onerous only to the extent ordered to do so, resulting in an enforcement procedure which is slow and cumbersome. One example of the dramatic contrast in enforcement effectiveness of the two approaches can be found in recent experience with sex discrimination in retirement plans. Title VII of the Civil Rights Act of 1964[5/] prohibits sex discrimination in employment and the Equal Employment Opportunity Commission is given strong enforcement authority through the federal courts.[6] Regulations under the Act, promulgated in 1968, provided specifically that differences in retirement ages based on sex are prohibited.[7] But reaction to the statute or regulations among pension plans containing such differences has been slow. The reluctance to change voluntarily in response to these rules is evident from the decided cases appearing in the advance sheets for years thereafter each of which has resulted in a court order to single employers to eliminate age differences in a plan.[8] By contrast, when the Internal Revenue Service in 1971 changed its rules on plans integrated with Social Security to require for the first time use of the same retirement age for men and women,[9] it was my experience that every employer affected by these rules voluntarily amended its plan to bring it into compliance before the deadline of April 1, 1972 set by the Internal Revenue Service for such changes. Based on evidence of this type, I strongly submit that the approach of S. 4 to administration and enforcement of proposed rules on eligibility, vesting and funding may be expected to be less effective than the approach taken by S. 1179 and S. 1631 which continue the present system reinforced by more specific requirements in each of these areas.

To say that the present requirements are largely self-enforcing is not intended to imply that no administrative bureaucracy has been required in this area. For corporate plans covering most workers, the present statutory rules are very general, centering basically around the legislative requirement that in order to avoid unfavorable tax treatment a plan must not discriminate in favor of officers, stockholders, or supervisory or highly-paid employees.[10] Around this legislative standard the Internal Revenue Service, through detailed regulations developed over many years and through hundreds of published rulings, has evolved numerous specific criteria with which plans must comply, including administrative rules specifically relating to eligibility, vesting and funding.[11] Furthermore, local District Offices of the Internal Revenue Service, which are staffed with agents who are specialists in this area, are empowered to review specific plans and issue advance determination letters concerning qualification when plans are established and amended,[12] and the vast majority of plans seek such determinations, again because of the risk of adverse tax treatment inherent in failure to qualify. Detailed reporting by employers and trustees is required, which forms a basis for office or field audit by agents who are specialists in this area.[13]

It seems evident that the provisions of proposed legislation, if added to the Internal Revenue Code as requirements for tax qualification, would be administered in very much the same way as the present provisions with hardly a ripple in the bureaucratic machinery. Administration and enforcement of such provisions by the Department of Labor, however, would require the creation of a completely new and quite extensive bureaucracy. This seems not only unnecessary but unwise. Some of the proposed provisions, such as those concerning funding, are highly technical and would require considerable expertise to administer properly. The Internal Revenue Service has already accumulated this expertise, particularly in the area of actuarial techniques and actuarial personnel, but also in such matters as report processing and audit procedures, and the handling of rulings. It would inevitably require some time before similar capabilities could be developed in another department.

The most serious problem which would result from the enactment of S. 4 but which would be avoided by the approach taken in S. 1179 and S. 1631 is that of dual administration. Since S. 4 does not repeal the nondiscrimination provisions of the Internal Revenue Code on which are based the present administrative rules concerning eligibility, vesting and funding, we are not dealing simply with the question of which agency should administer private pension plan legislation. Rather, in the present posture of pending proposals we are dealing with the question of whether these rules should be administered by a single agency or by two separate agencies simultaneously. The approach of S. 4 would lead to a need for dual staffs, dual reporting requirements and dual audits which could not be fully avoided by interdepartmental coordination due to the differences in the statutory requirements. This would not only be wasteful and inefficient, but frustrating and burdensome and costly for those being regulated. Accordingly, it seems a compelling conclusion that if the approach of S. 4 should be adopted, the creation of an enforcement authority in the Department of Labor should be accompanied by a repeal of the provisions of the Internal Revenue Code dealing with this subject matter. In such circumstances, it would be sufficient and desirable simply to provide that the present tax consequences will follow from issuance of a registration certificate by the Secretary of Labor, and to specify the limits on the amount of contributions under registered plans which can be deducted by employers in any year. Unfortunately, even this would not be a satisfactory solution to the problem of duplication unless S. 4 were extended both in the aspects of the subject which it regulates and the plans to which it applies. For example, S. 4 does not deal at all with small plans (25 participants and under) and does not contain any rules on such matters as coverage and integration with Social Security benefits.[14/]

Some commentators have taken the position that the Internal Revenue Service should not administer retirement plan legislation because it is concerned not with the protection of the rights of employees but with protection of the revenue. This is merely to assume a conclusion. Internal Revenue Service personnel administering a set of vesting, funding or other rules designed to protect the rights of employees will, based on my experience of dealing with Internal Revenue Service administration of plans under current law, focus on compliance with those rules in the same manner as any other civil servant administering similar rules, without regard to revenue considerations.

Another conclusion which is sometimes stated as though it were foregone is that "pension regulation belongs in the agency established to protect the interests of workers." If pension coverage were made mandatory, perhaps so, but as long as it is not I believe that this proposition is no more warranted then would be the proposition that pension regulation should be centered in the Department of Commerce because pensions are established by private business interests. The fact is that the private pension movement has so many aspects and is typified by so much diversity that it cannot be characterized as the natural charge of any existing agency, but there are practical and historical reasons for continued administration of the program by the Treasury.

In summary, I believe that the approach to administration and enforcement of the eligibility, vesting and funding requirements which is contained in S. 4 is inferior to the approach taken by S. 1179 and S. 1631, because:

(a) it would be less effective;

(b) it would create an unnecessary new bureaucracy;

(c) it would not take full advantage of existing governmental expertise;

(d) it would inevitably result in duplication of governmental functions and dual regulation of retirement plans.

For these reasons I believe the approach of S. 4, given the same substantive content of the proposed new rules, would have a greater tendency than S. 1179 or S. 1631 to place unnecessary burdens on the many plans which to date have exhibited no need for additional government regulation and would also have a greater tendency to discourage the creation of new plans.

B. Portability and Insurance

Since there is nothing comparable to these provisions in present law, much of the above discussion is inapplicable to the issue of which agency should administer such programs if they are enacted. However, there seems no particular reason to place these functions in the Department of Labor if other regulatory functions are not placed there.

With respect to portability, the clearing-house approach of S. 4 creates an additional bureaucracy which, in view of its voluntary nature, could be justified only by citing the very marginal benefit of consolidating the pension checks of some workers who have acquired vested rights under several plans. The Report on S. 4 by the Committee on Labor and Public Welfare suggests that the clearing-house might be dispensable if the tax laws were amended to permit tax-free transfer of credits. This approach of amending the tax laws is adopted by S. 1179 and S. 1631. If portability is deemed desirable, there is much to be said for delaying the creation of any new federal bureaucracy until there has been more experience with a tax law change which might accomplish much of the same objective on a self-administering basis.

With respect to plan termination insurance, S. 1179 takes the approach that this sort of risk pooling among under-funded plans may not be strictly a governmental function, and proposes a nongovernmental, nonprofit membership corporation to perform the same functions proposed by S. 4 to be placed in the Department of Labor. If plan termination insurance is deemed desirable, the use of such a nongovernmental membership corporation seems a sound approach to continuation of the successful self-regulation which has characterized the private pension plan movement to date.

C. Fiduciary Standards and Disclosure

The Welfare and Pension Plans Disclosure Act provides that retirement plans covering more than 25 participants must file plan descriptions with the Secretary of Labor and that plans covering 100 or more participants must file annual reports.[15] For the last 10 years the Act has provided the Secretary with investigative and enforcement powers.[16] Although it is clear that the provisions of the Act are not as strong as they should be either with respect to the information required or the investigative and enforcement powers conferred on the Secretary, it is also clear that the Act has not been administered and enforced to nearly its full potential. My experience has been that there are many plan administrators covered by the Act who do not file or who file incomplete information without apparent repercussions. Furthermore, the information which up until this year has been required under the regulations has not been calculated to make the Act useful for its intended purpose.[17/] Therefore, to some extent the problem has been not one of inadequate laws but rather of a failure of enforcement.

The Welfare and Pension Plans Disclosure Act now in effect touches on fiduciary responsibility in requiring bonding of plan administrators and imposing criminal penalties for embezzlement and kickbacks.[18/] The Internal Revenue Code also deals with this area in its provisions resulting in loss of trust exemption where plan administrators engage in prohibited transactions, including various non-arm's length transactions with the employer.[19/]

Both S. 4 and the Administration proposals (S. 1557) contain substantially similar provisions on fiduciary responsibility and disclosure and provide for continuation of the administration of these functions by the Department of Labor. In addition, the Administration proposals embodied in S. 1631 would amend the prohibited transaction provisions of the Internal Revenue Code to define fiduciary duties by reference to the amended Welfare and Pension Plans Disclosure Act and to impose an excise tax on plan administrators who run afoul of these provisions, substantially similar to the excise taxes imposed on foundation managers by Chapter 42 of the Internal Revenue Code added by the Tax Reform Act of 1969.[20/]

While there has been little disagreement on the fact that new rules are desirable relating to fiduciary responsibility, it seems to me that in this instance the Administration proposals are guilty of the same duplication that it sought to avoid in the handling of eligibility, vesting and funding proposals. We are faced with two agencies being simultaneously granted investigatory and enforcement powers over identical offenses. One agency is told to proceed by action in the federal district courts while the Tax Court is granted jurisdiction to handle the more automatic penalties imposed by the other.[21] I am concerned that there may be a bit of overkill in this which is not present to the same degree in the private foundation area where, although state authorities may have concurrent rules, there is no duplication of federal enforcement agencies.

There are good reasons to continue the disclosure functions in the Department of Labor under a new statute expanding these functions. I believe it also acceptable to follow the approach of S. 4 and S. 1557 of placing responsibility for enforcing the new fiduciary responsibility rules in that department. However, I am intrigued with the excise tax approach taken by S. 1631. This approach cures the criticism which has been leveled in the past at IRS enforcement of prohibited transaction rules, *i.e.*, that the loss of exemption of the trust was so great a penalty on innocent parties that it would not as a practical matter be invoked. In view of the poor record of enforcement by the Labor Department under the statute now in force and the fairly good enforcement exper.ence of the Internal Revenue Service under the very general rules which it has been charged with administering to date, I would suggest to the Administration and this Committee that they take a careful look at the idea of using the proposed excise tax provisions as the primary enforcement tool in this area, cutting back the overlapping powers of enforcement of fiduciary responsibility rules proposed to be granted to the Secretary of Labor by S. 1557. In any event, I would urge that, if the excise tax rules are adopted, further study be devoted to the question of whether additional provisions are needed to avoid problems of concurrent enforcement.

II. Limitations on Pension Benefits

In discussing the question of whether upper dollar limitations should be placed on the amount of individual retirement benefits which will be given the tax treatment applicable to qualified benefits in general, it is important to put the matter in proper analytical context.

Some who have advocated such limits have done so on the ground that the treatment which the tax laws provide for qualified retirement plans should not be used as a means by which high income individuals may accumulate large estates, stating or implying that the provisions for qualified plans are in the nature of a "tax loophole " Whether it is more accurate to state that qualified plans receive favorable tax treatment under the Code or that nonqualified plans are penalized[22/] is a rather fruitless issue which does not necessarily lead to a correct solution to the inquiry, but there is, in my opinion, sufficient merit in the latter proposition to warrant rejection of the premise that lack of overall limits is a "tax loophole."

The question of whether there ought to be limits, it seems to me, should be addressed on essentially two levels:

(1) As a matter of tax theory; and

(2) As a matter of practicality.

In the first category are questions such as whether larger pensions should in effect be taxed less favorably, and if so whether this objective is not already accomplished more equitably and directly through the progressive rate structure. In the second category are such questions as whether the adoption of provisions relating to qualified plans which are designed to discourage employers from providing pensions for highly compensated employees which are as high in proportion to their cash wages as are provided for other employees would be ineffective because of a willingness to gross up the benefits to compensate for the higher taxes on nonqualified benefits. Another practical consideration is whether the incidental tax revenue resulting from such a practice would be worth the possible loss of incentive to management to adopt and improve pension plans, and whether limits are needed as a practical matter in some situations simply because of the opportunity for disguising business profits as earned income and the difficulty of drawing any clear distinctions between them.

Even though one subscribes fully to the view that larger pensions should be taxed less favorably than smaller ones, I believe there is much to be said for the proposition that the progressive rate structure is the best approach to allocating the tax burden among individuals according to income level and that it is generally poor tax theory to attempt to achieve further progression on the hit and miss basis of rather arbitrarily drawn dollar limits to deductions and exclusions here and there in the Code.[23/] Retirement benefits attributable to employer contributions accruing since 1969 are no longer eligible for capital gain treatment, and a very highly compensated executive will remain in a high bracket even after application of the applicable averaging provisions. The argument that tax deferral is worth more to the high bracket taxpayer than the low bracket taxpayer is incontrovertible, but this is merely an inevitable result of the fact that he would be in a higher bracket if taxed currently, is true of all deductions and exclusions, and does not assist in analyzing the issue.

Furthermore, in my judgment business will provide for its favored employees regardless of tax consequences. While making this more costly would have some revenue raising tendency (difficult to measure), this uncertain fiscal advantage is offset by an also uncertain but potentially more significant disadvantage. My pragmatic experience has often been that there is a great deal of enlightened self-interest on the part of management in its willingness to establish and improve retirement benefits and its inclination to administer them with loving care. As long as we are relying on private forces to maintain and expand the pension system, i.e., unless "private" pensions are in effect made mandatory, it may be dangerous to experiment with rules that might dull the incentives which have operated to date.

Accordingly, I believe that as a general proposition there should be a presumption against limits, and that limits should be applied only where compelling reasons exist. It is arguable that such reasons exist in the case of plans maintained by closely-held businesses where ownership interests are prominently represented among the covered employees. Where such businesses are unincorporated and capital (or goodwill) is a material income producing factor there is an obvious problem. The same problem exists where such businesses are incorporated, limited only by the rather imprecise rules concerning nondeductibility of unreasonable compensation. It is difficult to devise a workable set of rules for limiting covered compensation in such instances to the portion of the income from the business received by the owner employee which actually is derived from his services and indeed this may be a very subjective matter. One approach which I do not believe has been sufficiently investigated, as an alternative to arbitrary dollar limits, would be application of the principles being developed in the "earned income" area under Internal Revenue Code §§ 911 and 1348, including presumptions and limitations applicable where capital is a material income producing factor. Any such approach is inevitably complicated, but because of the maximum tax provisions will have to be faced in any event.

Nevertheless, it may be concluded that complications in alternative approaches or other practical reasons justify a judgment on the part of Congress that somewhat arbitrary limits on tax qualified retirement benefits should be imposed in situations where there is reason to presume that stated compensation or self-employment income is not determined at arm's length subject to the constraints of outside ownership. Such limits might be imposed where, e.g., more than one-half of the benefits accruing under a plan are for the benefit of persons owning directly or indirectly more than a specified portion (e.g., 5%) of the business, as sole proprietor, partner, stockholder, or otherwise. To promote tax neutrality in the question of form of business organization and discourage artificial reasons for incorporation of businesses which otherwise would operate in non-corporate form, any such rules should apply to corporations as well as unincorporated businesses and professional groups. This approach would permit repeal of the present limitations which discriminate against unincorporated businesses and Subchapter S corporations.

If dollar limits are imposed in such limited situations, it would seem desirable to provide a mechanism for adjustment to inflationary changes, such as tying the figure into increases in a recognized wage table or cost of living index. The base limits are obviously a matter of judgment. The limits of present law applicable to unincorporated businesses and Subchapter S corporations are intolerably low, and have a real tendency to discourage adoption and improvement of plans which would be of benefit to rank and file common law employees. The provisions of S. 1631 raising these limits to the lesser of $7,500 or 15% of earned income are a vast improvement and approach the reasonable area, in my view, although an increase in the dollar limit to $10,000 might be more realistic.

Footnotes

1/ For a historical account of the private pension plan movement, see President's Committee on Corporate Pension Funds, *Public Policy and Private Pension Programs* (1965) at 1-10; Bankers Trust Company, *The Private Pension Controversy* (1973) at 5-12.

2/ Internal Revenue Code, § 402(b) and § 83.

3/ Internal Revenue Code, § 404(a)(5).

4/ Internal Revenue Code, § 501(a) and § 641(a).

5/ 42 U.S.C. § 2000e-2a.

6/ 42 U.S.C. § 2000e-5 through 2000e-9.

7/ 29 C.F.R. § 1604.31(a).

8/ See, *e.g.*, *Fillinger v. East Ohio Gas Company*, Civil No. 69-788 (N.D. Ohio, August 17, 1971); *Rosen v. Public Service Electric and Gas Co.*, Civil No. 245-66 (D. N.J., August 25, 1970; reaffirmed, November 24, 1970).

9/ Rev. Rul. 71-446, 1971-2 C.B. 187.

10/ Internal Revenue Code, § 401(a)(3) and (4).

11/ See, *e.g.*, Rev. Rul. 70-75, 1970-1 C.B. 95; Rev. Rul. 71-150, 1971-1 C.B. 123; Treas. Reg. § 1.401-6(c).

12/ See Rev. Proc. 72-6, 1972-1 I.R.B. 20.

13/ Annual returns are required on Forms 4848, 4849, and 990-P. In addition, there are many other notification and reporting requirements applicable to specific situations, such as investment in employer securities, termination of a plan, etc.

14/ All of the same considerations would apply to the creation of a new independent agency to administer proposed retirement plan legislation, such as was proposed in earlier bills considered by the Committee on Labor and Public Welfare.

15/ Welfare and Pension Plans Disclosure Act, as amended, Sec. 4-7, 29 U.S.C. § 301 et seq.

16/ Welfare and Pension Plans Disclosure Act, Sec. 9, 29 U.S.C. § 308.

17/ In 1973 the Department of Labor amended its regulations to provide greatly expanded information concerning plan descriptions and requiring written explanations of plans and amendments to be provided upon request to participants and beneficiaries in language reasonably calculated to be understood by them. 29 CFR Part 460.

18/ Welfare and Pension Plans Disclosure Act, Sec. 13, 29 U.S.C. § 308(d); 18 U.S.C. §§ 664, 1027 and 1954.

19/ Internal Revenue Code, § 503.

20/ Internal Revenue Code, §§ 4940-4948.

21/ A penalty of 5% of the amount involved is imposed upon a finding by the Internal Revenue Service that one of the fiduciary standards has been contravened and a further penalty of 200% of the amount involved is imposed if it is not corrected within a specified period during which the fiduciary, if inclined, may petition the Tax Court for a determination that the administrative finding was erroneous. Internal Revenue Code, § 6213.

22/ For a discussion of this issue see Raymond Goetz, Tax Treatment of Pension Plans--Preferential or Normal?, American Enterprise Institute (1969).

23/ Such dollar limits may be found in the Code today in § 79 dealing with employer-provided group term life insurance and § 217 dealing with employer-paid moving expenses. However, unlike the pension area, these are situations in which the benefit, if not taxed when paid for by the employer, would escape taxation permanently, and are not comparable to a mere deferral situation where progressive rates will ultimately apply.

Senator NELSON. The next panel discussion will be on June 4.

[Whereupon, at 12:40 p.m. the subcommittee recessed to reconvene at 10 a.m., Monday, June 4, 1973.]

PRIVATE PENSION PLAN REFORM

MONDAY, JUNE 4, 1973

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

The subcommittee met, pursuant to recess, at 10.10 a.m., in room 2221, Dirksen Senate Office Building, Senator Gaylord Nelson (chairman of the subcommittee) presiding.

Present: Senators Nelson, Bentsen, Curtis, and Roth.

Senator NELSON. Today we begin the second of our 2 days of panel discussions.

The subject for this panel is the vesting and funding provisions of S. 4, S. 1179, and S. 1631, and the provisions in some of those bills for termination insurance, portability and fudiciary standards.

We have a distinguished group of panelists: Mr. Merton Bernstein, professor of law at Ohio State University Law School; Mr. Herman Biegel, partner, Washington law firm of Lee, Toomey & Kent; Mr. Edwin F. Cohen, counsel to the Washington, D.C., law firm of Covington & Burling; Frank Cummings, a partner in the Washington, D.C., law firm of Gall, Lang, Powell & Kilcullen; and Leonard Lesser, general counsel of the Center for Community Change, Washington, D.C.

As I stated in my letter of invitation to each panelist, we would appreciate if you would, instead of reading your statement, summarize it in 10 minutes. The statement will be printed in full, of course, in the record and you will be given an opportunity to discuss and make comments on the observations of the other members of the panel.

Our first panelist is Mr. Merton Bernstein, professor of law at Ohio State University.

STATEMENTS OF PANELISTS MERTON BERNSTEIN,[1] PROFESSOR OF LAW, OHIO STATE UNIVERSITY LAW SCHOOL; HERMAN BIEGEL,[2] PARTNER, WASHINGTON, D.C., LAW FIRM OF LEE, TOOMEY & KENT; EDWIN S. COHEN,[3] COUNSEL, WASHINGTON, D.C., LAW FIRM OF COVINGTON & BURLING; FRANK CUMMINGS,[4] PARTNER, WASHINGTON, D.C., LAW FIRM OF GALL, LANE, POWELL & KILCULLEN; LEONARD LESSER,[5] GENERAL COUNSEL OF THE CENTER FOR COMMUNITY CHANGE, WASHINGTON, D.C.

Mr. BERNSTEIN. Thank you, Senator.

I would like to start my testimony in Burlington, Wis.——

Senator NELSON. A very good spot.

Mr. BERNSTEIN. It was better, Senator, before this occurred.

In 1962, Burlington Mills, Inc., established a pension plan for salaried employees. There also was a rank-and-file pension plan but I have no information about that; but I have the feeling that the story there was at least as poor and maybe worse. In any event, starting in 1962, there was this salaried pension plan for executives who had service between 20 and 40 years with this company. Contributions between $15,000 and $19,000 a year were made each year for 4 years. The last contribution of $800 was made in January 1966. In early 1967, the company minutes show, that the officers decided to make no further contribution to the plan. However, formal termination of the plan did not take place until the summer of 1967. Meanwhile, these long service executives were being separated and they were being separated without pension eligibility. The principal stockholder, a Mr. Kinzer, who with his family owned 92 percent of the shares, was the president of the corporation; he was the trustee of the trust; he was also a member of the pension committee. It was quite clearly his determination, his decision, when this plan would terminate. And when it terminated, the bulk of the executives had lost any chance of qualifying for benefits. Mr. Kinzer's share appreciated by $11,000 in the period between the last $1,800 contribution and the termination of the plan.

Now, I think the committee members understand that termination of the plan means, under the code and regulations, that all credits vest even when there is no vesting provision.

This sad story in Burlington, Wis., shows some but not all of the defects of the private pension plan design.

Senator NELSON. You said the principal stockholder benefited by $11,000?

Mr. BERNSTEIN. That is right.

Senator NELSON. Is that $11,000 per year?

Mr. BERNSTEIN. The total value. This was a rather short term plan. The value of his benefits went from $15,000 to $26,000 in the year and one-half of delay.

Senator BENTSEN. Are you saying that forfeitures accrued to the benefit of the remaining participant?

[1] Prepared statement, p. 875.
[2] Prepared statement, p. 911.
[3] Prepared statement, p. 944.
[4] Prepared statement, p. 969.
[5] Prepared statement, p. 1040.

Mr. BERNSTEIN. Exactly, Senator, that is precisely right. This little sad story illustrates some but by no means not all of the defects of private pension plan design. One defect—and the critical one—is that length of service eligibility conditions are frequently used to defeat eligibility. Supposedly, they are there to help retain employees who are valued, but, in fact, again and again and again they are used to defeat pension eligibility for those who have no opportunity to comply.

It also is a stark illustration of employer control of pension trustees. A dissenting trustee, who did not agree to the termination when it took place but opted or preferred one that was earlier was simply removed. It showed employer domination of crucial decisions adversely affecting the employees but favoring management. The same could be said of jointly administered plans in the case of unions.

Although section 401(a)(7) of the Internal Revenue Code mandates vesting of all pension credits when a plan terminates IRS regulations and procedures do not protect employee interests this code provision supposedly serves, I would add that the courts failed to protect employee interest against employer self-serving plan language and actions. I would like to offer for the record—but will not summarize now—the decision of the Wisconsin Supreme Court which is remarkable for its insensitivity to employee interests, and for the intricacies of the private pension plans.

Senator NELSON. Is that the whole decision?

Mr. BERNSTEIN. Yes; this is the entire decision.

Senator NELSON. It will be printed in the appropriate place in the record.

[The referred to decision of the Supreme Court of Wisconsin follows. Hearing continues on p. 834.]

[From the Supreme Court of Wisconsin (November 28), August term, 1972]

ZEMAITIS, for himself and on behalf of all others similarly situated, Respondent, v. BURLINGTON MILLS, INC., and other, Appellants. [Case No. 276.]

BEGUHL, and others, on behalf of themselves and all others similarly situated, Respondents, v. BURLINGTON MILLS, INC., and others, Appellants. [Case No. 277.]

Nos. 276, 277. Argued November 1, 1972.—Decided November 28, 1972.

1. Master and servant—Noncontributory pension plan—Termination on "discontinuance of contributions"—Entitlement to benefits—Making final payment funding trust as not effecting termination.

Where a company adopted a pension plan for its salaried employees and simultaneously therewith created a trust to provide a vehicle for funding the plan (noncontributory as to employees), terminable by company resolution or as later resolved upon *permanent* discontinuance of contributions—at either of which times pension benefits were to vest—termination triggering such claims was not effected as a "discontinuance of contributions" when the employer contributed its last payment fully funding the trust thereby meeting Internal Revenue Code requirements, because no additional contributions were thereafter necessary to keep the plan fully funded and hence "discontinuance of contributions" could not take place.

2. Master and servant—Noncontributory pension plan—Termination effected following company move to another state—Claim for vested benefits by former employees based on prior termination not established.

Under evidence that the company, because of adverse financial conditions in Wisconsin moved its operation to another state, where it resolved to both terminate the plan and make provision for its then eligible employees who had accompanied the employer, class actions, by former salaried employees who remained in Wisconsin, seeking to participate in the trust could not be grounded on claim that they were vested with pension benefits on the date the company made its last contribution to the plan before the move—this on the theory that because no payments would be made thereafter there was a "discontinuance of contributions"—since it was not within the intendment of the resolution that the trust should be considered terminated by reason of the last funding payment.

3. Master and servant—Noncontributory pension plan—Termination—Claim for vested benefits by former employees based on bad faith termination—Refuted by record.

Plaintiff employees' entitlement to participate in the trust was not established under claim of the principal stockholder's bad faith in terminating the trust where credible evidence established (a) the company's labor problems in Wisconsin resulted in its decision to move its plant out of the state, (b) its loss of experienced personnel who chose to remain in Wisconsin and in having to find inexperienced personnel led to other unforeseen losses incurred after the move, (c) these losses led to the company's decision to find a buyer for the business and keep the plan in continued operation as an added inducement, and (d) it was only terminated after the company became satisfied the buyer did not desire to adopt it.

4. Master and servant—Noncontributory pension plan—Termination effected following company move to another state—Claim for vested benefits by former employees grounded on unjust enrichment—Evidence insufficiency.

Plaintiffs' right to recovery could not be grounded on unjust enrichment—by invoking the principle that employers are under a contractual obligation to pay pension benefits to employees entitled thereto under a pension plan communicated to them where they remain in employment and render services for the requisite period—since there was no proof of fraud or bad faith and it was undisputed that plaintiffs had not met the age and service requirements of the plan when their employment ended, hence they had not rendered services for the requisite period because each one of them terminated employment before he or she qualified for benefits.

APPEALS from an interlocutory judgment of the circuit court for Racine county: HOWARD J. DU ROCHER, Circuit Judge. *Reversed.*

These are actions by certain former employees of Burlington Mills, Inc. (hereinafter the "company") to participate in the trust fund established to provide pension benefits for salaried employees. The two class actions were consolidated for trial and tried to the court without a jury.

In 1962 the company adopted a pension plan (hereinafter the "plan") for its salaried employees, and the plan was qualified under the Internal Revenue Code of 1954, as amended. Simultaneously, with the creation of the plan, the Burlington Mills Pension Trust for Salaried Employees (hereinafter the "trust") was established to provide a vehicle for funding the plan. All contributions to the trust were made by the company and to this extent were tax deductible with earnings on the contributed sums not being taxed.

The contributions made were as follows:

1962	$18, 928
1963	16, 800
1964	19, 000
1965	14, 997
1966	800
Total	70, 525

The last contribution to the plan was made on January 19, 1966.

As originally set up, A. J. Rueter, Richard A. Kinzer and Floyd Steffen constitüted the trustees of the plan and the retirement committee which was charged with administering the plan.

Under the terms of the plan, benefits were based on two factors, namely the amount of salary and years of service, and any salaried employee was immediately eligible to participate. The plan provided benefits to retired employees who were over sixty-five years of age with ten years of company service; over age sixty with twenty years of service; or to employees who were permanently disabled while employed after fifteen years of service. It is conceded that none of the plaintiffs-respondents fit into any of these categories.

Art. XIII of the plan related to termination and as it was originally adopted, the material part read as follows:

"Art. XIII

"13.1 *Right to Terminate:* The Board of Directors of the Employer, by a duly adopted resolution, may terminate the Plan at any time and may direct and require the Trustee to liquidate the Trust. In the event the Employer shall for any reason cease to exist, the Plan shall terminate and the Trust shall be liquidated, unless it is continued by a successor to all or substantially all of the Employer's assets.

"13.2 *Liquidation of Trust Fund:* Upon termination of the Plan, each Employee's accrued benefit, based on his Service prior to the date of termination, shall become fully vested, and the assets of the Trust shall be liquidated, after provision is made for the expenses of liquidation, by the payment or provision for the payment of benefits in the following order of preference:

"(a) to retired Employees who are receiving benefits on the date of termination;

"(b) to Employees who attained age 65 and completed 10 or more years of Service to the date of termination;

"(c) to Employees who attained age 55 and completed 15 or more years of Service prior to the date of termination; and to retired Employees who are eligible for any Early Pension but who have not received any payments thereof prior to the date of termination;

"(d) to all other Employees according to the respective actuarial values of their accrued benefits as of the date of termination.

"If the assets of the trust applicable to any of the above groups are insufficient to provide full benefits for all persons in such groups, the benefits otherwise payable to such persons shall be reduced proportionately, and no benefits shall be paid to any person in a subsequent group."

On May 4, 1965, the company's board of directors (hereinafter the "board") passed a resolution amending sec. 13.2 and, after such amendment, the section read as follows:

"Upon termination of the Plan, or a *permanent discontinuance of contributions by the Employer*, each Employee's accrued benefit . . . shall become fully vested. . . ." (Emphasis added.)

According to the resolution, the added language was made necessary by a requirement of the Internal Revenue Service

In November of 1965, the board adopted a resolution to move the company's operations from Burlington, Wisconsin to Danville, Kentucky with the major impetus for the move coming from an adverse financial situation present in its Wisconsin operation. News of this move became known to the employees in early 1966 and was formally announced during the summer of 1966. The company's president, Richard Kinzer, testified that although most of the salaried employees were expressly offered a job in Danville, there were a few exceptions, such as where the employee's physical condition or family situation was such as to preclude a move. There was, however, testimony by five of the named plaintiffs that no offer of employment was ever made to them, and on appeal plaintiffs allege that a number of them were terminated outright when their employment was no longer needed in Burlington. Other plaintiffs, being aware of the impending relocation, sought, found and commenced different employment prior to the date on which their job would have actually shifted to Kentucky.

The move to Kentucky did not ease the adverse financial condition of the company. In the early months of 1967, efforts were made to find a buyer for the business. In order to give the officers an opportunity to either sell the company with the salaried pension plan still in effect, or to terminate the plan if the buyer was unwilling to adopt it, the board passed a resolution which authorized any officer to terminate the plan, and the plan was terminated by the officers on July 28, 1967.

At an August 24, 1967 meeting of the board a resolution was adopted to amend the provisions of the plan dealing with termination to provide that after making provision for all retired employees and all active employees over age sixty-five, the remaining active employees should be lumped into a single category to receive a pro rata distribution of the remaining trust fund.

On August 29th, the Internal Revenue Service formally approved the proposed plan of termination with an effective date of July 28, 1967, as not disturbing the original qualification of the plan. At a meeting of the board on September 27, 1967, it was announced that the sale of the company's assets to the Standard

Cotton Products Company of Flint, Michigan had been completed and that the Pension Fund for Salaried Employees was also being closed and distributed in the near future, and this distribution, in accordance with the above amendment relating to a pro rata distribution, was completed on December 1, 1967.

The plaintiffs in these two actions are 15 former salaried employees of the company whose employment had terminated on various dates between March, 1966, and June, 1967. The defendants are the company and two of the three members of the retirement committee, and trustees under the plan. The third member is one of the named plaintiffs who left the company in August of 1966.

The thrust of the first complaint was leveled at Kinzer who, it was alleged, directly or indirectly held 92 percent of the company's stock. It was alleged that Kinzer had engineered the move from Wisconsin to Kentucky as a scheme to defraud the plaintiffs out of their pension benefits. It was further alleged that the officers of the company had selected July 28, 1967, as a termination date in order to exclude the plaintiffs from participation and to enlarge Kinzer's share.

The complaint in the second action, while alleging the same circumstances, sought pension benefits under the theory of unjust enrichment in that plaintiffs had performed services for the company in reliance upon the expectation of receiving pension benefits and, therefore, had a contract right to participate in the distribution of the pension fund. After the two actions were consolidated, the defendants moved for summary judgment. The trial court overruled the motion, stating that the plaintiffs had the right to go to trial on the question of bad faith.

The trial court found that the plaintiffs had failed to establish by clear and convincing evidence any bad faith on the part of the company or that Kinzer was unjustly enriched and that the long term salaried employees had suffered corresponding loss. Nevertheless, the court did find that the plaintiffs were entitled to recover, because of the amendment made to the plan on May 4, 1965 which provided that upon permanent discontinuance of contributions by the employer, each employee's accrued benefit became vested. The last contribution made by the company to the plan was January 19, 1966, and since it was clear that no contributions were made after that date, the court concluded that the benefits of all employees became vested as of January 19, 1966, even though the company was not aware of that fact. The court entered formal findings of fact and conclusions of law consistent with this decision and on December 1, 1971, entered interlocutory judgment providing that the plaintiffs and other salaried employees of the company who did not share in the distribution of the trust found were entitled to interlocutory judgment against the company and against A. J. Rueter and Richard A. Kinzer, as trustees of the trust fund, and against Richard A. Kinzer, individually, jointly and severally, in an amount equal to the plaintiffs' respective proportionate share in the assets of the plan and trust as of January 19, 1966. The judgment further provided that after determination is made of what these interests in the assets of the trust were, the plaintiffs should apply to the court for a money judgment against defendants at which time the court will consider all other questions incluuding attorney's fees and disbursements.

The defendants have appealed from the whole of the interlocutory judgment and the plaintiffs seek review and modification of that part of the interlocutory judgment which determined there was no bad faith and self-dealing, or that the company was not unjustly enriched by plaintiffs being deprived of their share of the trust fund.

For the appellants there were briefs by *Whyte, Hirshboeck, Minahan, Harding & Harland, S.C.*, attorneys, and *Victor M. Harding* and *Anthony W. Asmuth III* of counsel, all of Milwaukee, and oral argument by *Victor M. Harding*.

For the respondent there was a brief by *Davis, Kuelthan, Vergeront, Storer & Leichtfuss, S.C.*, attorneys and *John G. Vergeront* and *John P. Savage* of counsel, all of Milwaukee, and oral argument by *Mr. Savage*.

HANLEY, J. Three issues are raised on this appeal:

(1) Was it error for the trial court to find that the plan terminated and the plaintiffs' right to share in the distribution of the trust, vested upon the company's last contribution to the trust on January 19, 1966;

(2) Was it error for the trial court to find that the plaintiffs had not established actual bad faith or self-dealing in connection with the plans to terminate;

(3) Was it error for the trial court to hold that as a result of the termination of the plan, the principal stockholder was not unjustly enriched to the detriment of the salaried employees.

Termination of the plan on January 19, 1966.

The trial court found that on January 19, 1966, the time when the company made its last contribution to the trust, each then participating employee's accrued benefit, based upon his prior service to that date, became fully vested in accordance with the terms of the plan as amended, and that these benefits could not, thereafter, be even innocently or inadvertently ignored and any action taken thereafter in disregard of their accrued and vested benefits would be ineffectual to divest the already assured benefits.

In making the above finding the court stated in its opinion "While the phrase 'discontinuance of contributions' might in certain contexts be subject to construction, it seems to the court that it may come about either by declaration or by conduct. It is abundantly clear that contributions could not be said to have continued after January 19, 1966." The trial court does not refer to any specific conduct on the part of the company to support the above finding. Clearly, the trial court erroneously concluded that a "discontinuance of contributions" takes place whenever the last payment is made. There was no evidence of any corporate intent that the plan terminate on that date.

The evidence in this case shows that the plan was at all times adequately funded and met the requirements of the Internal Revenue Service so that a "discontinuance of contributions" did not take place as of January 19, 1966. No additional contributions were necessary after January 19, 1966, to keep the plan fully funded. It is difficult to conceive how a "discontinuance of contributions" could take place when a pension plan is adequately funded to cover its employees' requirements, as actuarially computed.

We conclude that the trial court erred in holding that the plan terminated when the last corporate contribution was made on January 19, 1966.

Improper self-dealing.

The trial court found that the plaintiffs had failed to establish by clear and convincing evidence that bad faith or improper self-dealing was at the root of the decision to terminate the plan as of July 28, 1967. Although respondents do not contend that the relocation process itself evidenced bad faith or self-dealing, they do contend that the delay between the relocation and termination does evidence self-dealing.

The trial court was the trier of fact, and its findings of fact prevail unless they are against the great weight and clear preponderance of the evidence. Moreover, the evidence must be viewed most favorably to the findings. *Columbia Stamping & Mfg. Co.* v. *Reich* (1965), 28 Wis. 2d 297, 137 N.W. 2d 45.

The finding that there is no sufficient evidence of actual bad faith or self-dealing in connection with the termination of the plan is clearly supported by the evidence, *i.e.*, that the company's labor problems in Burlington, Wisconsin resulted in the decision to move the plant to Kentucky; that the company's loss of its experienced personnel who understandably chose to remain in Wisconsin led to unforeseen losses incurred by the corporation after the move and in having to find inexperienced personnel; that these losses led to the company's decision to find a buyer for the business; that the company acted on the premise that the existence of an ongoing and fully funded pension plan would be a definite asset to the prospective buyer who was going to take over the business and continue on with the same work force; that in negotiating with the prospective buyer, the officers of the company sought to persuade the buyer to adopt and carry on with the pension plan; and that it was only when the officers were satisfied that the prospective buyer would not do so that they exercised the authority to terminate the plan.

We conclude there is ample credible evidence in the record to support the trial court's finding on the issue of bad faith and improper self-serving.

Recovery on the theory of unjust enrichment.

Plaintiffs contend that payments to pension funds—even where the fund is created and contributions thereto are made solely at the employer's will— are in the nature of compensation for personal services and that to deprive an employee of that compensation after having accepted the employee's labor for that compensation, unjustly enriches the employer.

Noncontributory pension plans are held to give rise to a contractual obligation by the employer to pay pension benefits to the employees entitled thereto under the plan communicated to the employees where the employees thereafter remain in the employer's employment and render service for the requisite period. *Voight*

BEST COPY AVAILABLE

v. *South Side Laundry & Dry Cleaners* (1964), 24 Wis. 2d 114, 128 N. W. 2d 411, at page 116.

Here the plaintiffs did not render services for the requisite period, since each plaintiff had terminated employment before he or she had qualified for pension benefits.

Plaintiffs further contend that when fulfillment of the conditions precedent to retirement benefits is made impossible because of the employer's actions, recovery should be allowed. The record does not support this contention. Some employees stayed with the company and some elected not to stay.

After hearing all the evidence at the trial, the trial court held that there was no evidence of fraud or bad faith.

If defendant company or its successor had decided to continue on with the business and retain the pension plan, the plaintiffs would have no right to participate. They did not meet the age and service requirements of the plan when their employment ended. We are satisfied that the laws of "unjust enrichment" and "substantial performance" are not applicable.

By the Court.—Judgment reversed with directions to dismiss the complaints.

APPENDIX

BURLINGTON MILLS CASE—AGE AND SERVICE OF PLAINTIFFS

Name of plaintiff	Year employment began	Date of termination of employment	Age at date of termination of employment	Approximate years of service
Beguhl	1935	Dec. 31, 1966	51	31
Clements	1951	Feb. 1, 1967	45	28
Douglas	1955	Oct. 7, 1966	48	11
Grubb	1946	Sept. 30, 1966	49	20
Hoppe	1959	Mar. 3, 1967	55	18
Ide	1935	Dec. 16, 1966	54	31
Lange	1952	Aug. 26, 1966	55	14
Martin	1943	Mar. 24, 1967	59	24
McCann	1956	June 2, 1967	55	11
Roanhouse	1950	do	61	17
Steffgen	1960	Aug. 19, 1966	41	6
Stengel	1956	Mar. 25, 1966	37	10
Volkman	1927	June 2, 1967	58	40
Walsh	1956	Dec. 31, 1966	62	10
Weinborn	1954	Feb. 27, 1967	46	13
Zemaitis	1947	May 24, 1967	54	20

Mr. BERNSTEIN. Thank you, Senator.

Pension costs to the employees, employers, and the Treasury.—I would like very briefly to sketch the cost to employees, employers, and to the Treasury of private pension plans. Employees forego other kinds of compensation when pension plans are present. They are sometimes talked of as if they were an additional benefaction to employees, but there is not a labor economist in the United States who does not subscribe to the proposition that employer contributions to private pension plans are, in fact, a form of compensation. It is a form of contribution that takes from, in effect, one set of employees; that is, those who do not qualify, and gives to another set of employees, a minority who do qualify, the benefits.

Employers pay out pension contributions as they would pay out any other form of compensation and they pay it in lieu of other forms of compensation; they do not represent a net additional cost.

Senator BENTSEN. You said labor economists but do other economists agree?

BEST COPY AVAILABLE

Mr. BERNSTEIN. Oh, yes; I would suppose—I guess that Samuelson is not a labor economist but he would agree to the characterization. And so does the Congress. The legislative history of the Pension and Welfare Disclosure Act is replete with references to pension contributions as employee compensation. So also does the decision in the *Inland Steel* case in 1949 by the Court of Appeals for the Seventh Circuit and so, also, do decisions by arbitrators. Quite a few employer and employee associations and others do not readily accept this characterization as you may see later this morning.

The Treasury foregoes enormous amounts of revenue for these plans. If you take—and this is an oversimplification—but if you take the $150 billion of plan reserves and assume 5-percent interest on those reserves and assume further a 50-percent effective tax for corporate tax rate, then you will see that contributions cost the Treasury somewhere on the order of $3¾ billion a year.

I suggest to this committee that such expenditures—because that is what they are—they are revenue foregone—can be justified only if their social purposes are served. There is no other reason for the Treasury foregoing that income. There is no other reason for the rest of us in the United States to pay higher taxes to make up for that loss of income.

Private pensions are compulsory.—I would add one other thing, that is, I think of crucial importance, that by and large private pension plans so far as employees are concerned—this $23 billion to 30 million of them or however many there are, and I will get to that in a moment—are involuntary. They are involuntary where they are not bargained and that covers about half of the coverage of plans.

It is the employer's decision alone to have this kind of benefit and the employees must participate. In the collectively bargained area, the collective bargaining agent participated in that decision. But I suggest that when employees get to know how few of them will qualify that they will not willingly participate in programs of this sort. They do not yet realize—although they are getting to realize—that only a minority qualify. So when we talk about voluntary pension plans, I think that is a significant misnomer.

Plan coverage.—Inadequate and less than advertised.—The coverage of private plans is a good deal less than advertised. The enthusiasts up to a year ago were talking about private plan coverage of something in the order of 33 million persons. Buried in the footnote in the Interim Report of the Treasury on pension plan terminations, is the result of an unpublished study showing that actual coverage amounts to 23 million that excludes profit-sharing-plans. That is significant because when employees lose a pension-covered job the percentage of coverage in the rest of the economy affects their own opportunities to obtain pension-covered jobs and the smaller that area of coverage the less their chances of lucking into a pension-covered job. That is particularly true of the large mass of people, say, in the defense-related industry many of whom are only semi-skilled and do not have a great deal of pulling power in the job market.

Pending bills.—Inadequate on coverage.—Only some of the measures address themselves to increased coverage. S. 4, the Williams-Javits bill, does nothing about expanding coverage except perhaps the dubious matter of excluding plans with fewer than 25 members and that is a very dubious device for expanding coverage.

The administration.—Curtis bill and the Bentsen bill proposal do provide—and here I treat them together—for individual purchase of retirement coverage with tax deferral. The administration proposal was represented in several different statements; one by Mr. Cohen 2 years ago, before the House Ways and Means Committee, and more recently in material submitted before this committee, that said that 70 percent of the tax benefits of those proposals would go to persons with incomes of $15,000 and less. I don't begin to understand that. But even if it is true, it means that 30 percent of the benefits are going to 8 percent of the taxpayers. I would call your attention to my prepared statement. I do that because there is a table there which summarizes recent Canadian experience with somewhat similar proposals, of voluntary retirement savings with tax advantages. And if you will look at column 2—percentage of returns in income tax bracket—you will see that the taxpayers who have more than $15,000 taxable income constitute 2.3 percent—well, they constituted in 1968, 2.3 percent of the taxpayers, but their returns constituted 55 percent of the returns reporting contributions of this sort. If you take the amounts actually invested in that, you will also see a very similar disproportion. And the pattern for the taxation year, 1969, is exactly—well, not exactly, but is roughly the same.

I don't begin to understand where the 30 percent figure comes in from the Treasury's figures. I have a feeling it comes out of the blue, but perhaps Mr. Cohen could enlighten us on that score.

Pension plan losers.—The young.—The minorities.—Women.—The pension plan losers—and they are the majority—are the persons who never come under coverage. They are young people and women by and large. They are also those in low-paid jobs which means a disproportionately large number of racial and minority groups. These measures do nothing to reverse that discrimination against these groups and, indeed, they tend to perpetuate; that is not completely right for S. 4, which helps women to a minor degree but otherwise perpetuates the discrimination against them really.

It is demonstrable that women, for example, have shorter periods of work service than men. Possibility of their achieving 8 years or 10 years of service so as to qualify for vesting or to qualify under the Rule of 50 is very dubious. I call your attention to my prepared statement where it reports, for example—and this is a Bureau of Labor Statistics study—that in the wholesale and retail trade, where a very large number of women are employed, the medium service for women over 45 is 4.5 years of service. Moreover, the Code and several of the bills permit the exclusion of part-time and part-year service; the exclusion of people with part-time and part-year service. That is how many women work. They work year after year after year perhaps but large numbers of them work part-time and large numbers of them work part-year.

While many recognize the revolution that there has been in work patterns we don't realize the extent to which women's work now enables families to achieve the American standard of living. There are more families with a husband and wife employed in recent years than there are families where there is only the husband employed. The husband-wife families have significantly higher income. What that means is that when retirement comes, the measure of the effectiveness of retirement should be measured by the replacement by the family's earnings, both that of husband and wife. Our pension plan system is a male white program and these bills do nothing to change it. I am not hurling charges but this is an accurate characterization of the plan design. These programs are not designed to pay-off for women, quite the contrary.

An important factor here is that where a man only is working, his social security benefit will be higher than a family where a husband and wife earn an equivalent total income. If there is no private pension supplementation, and there would tend not to be because women are so rankly discriminated against by the age and service provisions, then private pension plans will fail what they are supposed to do and, that is, supplement for social security. That is their reason for being.

Senator NELSON. May I interrupt, Mr. Bernstein? You have exceeded your maximum time. We will get back to that point in the panel discussion, but I unfortunately, due to limitations of time, will have to move to the next panelist.

Mr. BERNSTEIN. Perfectly fair.

Senator NELSON. I understand you have to leave at noon?

Mr. BIEGEL. Yes, if it is convenient.

Senator NELSON. Why don't you just go ahead?

Mr. BIEGEL. Thank you very much, Mr. Chairman.

I would like to discuss the four or five issues presented by the three ills before your committee, namely, vesting, funding, termination insurance, portability and finally, fiduciary responsibility and disclosure.

First, with respect to vesting, the issue is one of priorities. With a given number of dollars available for pensions, who is to get them? Shall we let the young and old share equally, thus reducing the benefits payable at retirement? Shall we given increased benefits to the older workers where it is needed most or shall we adopt some middle ground, perhaps attempt to help the older workers and also giving older workers some expectation of pension fulfillment? Moreover, shall we put more money in vesting than increased benefits, or survivor benefits, or disability provision, group life insurance, medical expenses, all of the other financial benefits that employees and employers are interested in?

Another consideration is cost. Can we adopt a standard which is so costly that it will either inhibit the contribution of existing plans or the creation of new ones? We are now putting in—well, rather industry is now putting in—$46 billion in pensions, welfare, and social benefits each year. Moreover, we have——

Senator NELSON. Excuse me, $46 billion?

Mr. BIEGEL. Yes, sir.

Senator NELSON. You said $46 billion into pensions?

Mr. BIEGEL. And social insurance of all kinds; in other words, all of the fringe benefits. For example, we have about 30 million employees who will not be covered. Any additional burdens put on pension plans will certainly discourage the creation of new plans. However, in spite of these caveats, I think the business community, as well as the legislatures, no longer feel that vesting is a subject which is sacrosanct and should not be touched. Everything is not OK with vesting. All sides, that is, the administration, labor, management, agree that improvement in the statutory standard for vesting is warranted, which standard shall it be though?

The administration suggests a rule of 50. The Williams-Javits bill just 30 percent after 8 years and 10 percent each year thereafter. Senator Bentsen's bill suggests 25 percent vesting at the end of 5 years and 5 percent each year thereafter, so that 100 percent would be vested at the end of 20 years. Various estimates have been made as to the relative costs of these vesting provisions. I have read them and I have read the Wrinkelman report, as well as the Grubb study, and I must confess I cannot make too much sense out of them although I assume that is a failing on my part.

Nevertheless, there is an element of cost in each and while the percentage in terms of percentage of overall payrolls seems small, almost all of the vesting provisions represent substantial increases in the plan costs each year if either one of these vesting provisions is adopted.

Now, as to which of these formulas is best that is the subject of much debate, and I think at this point rather fruitless. My own feeling is that the employer should have a choice as to any acceptable vesting methods including the three I mentioned and the three under consideration. So long as that vesting provision is within the perimeters of one of the methods discussed, I believe it should be acceptable. This kind of flexibility is recognized by the Williams-Javits bill which gives the Government the power to waive a single statutory standard if the plan's vesting provisions are "as equitable" as the statute.

Senator NELSON. But that is a little different from what you said, isn't it? These three plans on vesting are quite different. You are saying—if I understood you correctly—that the Williams-Javits plan would say any vesting plan "as good or better"?

Mr. BIEGEL. Exactly, Senator "as equitable." It says "as equitable" and not necessarily "as good." I think this is a matter of interpretation. Each of these vesting formulas works best in a certain given set of circumstances. Let us take a man, age 32, who comes into a plan. Now, in 9 years under the administration's provision, he is 50 percent vested and 5 years thereafter he is 100 percent vested. Under the Williams-Javits proposal he doesn't get quite that good a setup—oh, I had some notes here but I seemed to have lost them—but in any event, under the Williams-Javits proposal he is 30 percent vested at the end of 8 years so he has 30 percent at age 40 and he has 40 percent at 41, as compared with 60 percent under the administration proposal. Senator Bentsen would have 25 percent at the end of age 37 and 5 percent a year thereafter, and he would be slightly behind the 100 percent vesting set out by the administration's bill in that single case, but this will vary, of course.

So if you take a man aged 29, the emphasis switches. If you take a man aged 40 or over, once again you get a different result.

Senator NELSON. In comparing them, don't you have to also include the question is prior service credits?

Mr. BIEGEL. Yes, there is a question of prior service credit and, admittedly, the administration's proposal gives no benefits. Senator Bentsen's gives benefits for past service credit for age 45 and the Williams-Javits proposal goes all of the way back. I would say there that my preference would be to go back, but, again, we have the question of cost. Will the estimates of cost become astronomical when you use the formula of including all past service benefits? In other words, the administration bill, if the past service costs were recognized, would increase substantially in cost as compared with recognizing only future service.

So, in any event, I don't hold any preference for either one of these formulas. I think all of them serve a purpose. I think any one of them would be an improvement over the existing system. I would urge only that whichever formula is adopted, as the statutory standard, there be a certain amount of flexibility so that an employer could adopt or rather lease one of these other two that are before this committee and perhaps other that would produce just as "equitable" a result. There will never be exactly this equivalent because of the various factors. However, once you recognize agent's service, you get a different break then if you recognize only service and, also, if you recognize past service, as well as future, the result is different than if you recognize all years of service.

My point is that none of us is omnipotent enough to say that only one formula is proper. And I heard Senator Bentsen describe the same point by saying these provisions are not engraved in stone. I think this is a most appropriate description of it. I would urge, therefore, that with respect to vesting the committee bill, that the action of the Congress permit the flexibility within the perimeters that you are presently considering. For instance, a 10-year vesting standard is not included in any of these but yet under certain circumstances, it would produce far better results than any of them although a lot more costly.

Now if I say, I would like to pass on to funding. This——

Senator CURTIS. May I ask one question on vesting?

Mr. BIEGEL. Yes, Senator?

Senator CURTIS. Are there any circumstances where past service has a significance, if the company already has an ongoing pension plan? In other words, if there is a question of past service, is that only important to the new plan that is developed?

Mr. BIEGEL. Of course it is most important there because you have no history of pension coverage. When you adopt a plan in the year 1973, you have all of the past service right now uncovered.

Now depending on the plan and in 1942, for instance, if a plan were adopted in 1942, the chances are that service between 1942 and today has been adequately protected or at least has been covered to some extent, so that the impact of recognizing past service is, of course, important in that consideration. But plans adopted in the intermediate period, would have varying effects. Now there is a question some have raised of constitutionality; that is, suppose a plan that is in existence had given no credit for past service and Congress, in its wisdom, were to adopt a provision, the question is, whether that plan would lose its past qualification or certification by the Secretary of Labor—or whatever qualified status it had—by this retroactive imposition of past service benefits.

I mentioned the point of constitutionality, but in my own feeling, I would doubt it would apply because, to the best of my knowledge, no tax statute has been declared unconstitutional since the *Welch* case in Wisconsin in 1933. In my experience, I know of no others. Have I answered your question, sir?

Senator CURTIS. Well, I still don't know how past service becomes a significant issue for a company that has a plan going?

Mr. BIEGEL. It would be significant only if a plan were to improve its benefits immeasurably and recognize those benefits for past service. Suppose, for instance, that a plan has a benefit formula which is predicated on the highest 5 years in the last 10 years of service or the last 5 years of service and that would apply to all years of service. Now if that formula were in effect and it would apply to past service as well as future in the sense that each year of service, including past service, would be recognized as a multiple for which the 5-year highest benefit would be applied, it is not as significant, and——

Senator CURTIS. But my question was——

Mr. BIEGEL [continuing]. And, to answer your question, past service is not as significant a factor as an element of increased cost where the plan has been in existence for a substantial period of time. It becomes an important factor where a plan is adopted for the first time and recognizes past service in some form or other or prefers not to recognize it. There are some wholly future service benefit plans, but there are not many. Most pension plan consultants recognize that past service must be taken into account. And were you to adopt a plan today with the increased vesting benefits that Congress will unquestionably adopt and with your increased funding requirements, then I assume that your past service would have a significant effect on the cost of that plan.

Senator BENTSEN. Mr. Chairman, could I make a comment? Had you finished?

Senator CURTIS. Yes.

Senator BENTSEN. Mr. Biegel, I agree that a vesting plan should at least be as equitable as whatever the minimum is that we adopt—I agree with that language—but my reason, of course, for favoring the vesting of 5 percent per year is in recognition that portability is very difficult to accomplish.

Mr. BIEGEL. Yes, sir.

Senator BENTSEN. Early vesting achieves a degree of portability. This helps take care of some of the problems that Professor Bernstein was talking about; of women, for example, with not as long a duration of employment, with this 4.0 years or whatever the figure was. In selecting my vesting formula I attempted to balance the desire for early vesting and the question of cost.

Mr. BIEGEL. I would agree, Senator.

Senator BENTSEN. And one of the things we must——

Mr. BIEGEL. I would agree, especially in the way your bill is structured because your eligibility requirement is age 30. In other words, we do not have to include employees under age 30. And that, in itself, is a built-in age factor, which the administration bill has, and I think that is a good one because we would not be putting our money, with all due deference to Professor Bernstein, we would not be putting our money in the younger worker, in the worker under 30, where there is a high degree of turnover.

Yesterday, the Washington Post or the New York Times, I forget which—had a survey of the attitude of employees toward their job and it said that on the whole, employees are satisfied with their position, but it showed, however, that that satisfaction rose in direct proportion to the age of the employee.

Senator BENTSEN. I understand that and I understand the problem of trying to interest someone in their 20's in a pension plan.

Mr. BIEGEL. Yes.

Senator BENTSEN. Age 55 or 60 or 65 seems like an eternity and he is not ready to participate in one.

But by the same token, what we have said in my bill is that by age 30 they must do it, but they may have the option to do it much earlier.

Mr. BIEGEL. Right.

Senator BENTSEN. And I would have to agree with Professor Bernstein, that when we speak of a voluntary plan that, in general, we are speaking of the employer, who makes that decision, when it isn't a part of the bargaining process. Some employers, however, have been known to be generous and have provided eligibility prior to age 30. But what we have to remember all along is that we are talking about a voluntary program and we have to sell this program to the employer. We have to convince him that it is for the benefit of that corporation to have this for his employees. And one of the arguments you make is to get a continuity of employees so that they will stay there until the time they reach full vesting.

Mr. BIEGEL. Right.

Senator BENTSEN. Which must, at the present time, not result in getting the cost so high that, in effect, we impede the installation of these plans——

Mr. BIEGEL. Right.

Senator BENTSEN. This is what we are trying to balance off.

Mr. BIEGEL. I agree completely. I think your formula, Senator, and we have this constant problem, which you touched on, namely, whatever the cutoff that if you have 10 years vesting—and I remember in some of our prior discussions with the task force, where they said 10 year vesting is important because a man can work for 10 years or more with a number of employers and leave without a pension—but if you have that, well, you also have the situation where a man can work for 9 years with a number of employers and never accumulate a pension.

Your vesting formula breaks down to 5—I think less than 5—years of service, and we can afford to ignore the turnover, but at 5 years you give him something; he gets 25 percent at 5 years of service. So that transition period is made a little easier. I think if yours were the standard from which others would have to prove their equitable status, I would not be objecting to it. I just think, Senator, there are variations possible depending upon the particular case and none of us it—at least I am not—wise enough to pick the one that is best for all cases.

Senator NELSON. Did you have anything to add?

Mr. BIEGEL. Not to that. May I go on? Is my time up? I will yield, Senator, if it is?

Senator NELSON. Let's hear from everybody and then we answer questions.

Mr. BIEGEL. Fine. Thank you, sir.

Senator NELSON. We will now hear from Mr. Edwin Cohen.

Mr. COHEN. Thank you, Mr. Chairman. If I may, I would like to say, Mr. Chairman, that I do not pose as a specialist or even as an expert in the field of pension plans. Yet for some 35 years in the practice of law and in Government service, I have been engaged intermittently and at times with some frequency in the designing, drafting, and operation of pension plans.

From 1970 to 1972, I participated in the formulation and presentation of the administration's pension plan proposals, although not in the supplemental recommendations made this year.

Before commenting on the specific issues, I would like to offer a few general observations, if I may.

First, in pension plans, as with many other matters, we secure only what we pay for. A dollar paid into a pension plan will produce benefits which expert actuaries can estimate. To the extent that by law or regulation or by design of the plan itself, we require certain minimum standards of eligibility, vesting, or other requirements, we must sacrifice other benefits, or else we must increase the cost of the plan. Increased costs for prescribed items mean decreased costs to employees in other respects; or they may mean increased costs to be borne by consumers in the price of goods and services, affecting the price level and our ability to compete in world markets; or they may mean decreased return to investors, affecting the level of investment, that is the source of job opportunities.

Second, a most important feature of our private pension system is the flexibility that it permits to meet the special needs and desires of employers and employees in different industries and different businesses. Experience shows the need for increased minimum pension plan standards in a number of respects; but in fashioning the new law, if we were to set minimum standards too high, we would tend to limit the desirable flexibility of the private pension system because cost considerations would force reduction in benefits that would be beyond the required minimum.

So, in our discussion of what the law should require of pension plans, I suggest that we should avoid requiring by law what each of us might think reasonable for the average plan, but confine the law to what we think, at this time in our history, is a minimum standard of fairness for all employees. We should, I think, leave to negotiation more liberal provisions that may be traded off against increased current wages or other employee benefits and, in particular, we ought to be cautious that we do not drive so high the costs of private pension plans as to impair the prospects of legislation for increased health insurance for employees.

Now, third, in my experience the pension field requires a great diversity of expertise on a variety of different subjects. It necessitates a merger among other matters of actuarial science, accounting, labor-management relations, tax law, trust law, and labor law. When the respective experts have given their views, sometimes conflicting, generalists in the Government and private sectors must ultimately absorb the analysis and make the ultimate decisions. The process is time-consuming and unfortunately tedious.

In making the needed statutory changes, we should be careful that they are not so extensive that they exceed the capacity of Government and private personnel to institute and administer the changes. Those that seem marginal or dubious could reasonably be deferred until the system hs absorbed the essential changes and the effects can be weighed. To move too rapidly at one time in all fronts in the pension area could produce uncertainty and confusion that would be counterproductive.

Now, as to the four matters which you have asked us specifically to discuss today:

First, as to vesting requirements, the studies have indicated that only about 32 percent of participants are now entitled to vested benefits under corporate pension plans. It struck me as particularly disturbing to find that only some 40 percent of participants over the age of 40 have vested benefits and only some 46 percent of those participants over age 60.

Now, my study of various minimum vesting standards——

Senator CURTIS. What was the percentage for over 60?

Mr. COHEN. Forty-six percent of those over 60 have vested benefits; 40 percent of all over age 40; 46 percent of all of those over age 60; 32 percent for all participants.

Now my study of the various minimum vesting standards that have been suggested for legislation has led me to the conclusion that the so-called rule of 50 proposed by the administration is the most satisfactory. It would, I understand, increase the total number of plan participants with vested rights from 32 percent to 61 percent. An even more important effect would be that with respect to participants age 40 and over, it would increase the percentages with vested benefits from 40 percent to 92 percent.

The rule, when fully effective, would essentially solve this problem for the older worker and it is his problem that I think is more serious than that of the younger worker, although I suppose I should let the record indicate, Mr. Chairman, that I am 58 years of age.

Now, I have been persuaded to favor this proposal among those that have been advanced because I understand the data to indicate that, in general, it involves less additional cost than the others, but, particularly because it concentrates protection on the older workers who, as I say, seem to me the most deserving of vesting protection.

Now the vesting proposals in S. 4 and S. 1179, are, as the discussion has indicated, based exclusively upon years of participation by the employee and give no consideration whatever to his age in the relative priority of vesting among employees. Now, as the discussion indicated, age is a factor in determining eligibility for plan participation under all the pending bills, and it is generally used in determining normal retirement date and early retirement privileges and for other purposes. I do not think it wise for the legislation to rule out age entirely as a proper consideration in a vesting standard minimum for pension plans.

It is true that the rule of 50 gives, in effect, an equal weight to age and years of participation in determining vesting. It would, of course, to vary the formula, or to set a schedule based on age brackets, that would give greater weight to years of participation than to age. But to say that age may not be taken into account under any circumstances in the minimum standard of vesting seems to me inadvisable.

Now, the objection that I understand has most frequently been made to the rule of 50 is that it would tend to discourage the hiring of older workers by employers who have fixed benefit plans. On the other hand, it has been my conclusion, that from the standpoint of pension costs, the principal discouragement to the hiring of older workers is the fact that the older worker having less years to his retimement at age 65 will have a shorter period of time in which the contributions to the plan made for his benefit can earn compound interest. That is the principal discouragement to the hiring of the older worker because there is less time to fund a fixed benefit for him; but the vesting aspect of it would add relatively little to the annual cost of the pension of the older worker, either proportionately or in absolute amounts. It is my conclusion that it wouldn't be a material factor in the choice between the hiring of an older and younger worker, and the reason is——

Senator BENTSEN. Mr. Chairman, let me say here, Mr. Secretary, that my personal experimence has been that there are a number of corporations who have in their plans vesting tied to age, and these corporations have had policies not to hire older workers because of that; that is, because they have found that they have to fund them that much faster and therefore they discourage the hiring of older workers. Now, this is of concern to me. I don't want to see this man of 50 cast adrift when he will have a tough time finding reemployment. That is my very serious concern with the rule of 50. Now I understand very much your argument on the other side that those who are already working for the firm, well, that you would like to see those funded and that is a saving point but I think it is counterbalanced and even more so by the fact that this man, who has reached age 50—and I am getting very sensitive to those people because of my own personal situation—well, of course, I just feel there should be no further impediment put in their employment.

Mr. COHEN. Senator, I would agree, and if I came to the conclusion that this would be a substantial factor, I would agree, but I have thought about this and discussed it with many people. I think that the principal cost of hiring an older worker as against a younger worker as far as a pension plan with a fixed benefit is concerned is the fact that I mentioned; namely, that you have got a shorter period in which to provide for it and, therefore, you will have to pay in three or four times as much each year. But the additional cost that would be involved for the older worker in giving him vesting, as against an unvested plan, is really negligible.

If I thought it were a significant additional cost, I would be concerned, but the advice that I have had, the figures I have seen from the studies by the Treasury staff, indicate that that is not so. It is my understanding, for example, that if you want to provide $100 at age 65 for a man aged 55—that is, a $100 annuity beginning 10 years later—it would cost $570, with no vesting. But if you were to give him full vesting, it would cost $585.

Senator BENTSEN. Well, the point is under my plan of vesting, say, starting at age 55, you have 50 percent vesting at age 65, so you wouldn't have all of that makeup——

Mr. COHEN. Senator, could I say something? If I may repeat my statement——

Senator BENTSEN. And, in addition, you might say that the man who is 55 might have been working under a pension plan some place else and at least had partial vesting and under my proposal he would have a tax-free transfer of whatever was vested previously.

Mr. COHEN. Senator, could I say something? You may have heard these figures elsewhere and there is nothing novel about my statement, but I believe that you were speaking to someone else when I made this point, and if I may just briefly repeat it?

As I understand it, to provide $100 annuity at age 65 for a man aged 55, it would require $570 a year contribution for the 10 years.

Senator CURTIS. $570?

Mr. COHEN. $570, yes. Now that is with no vesting.

Now this depends upon the rate of turnover of employees, obviously; it is an acturial average as I understand it.

Senator NELSON. The $570 wouldn't do it, though.

Mr. COHEN. The $570 a year contributed every year for 10 years will provide an annuity at age 65 of $100 a month—oh, no, of $100 a year.

Senator NELSON. Oh, well, then——

Mr. COHEN. But you can do it on a monthly basis or annual basis. The $570 a month would provide $100 a month. The $570 a year contribution would provide $100 a year.

Senator BENTSEN. I think you would have to check the figures again. I haven't looked at these actuarial and annuity tables for awhile but that doesn't add up——

Mr. COHEN. I would say this is a single premium cost, Senator, I am sorry. This is a single premium cost of providing the $100 of annuity commencing at age 65. So this is single premium cost of providing $100 of retirement income at age 65 for a worker now age 55, if no vesting is provided and that cost figure is $570 and the cost rises only to $585—or only $15 more—if the rule of 50 is operative.

Now, those are the figures that were given to me last year in our studies in the Treasury Department which I presented to the Ways and Means Committee. Now, I am not an actuary, but I have discussed it at great length and that seems to me to be a minimal increase in the cost. Now, this depends, of course, upon the rate of turnover that the actuary will assume but that difference is only $15 out of $570. Now, the equivalent cost for a younger worker at age 35 is $125 without vesting—and that is $125 in relation to the $570 without vesting—and $155 with vesting in relation to the $585.

Now, the biggest difference here, the biggest gap, is simply because of the age factor. If you compare the two plans without vesting and if you compare the two plans with vesting, it is an enormous gap in the cost, but the cost of vesting as against nonvesting is a relatively minor sum. Now, it is true that if you hire a younger worker there is a greater chance that he will leave and not receive benefits under the rule of 50, and so, if you hire the man with the assumption that there is a greater chance that he will leave, then your pension costs will be less, but I think most employers would hire younger people with the hope that they would remain and not with the hope that they would leave because there is the cost of training them, of course.

Senator BENTSEN. Mr. Secretary, I still think that we are not really comparing apples to apples, because you are talking about single payment annuities and using this 55-year-old man as an example in trying to use your rule of 50, but under my proposal if the man started at 55, he wouldn't have 100 percent at age 65, but he would have 50 percent vesting.

Mr. COHEN. But he would have 100 percent vesting when he retired, Senator, when he reaches retirement age. Everyone is vested when they retire, of course.

Senator BENTSEN. No; but up to 50 percent of the benefits. They are vested up to 50 percent.

Mr. COHEN. Yes; I understand that, but this is the choice, and all I can say, Senator, after having been up and down this subject, and I think we both know the arguments pro and con, is that I have thought that the rule of 50 concentrated the benefits largely in the older worker group, who do not have the opportunity to turn around and make up for it in other directions, which the younger workers do have. Now, on the other hand you have the problem that you have alluded to—and I am inclined also to agree, and as Mr. Biegel said earlier—on thinking about it further in preparation for these hearings, it seems to me it is an extremely difficult thing for one to pick between these three principal standards that are in the three bills. We would make enormous progress in this problem if we enacted any one of them and I think that we would make sufficient progress at the moment if we were to allow the employers, the employees, whoever is creating the plan, to put in as a minimum any one of these three standards. I think that would be an enormous move forward.

Mr. Biegel suggested that and I agree.

Senator BENTSEN. I agree with you that if you put any one of the three it would be an improvement but I just happen to think that one of the formulas is better than the other.

Mr. COHEN. Well, I would say, Senator, that one concern that I have is that there are many existing pension plans that have one or the other of these formulas and that may be quite fair, but if you have just one standard, then a great many of these plans that have good vesting provisions from the standpoint of the employee are going to have to change. That is true of the rule of 50 also—if they now have a vesting rule such as yours; that is, a minimum of 5 years, then under the rule of 50, they would have to change to that standard.

Senator BENTSEN. That is correct.

Mr. COHEN. And that is one of the reasons, as regards the existing plans, they should be able to take any one of the three.

Senator NELSON. Would you apply different rules for existing plans contrasted with new plans?

Mr. COHEN. Well, I suggested that as one possibility in order to avoid having to require so many plans that have good vesting today to change to a new standard. You could say, particularly as to existing plans, that they could choose any one of these three rules, but you could make a distinction as to the future and say that all plans hereafter instituted should have a single rule so that you would ultimately have conformity.

Now, Mr. Chairman——

Senator NELSON. May I interrupt here?

Mr. COHEN. I don't want to go over my time. I wanted to make a few comments about some of the other provisions though——

Senator NELSON. Why don't you withhold that until we hear from the other panelists.

Mr. COHEN. Fine.

Senator NELSON. Mr. Cummings?

Mr. CUMMINGS. Mr. Chairman, I find myself at odds, which is not too surprising, with everyone who has spoken so far. I would start from these premises:

First, this is an industry not controlled by evil men but by basically good men, and this industry ought to be in the control of businessmen, and as the case may be, of Union leaders, subject, however, to regulation.

Second, this is a middle-class problem, not a poor person's problem. It is essentially a question of enabling a man to maintain the standard of living he is used to, and not just to maintain himself barely above the poverty level, as social security tries and fails to do, but to enable him to develop a way of maintaining decent living standards in his retirement years.

Third, this is a problem for the young. Earning pensions has nothing to do with the old, for this reason: If you don't earn it when you are young, it is too late to earn it when you are old.

Fourth, this is a problem of private rights. This is a problem of developing a law which will enable a man or woman to get what he or she has earned; and there is nothing that has ever been or ever will be in the Internal Revenue Code which will create a private right.

Fifth, it is high time that Congress acted. As you know very well, Mr. Chairman, I spent too many years fooling around with this legislation on Capitol Hill, and there is nothing that you will hear today that hasn't been said 10 times before these hearings, in committee after committee. It is high time Congress did something about this.

Now, with those as my premises I will take up the proposals, skipping over sections of my paper having to do with why existing law doesn't work.

I do want to say a little bit about enforcement though. It was the subject of your previous panel discussion, but I think you simply cannot separate the substance of the proposal from how you go about getting it. You can't sue for a pension today. Even if the plan owes it to you, you can't sue unless someone is backing you or unless you have a class action. The legal fee for the first day of the lawsuit would exceed the amount of recovery.

Senator NELSON. Is that why you say you can't sue?

Mr. CUMMINGS. I say you can sue if you are a charity or if you would like to win a sort of victory over your employer and then pay your lawyer, but the cost of the suing for one pension is so little compared to the cost of your lawyer who sues for that pension, that you can forget about it unless someone is financing the lawsuit, which means that you need an agency to enforce those private rights, or a union. But not everyone is unionized and not everyone wants to be unionized. Or you can sue in a class action, but classes of retirees are pretty hard to put together because, typically, workers disperse when they retire. In the courts, there is lots of litigation but, in general, you do not litigate pension rights, and I know I turn people down all the time, because I am not a charity either and I can't in all fairness say to a man, who has a pension which has a current discounted value of $5,000, that I am going to bring a lawsuit of the complexity of a private pension lawsuit—and I describe one in my paper here and

BEST COPY AVAILABLE

you will see how very complex it is. You can't find out what is the applicable law, how you get service of process on these people, what court has jurisdiction, and by the time you get through figuring out what the ground rules are, you have spent more than $5,000.

So you need an agency to enforce it, and the Internal Revenue Service will not, cannot, never has, doesn't want to, be an enforcement agency. So I put it to you in my paper that the question is not who should enforce, as such, because if you were really arguing Treasury versus Labor, you cannot be saying that someone should strike out the words "Secretary of Labor" from S. 4 and put in "Secretary of the Treasury." I think the Treasury would be horrified. The Internal Revenue Service would go up in smoke. They are not in the business of enforcing private rights. They are in the business of collecting taxes. They are in the business of enforcing the Internal Revenue Code. Conversely, you can't strike out the Secretary of Treasury and say that the Secretary of Labor should enforce the administration's bill. You can only collect taxes through the Internal Revenue Service. So if you decide you want a bill that creates enforceable private rights, and which enforces them, you have to do it through some agency other than the Internal Revenue Service. If you want to create a "hypothetical imperative" that says to the employer, if you want the benefits of the Internal Revenue Code, then this is what you have to do to get them, maybe tax would work. I give you some case histories in here of how that works.

Now, getting down to the details of the bill——

Senator NELSON. Let me ask a question. You would allow the Internal Revenue Service, I take it, to make the judgment as to whether or not the plan was tax deductible?

Mr. CUMMINGS. Yes.

Senator NELSON. And enforcement of the rights would be in the Labor Department?

Mr. CUMMINGS. What I am saying, Senator, is that whatever the substantive rules are for taking a tax deduction, obviously, only the Internal Revenue Service can make those judgments. Now, whatever the substantive rules are that an employee wants to enforce, to get his pension or to get his fund administered in a certain way, or to get it funded in a certain way, or to get it reinsured in a certain way, the Internal Revenue Service cannot, will not, doesn't want to, isn't equipped to enforce those rules. It isn't equipped to enforce private rights. Only the Labor Department is, which, after all, enforces private rights all of the time. For example, if you don't pay time and one-half for overtime, you go to the Labor Department and the Labor Department says "do it" and it goes into the court and the judge says "do it." So, if you want to protect private rights, you have to create private rights and you have to create an agency that will enforce those private rights.

Now, you create incentives under the Internal Revenue Code. The coverage problem has to be dealt with under the Internal Revenue Code, and can't be dealt with any other way because it is an incentive problem. If you want to create private rights, however, you have to create them and you have to create a private agency that will enforce those private rights.

BEST COPY AVAILABLE

Senator BENTSEN. We are talking about funding provisions and vesting provisions and we set minimum standards. Now, certainly the Internal Revenue Service can, in effect, force compliance with that by denying deductibility?

Mr. CUMMINGS. Senator, if you will turn to page——

Senator BENTSEN. And one of the real precious things to an employer and to corporations is the fact that their contributions to qualified plans are deductible. If you were to deny the tax deduction, the employer would be horrified. Therefore, I think you would force them to comply with minimum standards insofar as funding and vesting are concerned.

This gets back to the very fact that Professor Bernstein made earlier when he was talking about an employer in one particular situation who had discharged employees with long tenure, and apparently had discharged them in order to keep them from vesting and, therefore, he acquired whatever they forfeited to his own pension, since he was the principal employee also.

Mr. CUMMINGS. Senator, in my statement on page 25 of my paper, there is an excerpt from a transcript of testimony of a witness in St. Louis, when I was counsel for the Labor Subcommittee just last year in hearings involving underfunding of a pension plan of employees of American Zinc Co.—underfunded even according to the Internal Revenue standards. Just let me read an answer to you.

"Question. As far as you know, this is a tax qualified pension plan, is that correct?"

"Miss HILLMAN. As far as we know, yes. We have been so informed by the company." And I would interrupt to say that, of course, the employee doesn't get to look at his tax returns.

"Question. I take it you are aware that, at least under the present interpretations of the Internal Revenue Code, a continuing plan has been obligated to fund no less than current service costs, plus an amount equal to interest to past unfunded credits, and I take it that what you are saying is that they have not even complied with the requirements of the Internal Revenue Service; is that right?

"Miss HILLMAN. The information we have now leads us to believe so, yes."

And I then asked her:

"Do you have any information which would suggest that the Internal Revenue Service ever took any notice of the fact that this plan was not complying with the code?

"Miss HILLMAN. We have no such information, no.

"Question. And I take it, finally, just to let the record show that if you had known that it wasn't complying with the code and sought to enforce the code, you would have only cut the throats of your own members by disqualifying the plan?

"Miss HILLMAN. Right. We are in a real bind here."

And then I said:

"So these requirements put you in a vicious circle, I take it, where the only remedy you get is to take money away from your own members?

"Miss Hillman. That is correct."

So what we found in case after case in that investigation is that the time when the Internal Revenue Service funding requirement doesn't work, and will never work, is when the employer is about to go bust or when he has no profits. If he has no profits, he doesn't need the deductions so he doesn't make the contribution and, as far as the Internal Revenue Service is concerned here is an employer who didn't take a deduction, so isn't that wonderful? And, of course, there is nothing wrong with him taking that position. That is what he is there for—to collect taxes. That is his inherent function and motivation. Recognizing that, he doesn't run down to the employer who has filed a tax return and say to the employer, "you didn't take a deduction, so quick, quick pay some money and take the deduction." They are not going to do it, Senator, and the proof of the pudding is they don't.

Senator BENTSEN. Under my legislation, it would make it mandatory that you have certain minimums and then the Internal Revenue Service would be mandated to do such.

Mr. CUMMINGS. They are a receiving agency, Senator. They receive tax returns. That is what triggers an investigation.

Senator BENTSEN. But they also send people out to audit tax returns.

Mr. CUMMINGS. But if there is no return filed because there is no deduction taken, what have you to investigate?

Senator BENTSEN. Well, they already have the investigating on there. They have the employees who are versed in this and have the experience.

Mr. CUMMINGS. Senator, there is no reason to duplicate any of this stuff. This could very readily be consolidated in one place or the other, but the kinds of standards we are talking about here are not enforced by anyone right now.

If I may, Senator, may I just briefly go on to the standards of the various bills?

Of course, I support S. 4 not because it is perfect but because it is better than the other bills. As to preparticipation—up to age 25—that is too long. It shouldn't have an preparticipation period. It shouldn't be counting years and——

Senator NELSON. Excuse me, but I don't understand.

Are you talking about eligibility or vesting requirements?

Mr. CUMMINGS. For the purpose of crediting service. You should credit service when you serve, which is to say if a fellow starts work at age 16 and he makes his 8 years by 23, he should be vested in those 8 years. The reason for that, Senator, is because pension contributions are very slow, and there is a tremendous burden, to which the other witnesses have testified to, a tremendous burden on the last employer. The last employer has to provide that pension. Why? He has to provide it because he knows that nobody else is going to do it. The other employers didn't do it. So, if you could mutualize that burden by saying to each employer, you have young men here, let them vest a little, let them earn a little bit of a pension in their teens, in their twenties, in their thirties, then by the time he gets to age 60 and happens to get another job, he may not earn much pension, but he doesn't really have to because he has three or four pensions already.

Now, conversely, if he hasn't earned anything until 55, the odds against him earning anything substantial between 55 and 65 that will begin to approximate the kind of income he wants to live on, and that he has been living on, are just overwhelming. So I say that I think all preparticipations are bad. I like S. 4 because it is the earliest.

Senator NELSON. So I understand you: Are you saying that vesting should start as of the first day of employment?

Mr. CUMMINGS. No, I am certainly not. I am saying that credited service should start immediately. You see, what these bills do: First of all, take for example the administration bill. It washes down the drain every year until the age of 30; in other words, you have shot 10 years right there.

Senator BENTSEN. You wouldn't put an age limitation on it at all?

Mr. CUMMINGS. No age limit.

And then as to vesting, I think either the Bentsen bill or S. 4 is fine. The Rule of 50 is terrible because it is not "age neutral" and it gives a man or woman one pension only, from his last employer, and not from all of the earlier years, which are the years when you have to earn a pension or, otherwise, you are not going to earn anything that is worth getting. If you look at some of the examples that I set forth, and I did the arithmetic myself on compounding of interest and so on, you will see—and these examples in my statement, you will see what a radical difference it is when you earn it your whole life—40 years worth, your whole working life, socking it away, year after year after year. You cannot pick it all up in the last few years. Now, that is not to say that we should have immediate vesting, because I do not think you should have immediate vesting, and the reason for that is a simple balance of interest; I don't think an employer ought to be obligated to provide anything for an employee who is essentially casual. But, an employee after 8 years isn't casual. Indeed, as Senator Bentsen points out, an employee after 5 years isn't casual. Maybe after a year or 2 or 3 or 4 he is casual, but after that, he has earned something and he ought to get it. Now, that doesn't say how much he has to get.

Senator NELSON. Let me ask a question: Maybe I misunderstood something about the administration's Rules of 50 proposal, but I have assumed that if somebody started working at age 20 and worked 15 years, then the Rule of 50 applies?

Mr. CUMMINGS. No, sir.

Senator NELSON. Well, but he is 35——

Mr. BERNSTEIN. Not under the bill.

Mr. CUMMINGS. It permits you to exclude the first 10 years up to the age of 30, so he has only 5 years of credit under the administration bill after 15 years, and those 5 years aren't vested, because his age 35 plus 5, equals 40, and not 50, so he has nothing.

Senator NELSON. But I was saying age 20 to 35 is 15 plus——

Mr. CUMMINGS. Senator, they don't count the years from age 20 to 30 under the administration bill. They exclude every year of service under the age of 30, or they permit you to exclude every year of service under the age of 30, which is, as I say, not "age neutral"; it throws out the early years and puts all of the burden on the last employer.

Senator NELSON. So that I understand what you are saying, if the rule of 50 included all service and you did start at age 20 and worked until age 35 that makes 50 years, and what you are saying is that in 15 years he should be accumulating his credits?

Mr. Cummings. And he shouldn't have to wait the full 15 years to vest anything.

Senator Nelson. I understand. So whatever the vesting period is, you are saying that he should accumulate his credits for every year he works, is that right?

Mr. Cummings. Right.

Senator Nelson. All right.

Senator Curtis. I want to make sure I understand what everybody means by "vesting." If an employee asked you what is vesting, what would you tell him?

Mr. Cummings. Vesting is the nonforfeited right to a deferred life annuity contingent only upon living to retirement age.

Senator Curtis. It has no relation to the amount?

Mr. Cummings. None whatever.

Senator Curtis. It just means that you wouldn't be let out and get nothing?

Mr. Cummings. Well, it is a vested interest in a portion, in the accrued portion, as defined, of the pension, that is, as defined in the plan. If the plan sets a pension at $150 a week, and if you are 50-percent vested in it, you are vested, I suppose, in $75 a week. That has relation to the amount of the pension, yes.

Senator Curtis. That leads to my second question. When you deal in terms of partial vesting, is that where the percentage is applied?

Mr. Cummings. That is right. It is an ascending curve, actually, because, as the percentage of vesting increases, the accrual also increases, so that each time, well, say the percentage goes up from 30 to 40, it is also 40 percent of a larger number so it is like a geometric curve.

Senator Curtis. Now under the administration plan, if you have an individual 40 years old, if he were on the job from the time he was 30, he would be vested, correct?

Mr. Cummings. If they started at 30 and they worked until when?

Senator Curtis. Well, let's use the example of prior to that, maybe he started at 20.

Mr. Cummings. From 30 to 40 they would accrue 10 years, although they use a 3-year preparticipation period, which I believe the administration bill allows, so they would really have to be 43.

Mr. Bernstein. That is correct.

Mr. Cummings. Is that correct?

Mr. Bernstein. You have to have a minimum of 3 years, yes.

Mr. Cummings. Three years. You can exclude the first three years.

Senator Curtis. The first 3?

Mr. Cummings. I think so.

Senator Curtis. Can you exclude them twice?

Mr. Cummings. You can exclude 3, and you can exclude everything up to age 30. So if you start at 30, they could keep you out for the first 3 altogether. Am I correct?

Mr. Biegel. I don't think so. I think the 3 years before 30 would count.

Mr. Cohen. As I understand it, Senator, if you started at age 27 and served your first 3 years between 27 and 30, then you would vest at least 50 percent by the time you were age 40, correct?

Mr. Cummings. Correct.

Mr. COHEN. So if you started your service with the company at age 30, then the company could exclude you from the plan for the first 3 years until you were age 33 and then by the time you are 41 or 42, the accumulation of your age of 41 or 42, and your years of service, would equal 50.

Senator CURTIS. But 27 or less, well, say he starts at 22, now when you once eliminate everything below 30, you would have to again eliminate the 3; is that correct?

Mr. COHEN. That is correct.

Senator CURTIS. You can't deduct the 3 twice?

Mr. CUMMINGS. Not twice, but let's put it this way. First, you can knock out everybody up to the age of 30, and then the employees he hires at age 30 or thereafter can be excluded for the first 3 years of their work. Of course, the further problem with that is that when you earn pension accruals in years around 40 and 50 the compounding effect of the contributions and the interest rates over a long period of time is much weaker. You can put in a very small amount of money regularly beginning at age 20, and it is astounding how much money you have when you are through. If you look on my arithmetic of vesting in my statement you will see that——

Senator CURTIS. What?

Mr. CUMMINGS. In my statement, I am taking a $1,500 a year contribution which is the maximum permitted by your bill in the individual retirement savings account, and I am saying if you start to contribute at age 25, and contribute regularly for 40 years—remember you are compounding 40 years—you will have at age 65, $232,000, which will produce for you a retirement payout for your life expectancy of $23,901 per year, which is pretty nice living.

Senator CURTIS. And that is the beginning at what age?

Mr. CUMMINGS. Beginning at 65.

Senator CURTIS. No, the set-aside, the savings, that is beginning at what age?

Mr. CUMMINGS. You begin to set aside at age 25 and contribute regularly for the full 40 years.

On the other hand, if you are hired at age 48——

Senator CURTIS. I wish you had given me that information 43 years ago. You've given it 43 years too late.

Mr. CUMMINGS. I gave it to myself, too, Senator, because I don't have a pension either.

Senator, I agree with you 100 percent, if you focus on the legislation from the point of view of someone who is already approaching retirement age. Nothing is going to help him as much as the rule of 50, provided he has already forfeited everything else. But the problem you are trying to solve in legislation like this is to insure that when a man gets to the point where he is approaching retirement age, he hasn't forfeited everything else and he has already earned his pension. As I say, it is a problem for the young, and it can only be solved if you earn that pension when you are young. It is just too late to earn it when you are old, unless, of course, you are permitted to sock away vast, vast sums of money in a short time.

Senator BENTSEN. You know, one of the problems you run into if you are talking about smaller pension plans—and I prefaced this by saying they are the exception—but you find some contributory plans, you find some employers who feel that the employees should contribute in part to their retirement.

Mr. CUMMINGS. Yes.

Senator BENTSEN. If you run into those and then get to the point of requiring eligibility at age 21 or 22, or whenever they start to work, you find a great deal of resistance to that by those people at that age.

Mr. CUMMINGS. I agree with you, Senator.

Senator, might I say just one word about funding? I probably went over my time, but there is a difference between funding to protect the plan and funding to protect a reinsurance fund. S. 4's funding is not there to protect the plan; reinsurance is there to protect the plan. Funding is there to protect the reinsurance.If you don't have reinsurance, funding is not only there to protect the plan but funding is an allocation scheme and determines who gets it and who doesn't. As you will see, if you examine the history in the Studebaker case, which both Mr. Lesser and I knew quite well from personal experience, these levels of benefits which were piled one on top of the other were not funded separately and the consequence was that the funding produced pensions for the retirees, but produced nothing for the vestees, even though some vestees had 40 years of service and had devoted their entire lives to Studebaker; they forfeited 85 percent of their pensions. Now, I think there is no funding scheme realistically that is ever going to protect Studebaker-type cases. Studebaker's plan would have qualified under any funding schedule in any bill. It would have qualified under Accounting Principle Board's opinion No. 8. It clearly qualified under S. 4 and under any of the other bills, but still the vestees forfeited their pensions. In fact, the Studebaker funding schedule was better, much better, than would be required by the administration bill, and yet the vestees with 40 years of service forfeited 85 percent of their pensions.

You cannot solve that problem without reinsurance, and the administration's study demonstrates that the cost of the reinsurance is so low that it ought not to be thrown aside, particularly as the supporters of this legislation are after reinsurance more than anything else. It is almost like saying to your constituency, who want pension reform, "well, I understand what is really moving you is that you want reinsurance. However, we decided to give you everything but what you want."

The Studebaker problem generated it all. If you don't solve that you haven't solved very much.

Thank you.

Senator NELSON. Mr. Lesser?

Mr. LESSER. Thank you. I would like to pick up from where Mr. Cummings dropped off because in the hour and one-half, this has been the first mention of what is, as Mr. Cummings says, the most important part of any pension reform; namely, termination insurance.

It has been pointed out that funding is important to accumulate assets, but funding will never or very rarely meet the problem of a plan that terminates from the point of view of all of the employees who have accumulated rights under their plan. The simple reason is that pension plans are not static. It is not just a question of a transitional period of 30 years—if that is the period for funding past service—until the plan is fully funded because every time there is an improvement in that plan to take care of cost-of-living increases or other economic conditions, you have past service unfunded, you have new past service unfunded liabilities, which are created and you immediately start another 30-year period to fund those past service credits which have now become accumulated.

Now, this goes on and on. As Mr. Cummings says, this was the problem of Studebaker. It met the requirements. It is true it was only in existence for about 15 years, but even if it had been in existence for the 30 years, it would not have been a fully funded plan because the benefits had been improved. The argument of the administration against reinsurance is that it doesn't affect too many people. The statistics are there, though. I believe it was 8,000 people in 7 months and some $20 million loss for an average benefit of $2,400 to an individual. I think we should not consider just numbers. I think the numbers to the individual—and I know this has been pointed out to this committee before—to the individual who is involved does not make much sense; he does not take much comfort from the fact that he is one of 8,400 people who lost rights under terminated plans, of which there was a record in the study.

I don't know how many stockholders were threatened by financial insecurity of their brokers, yet Congress passed an act a couple of years ago to protect them. I don't know how many banks go out of business yet we do have the Federal Deposite Insurance Corporation. I also know, which may be more analogous, we do have a compulsory insurance of mortgages. In other words, the unpaid balance of mortgages, FHA insurance doesn't insure the money that has already been paid in, but it does insure the mortgagor against the possibility that the mortgagee will not be able to make the payment. Now, termination insurance would insure the person who is covered by the pension plan against the possibility that the assets accumulated in the fund are not sufficient to pay him benefits to which he is entitled.

Senator CURTIS. Let me ask right there: What do you insure for? You mentioned pensions were not static and there were improvements in benefits. Suppose not too long before a plan terminated it was liberalized?

Mr. LESSER. Well, both S. 4——

Senator CURTIS. And yet the insurance would have been collected under the old plan.

Mr. LESSER. Both S. 4 and Senator Bentsen's bill do provide that if a plan is improved within 3 years of the date of termination, that additional benefit resulting from the improvement would not be insured. In other words, the benefit, the improved benefit would have to be in effect for at least 3 years and the employer would have to have had to pay a premium on the unfunded liability created by that increased benefit.

So you do have that as one safeguard against an employer or an employer in a union immediately increasing benefits with the expectation that the plan will terminate.

Secondly, S. 4 does also provide that there is a liability on employers who are at the point of termination, which again would take away some of the incentive to inciease benefits in the expectation of termination.

Senator BENTSEN. Mr. Lesser, I think that is an improvement frankly on my bill. Some liability should be imposed on the employer or the corporation in the event a plan terminates with insufficient assets to pay all vested benefits. There ought to be some punitive action in effect against the employer.

Let me ask you another thing that concerns me, if I may, Mr. Chairman, at this point.

Senator NELSON. Yes.

Senator BENTSEN. It has been argued that in negotiations a corportation and a labor union might agree to unrealistic benefits with the idea that termination insurance would protect them. What do you think about putting in certain minimal actuarial assumptions to try to avoid some of the abuse in that type of situation?

Mr. LESSER. Well, I assume, you know there would have to be some standardization or at least some regulation affecting actuarial assumptions, and so forth, in order to determine unfunded liability. That would be part of a plan; that would be part of a funding plan. I think that it would be perfectly proper and I think that both your bill and S. 4 do contain limits on the amount of benefits that can be insured and I think that is perfectly proper, too. I believe the limit is $500 a month.

Senator BENTSEN. I think mine is $1,000.

Mr. LESSER. $1,000 or whatever, but it does contain a limitation on people getting together and saying, well, maybe 4 or 5 years from now you will terminate because, in other words, they still have to say it has to be more than 3 years——

Senator BENTSEN. I must say that was a misprint in my bill. Mine is 5 years; S. 4 is 3 years and mine is 5 years.

Mr. LESSER. Oh, I am sorry.

Senator BENTSEN. But that was a misprint in the first copy, I believe.

Mr. LESSER. There is one other thing I would like to mention just briefly, Senator, on the termination insurance and the liability of the employer. Some question has been raised that the potential charge against the employer may have an effect on his credit; in other words, his assets or part of his assets are being pledged in the event of termination. One of the things that might be considered would be to provide that the repayment or that the reimbursement of the insurance fund would be a charge, but it would be paid out of a certain percentage of profits as they accrue after the plan terminates.

I would like to make, in the next minute or two, Senator, I would like to go back to the vesting thing because I do think that it is important to stress the importance of giving full credit for all periods of service. First, as was pointed out, it depends where a person is as to which plan might benefit him, but the rule of 50, together with the disregard of service prior to age 30, would mean that substantial periods of service prior to age 40 would not be taken into account in determining what the benefit is to which the individual is entitled to deferred vesting. The amount of benefit—and it is important to protect him for some of his rights—but it is also important to protect him as to the amount of benefit. If each time he loses 30, or 40 or 50 percent of the benefit rights which he had accumulated as of that point, when he does reach retirement age the amount of benefits to which he has a vested right will be much less than he would have been entitled to had he stayed in service.

Senator NELSON. With one employer?

Mr. LESSER. One employer; that is, if he had had full vested rights, with each employer. Personally, I happen to prefer the 10 years with no age requirement.

Senator NELSON. Of vesting?

Mr. LESSER. Vesting, yes. I think Senator Bentsen's recognition of service beginning with 5 years as the breakpoint has a lot of merit. I happen to think that the 5 percent a year thereafter is too low a rate. It takes 20 years before there is full vesting under that formula. Of course, you can increase the rate above the 5 years and shorten the period, but I do think the 20 years is too long a period of service for full vesting benefits, although I do think the graduation beginning after 5 years has some merit.

Senator BENTSEN. Well, I think we have to always remember that we are not talking about the ideal plan; we are talking about minimum standards.

Mr. LESSER. Well, I recognize this but I do think the studies that have been made indicate that the cost differentials are not that great. I think, as Mr. Cummings pointed out, it costs much less to provide a benefit for individuals at early ages. Now, we are not talking, as was pointed out, about turnover. Someone pointed out about the turnover and that we have more turnover at the earlier ages. Well, that is true but the individual who has worked 10 years—well, turnover is usually an attribute of age and periods of service, and while there may be rapid turnover in the first several years, I notice statistics in the auto industry demonstrated that once an individual had put in 10 years of service, it was little or much less turnover on the part of the employees and, therefore, of course, the cost of vesting after that period is a very small cost.

I would like to throw out one other suggestion which just ties in and; that is, no one has mentioned portability. While I think myself that vesting and termination insurance are the keys. In other words, I think that portability without the termination insurance would be disastrous but what it would mean that the person who leaves and can take money with him, would be better off than the fellow who stayed with the employer who then terminated. And one of the advantages of portability is that you do have a single place where records are kept as to rights which an individual has to pensions, and I would suggest that a requirement might be that when an individual accumulates a vested right and leaves, that plan be required to notify the Social Security Administration of the vested right. Everybody knows to apply for their social security benefits. Now when an individual applies for the social security benefit, they would then be notified of all of the rights they have to vested benefits and how they might be applied.

Mr. Cummings pointed out that is in S. 4, but I do think that is one that is not mentioned much and doesn't cost anything and that whatever the vesting provision is, I think that it would serve a terribly important function.

That is all. Thank you.

Senator NELSON. Thank you very much.

Mr. Cummings and Mr. Lesser are the only panelists who have discussed the question of termination insurance. Would you like to comment on that issue Mr. Biegel, before you have to leave?

Mr. BIEGEL. I am afraid I must.

I would say, Mr. Chairman, that in spite of the apparent differences among the panelists on most of the subjects, we are fairly well agreed that something should be done with vesting and funding, and, perhaps with the exception of Mr. Cummings, nothing need be done with portability other than Mr. Lesser's suggestion of notifying social security. I don't regard that as a portability problem and I think no one would object to keeping records at the social security office of the various pieces of pensions.

Now, similarly, our fiduciary responsibility and disclosure, which hasn't been discussed at all, I think you will not find very great disagreement among us. However, I do believe that there is a tremendous difference among industry, in particular, on the one hand and perhaps some labor on the other with respect to insurance. In the first place, we have had a number of studies on insurance and your committee, I am sure, is inundated with statistics on it. Let me just restate them if I may.

The Bureau of Labor, the Department of Labor, and the Internal Revenue Service in a 1968 study, made a study of 8,000 plan terminations in a 10-year period ending 1965, and only 20,000 employees were affected each year. This is one-tenth of 1 percent of the pension plan universe.

Senator NELSON. One-tenth of 1 percent of the insured?

Mr. BIEGEL. Of those who were covered. This is one-tenth of 1 percent of the people covered.

The Treasury Department has updated that study in 1972 and it made a study of plan terminations in the first 7 months of 1972, which showed that four one-hundredths of 1 percent of the employees covered lost vested benefits. Now, I know the argument works both ways. My point is, with such a low incidence of loss, is there any necessity of adopting insurance? I heard Senator Bentsen say that with such a low incidence of loss, why not? Well, it would be like adopting marriage and divorce laws based on the track records of Zaza Gabor and Liz Taylor. We do have some examples. We have the FDIC, which Mr. Lesser mentioned. However, that was adopted and enacted when all banks were closed in 1933.

We have the Securities Protection Act which was adopted a few years ago. This was adopted at a time when most brokerage houses were on the verge of folding; at a time when the problems of the backrooms of brokerage houses were immense and there was a possibility that all people who had securities—and people who hold securities are not only the richest because everyone buys them or most everyone does—but here we have a different problem. Here we only have a fraction of employees involved. In addition, we have new funding standards, I think, with which most people agree.

Now if you were to assume—and I have to guess at some of these figures because I am not privy to all of the statistics in the Government or in the labor force. But if you were to assume that the unfunded accrued liabilities today are, roughly, $30 billion, and if you assume a 30-year period for funding, you are going to get funds into pension plans at the rate of $1 billion a year. Now, conversely——

Senator NELSON. Increase?

Mr. BIEGEL. Yes, sir. You are going to have $1 billion of funds paid in each year under your required 30-year funding. Now if you assume that your insurance will be on the unfunded vested liabilities, I think that figures show that there is about $13 billion of unfunded vested liabilities. Just to make my arithmetic simple, let me assume $14 billion. Now, if you have two-tenths of 1 percent as your premium, which has been suggested in Senator Bentsen's bill, and in the Williams-Javits bill, you have $28 million that is coming in, in the way of insurance premiums.

Senator NELSON. $28 million annually?

Mr. BIEGEL. Yes, sir, $28 million annually. Now of the total losses that have been shown or plan terminations in 1972, it was estimated to be $20 million. Now that is the single sum required to fund all of the benefits, the vested benefits of the employees whose plans were terminated. Now, that doesn't mean $20 million was payable immediately. It means that some portion of that—maybe a couple of million dollars was payable to those who were at the retirement age. Much of it, a good deal of the $20 million, is attributable to people who wouldn't retire for 20 or 30 years in the future; certainly 10 or 20 years in the future, namely, they are age 45 or 50 and they are going to get whatever vested benefits they would have at age 65. So you have a long period of time there. You don't need anywhere near $28 million insurance premiums to cover that liability.

Now the Federal Deposit Insurance Corporation was mentioned as an example and a good one. It was adopted at a time when it was necessary to have it. At the end of 1969—and these are the last figures for which I was able to get figures on—there were 13,000 banks covered. The FDIC employed almost 3,000 people at the end of 1972. They had accumulated a fund of $4.7 billion at the end of 1971. This came from annual assessments. The Deposit Insurance assessments in a single year were $416 million. The expenses of the administration plus the losses were only $54 million, so that the net assessment was $362 million. In addition, that fund, that $4 billion fund, was earning substantial sums of income. So here we have built up a huge fund to take care of a liability, which was less than $25 million in that year of potential liability.

Now, I am afraid that we would have substantially the same track record in a termination insurance organization. There have been various suggestions as to what kind of organization ought to do it but regardless of that, you would soon build up a bureaucracy that would be tremendous.

If you will allow me to go on for 1 more minute, Senator, what troubles me more is that it is not merely insuring the gap, the vested unfunded liability. No insurance program could merely operate on the cavalier assumption that you take two-tenths of 1 percent of that figure and you are home because it would violate all of the principles of insurance. In order to do this, this bureaucracy, this organization, whatever it is, whether it is private insurance or a governmental separate insurance company, or a part of the Department of Labor or whatever, would require that the valuation of plan assets be done on a single basis. They could not permit the employer to value plan assets as he chooses, because he could thus determine the extent of his liability. They would soon require all actuarial assumptions to be fixed and immovable. They would define risks; obviously, that would be the first thing they would do. They would unquestionably move into the area of controlling the investment of all plan assets.

It could not, such an agency, could not allow employers or the trustees to invest as they please in all forms of assets and, if the assets went down in value, the insurance fund would make up the gap. There would have to be rigid controls of the investment of the plan assets, the method of value of plan assets, the actuarial assumptions to be used, all of which in my opinion, make this a vast burden that the industry as a whole does not want to assume.

Now, let me suggest something that probably is not even acceptable to the few clients I have left after this morning's performance. But instead of a premium based on the unfunded vested liability—and I would be certain with my long tenure in this field that that would not remain in force very long because it would, as some of the witnesses before the Ways and Means Committee, in a similar panel admitted, it would have soon the impetus to tax those who are best able to pay, rather than those who are least able to pay. Therefore, instead of adopting a premium structure, suppose we adopted a head tax? We have 30 million people covered by existing pension plans.

Let's use a 10 cent per head tax, which would produce $3 million per year which would more than cover these vested benefits that are payable in that year to a terminated employee.

I know that is probably radical, but that 10 cents could be raised as the need demanded. We would not have to go into the highly complicated and bureaucratic method of controlling plan assets and investments and actuarial assumptions. This head tax would fall heaviest on those with the largest plans and on those best able to pay.

Senator CURTIS. May I interrupt there?

Mr. BIEGEL. Yes, sir.

Senator CURTIS. The thought has been thrown out here that instead of insuring an amount of payment according to the plan, that everybody be insured in the case of termination to—the extent of say, 1½ times the social security benefit. In other words, the objective of the termination insurance would not be to pay everything that a plan proposed to promise, but it would be a payment in lieu of that in case of a termination. I don't know that it would work but have you any comments on that?

Mr. BIEGEL. I suggest in my testimony——

Senator CURTIS. Pardon?

Mr. BIEGEL. I suggested in my testimony before the Ways and Means Committee that the insurance, if there is any, would be a multiple of social security benefits. Now I think there is built into all of the schemes the following: And Senator Bentsen's scheme is a little more liberal than Frank Cummings, namely, 50 percent of pay for $1,000 a month; the Javits-Williams Bill has $500 a month. Now, that, too, limits Senator, the availability of funds on termination. They would, go towards those in the lower brackets and, therefore, the $20 million that has been forecast as the loss in 1 year's termination is nowhere near realistic because, if we cut it down by those who retired in a given year only and limited even those to the benefit limits of the Williams-Javits bill, that is $500 a month, or $6,000 a year, I think you would find that there is probably sufficient funds by this new funding method to take care of that.

Senator BENTSEN. Mr. Chairman, may I make a point.

Let me say, first, that when we talk about the number of people that are involved, we said 8,000 in a period of 7 months and $2,400 average loss. Of course, to the person who suffers a loss it may be a 100-percent loss. Second, we say that FDIC was installed at a time when all banks were closed. But must we wait for a crisis to insure pension plans?

And, if you really believe that you can avoid certain perimeters on investments—and when you are in a fiduciary position you are a trustee of someone else's money—that you can avoid it just by not having termination insurance, I don't think that is very realistic. I think that is going to come anyway.

Let me say I have owned banks and I was delighted to have FDIC to provide my depositors with some additional piece of mind. If we are talking of only 8,000 people who lost their pensions in 7 months, that is a small number but, nevertheless, we would contribute to the piece of mind of all of those people who might have been one of those 8,000 by this kind of insurance.

Now, let's get to this point of how much the premiums should be. We are not sure what the premiums should be and that is why we put a 3-year provision in there so that there could be adjustments at the end of that period of time. We could then determine which is the proper approach. We could determine whether there should be a premium based on the unfunded vested liability or whether there should be a premium based on a percentage of all the contributions to the pension plan or a head tax, as you say. But anyway, you will have 3 years of trial of this. This premium will not be burdensome.

And insofar as the FDIC building a substantial sum of money, well, of course, they should. Since the time when the FDIC was created, we haven't had a serious depression. We have had some recessions, but no real serious depression. You have to build a fund for that crisis. The same thing is true, I think, of pension plans so that you would have to build up a surplus. I recognize that. I think that would be necessary in order for the insurance to work. So, yes, there are complexities to it and there are problems to it, but I think we can resolve these problems.

Mr. BIEGEL. We may eventually come to that, Senator, but let me just add I am as concerned as anyone with the 8,500 employees who lost their benefits. No one can talk in terms of statistics and be cold-blooded about it. These are individuals and not statistics. I know also there are, looking across the numbers, some 30 million who are not covered; a very large number in this area that are not covered and my point is that, which group shall we favor, which group shall we give some prime consideration to? Now, we are improving, as all of us agree, we are going to improve vesting and that costs. We are going to improve funding and that costs. We are going to improve other areas on fiduciary responsibility and disclosure, all of which costs. Now, it is easy for an economist or an actuary to say the additional cost of vesting is only 0.2 of a percent of the salary of the employees

BEST COPY AVAILABLE

involved, but that point 2 percent may be 10 percent additional cost to the plan. We have the cost of funding which will go up and that will be an additional element. All of these costs make it quite unattractive for an employer to go into a new plan and moreover, if they become burdensome under this voluntary system, employers can either terminate their existing program or, failing that, they can adopt a money purchase system which would mean that they would put in a flat percentage of payroll, like 5 percent or 10 percent, spread it across the board, and it would buy more for the younger man than it would for the older man. It would not put the money where it is needed and you would have a plan that would not work.

We had the experience in the 1930's with money purchase plans and they were found defective. They lost faith and they are a rare thing to do today, but we could go back to that if these cumulative costs, each of which is small in itself, but when you add all of them up, they become very expensive. And if we were to do that you would discourage the 30 million from entering the pension fold at the expense of taking care of 8,500—very worthwhile citizens and employees—but you have to balance these equities.

I don't know where the breaking point is. As I indicated, I quoted the statistics of $46 billion in fringe benefit costs per year. Now, how high can we go without breaking that economy. That concerns me and that is why I would say for starters, let's not buy the whole package. You have vesting and funding and fiduciary responsibility and disclosure, all of which costs money, so let's take care of that for starters. If you are concerned about insurance as all of us are and want to adopt some system, then let's do the minimum that we can in the way of a minor head tax and get funds there that would be available to take care of the terminations in that year.

Senator NELSON. We haven't heard from Mr. Bernstein and Mr. Cohen on the question of termination insurance.

Mr. Bernstein?

Mr. BERNSTEIN. Public employee plan coverage.—I would like to reserve my time on that, Senator. I only have one contribution that I would like to make on termination insurance. I think it is a very fragile thing at best. I would like to introduce on that point this consideration—the bills before the Senate deal only with p ivate employees. One of the measures before the House, one of the Dent bills, would apply about equally to plans covering public employees. That is another vast area but the public employee domain presents many of the same problems that were discussed here today. You have the difficulty of eligibility, the problems of funding. However, you have the difference in the public employee domain in that the tax resources of the employee unit are available. In other words, in the termination insurance area, were you to add public employees you would have a vast area that would not draw down your termination insurance fund and you would have a ballast, if you will, or a reservoir that would help make your private system go.

Senator NELSON. How do you mix a private voluntary insurance pension plan with a public voluntary plan?

Mr. BERNSTEIN. Well, neither one of them is voluntary and the public less obviously so. They are both compulsory but, Senator, you mix money. The great common factor here is money.

Senator NELSON. Well, maybe I am missing something but if you would extend the plan——

Mr. BERNSTEIN. Not the plan. Because they have their own plan.

Senator NELSON. Just the termination insurance?

Mr. BERNSTEIN. The legislation might apply the vesting provisions, which may very well be equally needed in the public sector—and I think they are—and you would consider applying the funding principles, because there has been a great deal of irresponsibility in funding public plans. And you could apply the termination insurance and then you would give yourself a much more solid base.

Senator NELSON. But who joins it?

My State has a retirement plan which is contributory. It is both State and social security combined.

Mr. BERNSTEIN. Yes; I am familiar with it.

Senator NELSON. Every dollar that any employee puts in is of his own. He may withdraw this money after 1 year, 2 years, 5 years, whenever he leaves the service.

Mr. BERNSTEIN. Correct.

Senator NELSON. It is funded. I don't think our legislature would vote to come under a plan that imposes a tax upon them to pay for termination insurance when they are satisfactorily covered now.

Mr. BERNSTEIN. I am not suggesting that the legislature would adopt it. I am suggesting that the Congress might very well decide that on a national basis there are public plans which are seriously underfunded and present the same kind of problem on termination that private plans do.

Senator NELSON. I understand that. Apart from the constitutional question of imposing that on a State, and apart from the practical political question of passing it with Congress imposing it on the States—if you mean by that Congress imposing it——

Mr. BERNSTEIN. Yes.

Senator NELSON [continuing]. My State and many others would resist it. We are already supporting financially other communities which don't shoulder the heavy tax burden of Wisconsin and we ain't about to buy a proposition where we spend money to insure somebody else's incompetence.

Mr. BERNSTEIN. Senator, I don't purport to be speaking for employees in your State, but when you say that the Wisconsin Legislature might resist it, that might be a premature determination. I have spoken to employee representatives in the State of Wisconsin who find it possibly an attractive proposition. You may be hearing more about that in the weeks ahead. I wouldn't come to a premature conclusion as to where Wisconsin stands on that question.

The problem of plan termination.—I would make one other point on termination, Senator, on termination insurance, and that is that Mr. Biegel and the Treasury Department give us the good news that only four-tenths of 1 percent of the employees lose.

Now, if you multiply those figures over the next 30 years, which by pension standards is not a very long time, you would find that three-quarters of a million participants would lose their benefits from this one cause alone. Now that is a very significant number of people. However, this study seriously understates the problem of termination losses.

It nowhere gives figures indicating how many people were washed out of these plans before the time of termination and that is a critical factor. What the report does say—and I summarize this in my prepared statement—that some 46 percent of the plans had declining membership in the years preceding, that they had declining membership that exceeded 25 percent of the membership in the years' proceding plan termination. So you really must find out what the pension losses were by reaching back to when the death throes settled in in order to find out how many people were washed out of plans without vesting and in order to find out how many people lost the value of credits earned. I urge this committee to go to the Treasury and say: what are those figures, and ask Treasury to recompute the percentages of losses. You will find a figure that is substantially above this figure.

Senator NELSON. You are talking about the situation where, for example, there has been a substantial coal mining operation, which has reduced by half the number of its employees in a 20 year period, or a railroad which has lost half of its employees or more in a 20-year period, and that computation is not included. Is that what you are saying?

Mr. BERNSTEIN. Yes but in a shorter period, the period just before plan termination. For example, one figure—and I will pick this just at random because you can find this again and again and again—but the Electronics Park in Syracuse, N.Y., recently had an employment level of 18,000 and in 1971 that had gone down to 7,500. Now unless you count all of the people who were plan participants during the period of contraction, you do not have an accurate figure for the plan losers. These are participants whose credits mean nothing to them. These are plan losers. These are not covered by the report and I would urge you to get those figures from Treasury and find out how many people are in that category because a very significant number of plans were covered in just that way.

I would point out one other thing about the termination study and that is when plans terminate, if the termination is delayed long enough—as it was in the Burlington Mills in Burlington, Wis.—money may be left over that the employer can pocket. The termination study the Treasury did show that there were no plan losers in more than half the plans. That means in those plans there was money left over for the employer to repocket.

Senator NELSON. Mr. Cohen?

Mr. COHEN. Thank you, Mr. Chairman. I think that there is a fundamental problem—what I have come to be convinced is a dilemma—with termination insurance. Regardless of the small number of people who may be injured, and seriously so, it is a problem that tugs at the heart of anybody who considers it, and we would all like to find a solution to it. It seems to me that when you set up an insurance scheme that the insurer; namely the insurance company, the insurance fund, is going to have to establish certain standards for the operation of the pension plan, for the actuarial assumptions, for the types of investments that are made. Otherwise you are insuring; for example, the investments in bonds and stocks and even assuming that they are blue chips, you are insuring the level of the stock market. Now I think inevitably—whatever you think the degree of it is—as Mr. Biegel has said, the insurance fund will have to insist upon standards that will be much stricter than any that are provided for in the bill; standards with respect to investments, among other things, as well as actuarial assumptions.

Now to avoid that, the bill, at least in S. 4, provides—and Senator Bentsen indicated that he was favorably inclined toward this—putting a liability on the employer for the unfunded amounts at the time of termination. Now S. 4 provides that in the light of the fact that this might involve potentially enormous liabilities—and I use those words in quotes—potentially enormous liabilities, the liability is confined in S. 4 to one-half of the net worth of the employer.

Now the term "net worth" is not defined and it would be a very significant item. I think it ought to be defined, but I won't dwell on that at the moment.

One of the problem that bothers me is that if this means a company would be responsible for the liability up to half of its net worth, then a company may have a potentially enormous liability and there is a serious question as to whether the certified public accountants auditing the financial statements of the employers are going to require that that liability or that that figure be reflected as a liability in the balance sheet or a reserve for it be provided in the financial statement. If that were to be required by the accountants or by any Government agency that has to deal with accounting, you could readily have substantial defaults in bonds, debentures, preferred stocks or agreements or contract which require an employer to maintain a prescribed ratio of assets to liabilities.

But, however the accounting determination is ultimately made by the certified public accountants, even the existence of it in a footnote, which would be seen by creditors or investors, would call for a judgment by someone as to what is the likelihood, the potentiality of there being a termination of the plan and invocation by the insurance fund of this liability for the unfunded amounts. You can see where this would lead to——

Senator BENTSEN. Let me ask you this, Mr. Secretary, if you gave preference to all creditors—and if you are talking about net worth, to me that is what net worth would mean, in the most simplistic terms—but if you gave preference to all creditors before this liability was incurred, wouldn't that take care of any problem of your accountant and any concern of the creditor of any footnote that might be attached?

Mr. COHEN. But this cuts both ways, Senator. To the extent you do this, then you put more of the burden back on the insurance fund.

Senator BENTSEN. Perhaps we are all influenced to a degree by our own experience and I used to run a life insurance company and I had certain limitations on what we could invest those funds in and they weren't particularly burdensome. We operated within that framework all right. Certainly I think the degree of fiduciary responsibility in operating a pension plan is just as important as operating a life insurance company or as important as operating a bank or a savings and loan asosciation and I have done that too.

Mr. COHEN. Let me come back to the first question as to whether if you just take care of creditors—all other creditors, including perhaps subordinated debenture holders, would be protected in priority—you would still have the problem of preferred stock and you would have the problem of the investors—not just the big investors, but anybody buying stock on an exchange or in the over-the-counter market. You would have the question to what extent do you have to inform those investors of the potentiality or the likelihood or the possibility of the plan being terminated? It seems to me it is a rather serious dilemma. And if this had to be reflected as a liability or a reserve and provided for in the balance sheet, particularly for companies whose earnings don't have the financial strength of some others, you could drive some of them under.

Now I am not saying you have to do this. You don't have to have liability up to half the net worth. You can try to work this out in some other way, but you go back and forth between creating standards and creating this liability. I think the liability up to half the net worth is a very serious problem for many businesses, and I think it would be a substantial discouragement to the formation of new plans. In particular it seems to me it is a serious problem because, as I read this bill, it would apply to the liability for benefits accrued prior to the effective date of the act—for all of the benefits now in effect. If a plan isn't terminated before the new law would go into effect, this would become a liability to the employer and that wasn't the deal when the plan was set up. It would be the deal, however, as soon as this act became effective.

Senator BENTSEN. My point is I think there ought to be some deterrent to keep the employer from making an unrealistic settlement when negotiating a pension plan.If the employer had something punitive, that would perhaps help in preventing abuses of termination insurance.

Mr. COHEN. Senator, I think for example, this might be true with respect to insiders, to controlling stockholders—and there was a case mentioned earlier of a man who controlled a company. You might distinguish those cases from those where there is a widespread ownership and no one bears that responsibility.

Senator BENTSEN. Thank you very much.

Senator NELSON. Senator Roth?

Senator ROTH. Mr. Biegel proposed one alternative approch to the problem of protecting the 8,400 or 8,500 people that have lost their pension rights. I wondered if any of you gentlemen have any other suggestions? These people may be a small percentage, but to each individual affected, it is a very important problem.

What other alternatives are available to us?

Mr. CUMMINGS. Senator, the one alternative Mr. Biegel didn't discuss is the one that is before you. The fact of the matter is that no one in his wildest imagination suggests that the fund itself is going to be built to pay the $28 million or $20 million which Mr. Biegel computes.

In other words, the fund is subrogated, as Mr. Cohen was saying, against the general assets of the contributing employer. I would guess, although no one knows without experience, that very, very little of that $20 million is actually going to come out of the fund, which means in turn that the two-tenths of 1 percent contribution is very high and doubtless would fall like a rock.

The other side of the point which Mr. Cohen is talking about is this "horrible" prospect that somehow or other a company would have to show on its balance sheets a footnote indicating that it has made a promise, which God forbid, it might have to keep. As far as

I know, this is the only promise in American law which we have set up as something you don't have to keep. Any other promise, any other contract, any other obligation, you are supposed to keep. Rare it is that we see a nonrecourse loan. Recourse is the name of the game. Why is it so horrible? As a matter of fact, there has been a lot of talk over at the SEC about requiring this footnote on the S-1 registration now, without benefit of this new law. Why is it so horrible that they would have to put this footnote on there and say, oh, yes, by the way, we promised our employees a pension—they have been working for us for 30 years, in reliance on that promise—and it is just barely possible that we might have to keep it. I say that doesn't frighten me.

Now, regulation of actuarial assumptions: do you realize the actuarial profession is absolutely unlicensed in this country? If you wanted to be an actuary, Senator Roth, tomorrow, you would just hang out a shingle and you are an actuary, in terms of the law. And by that I don't mean to say actuaries aren't very well qualified, because most of them are. What I am saying, though, is they don't have to be, or there is nothing in the law that says that they have to be, licensed. We regulate good accounting practices. Why not regulate good actuarial practices?

As far as putting the fund and investments in a straitjacket, your banks downtown don't operate that way. They are insured by the FDIC, and yet they decide where they are going to invest. They decide what commercial loans they are going to make. They are dealing with insured money there, but still they use their good, honest prudent man judgment. That seems to be good enough for the banks. There is no reason why, absent conflict of interest, it shouldn't work just as well with the pension funds. There is no reason why it couldn't work, with the same sort of prudent man judgment we use with the banks, plus inspection, plus regulation of actuaries, which is provided in S. 4. I think you could have a great deal of flexibility in the kinds of investments you could make. You could have a great deal of flexibility in the plan. You could have the footnote on the balance sheet, and the world would not come to an end. It is not unheard of, by the way, in the steel industry; when a steel company promises a pension, it pledges its general credit to that pension. What is so awful about that? The steel companies have to live with it, so why can't the rest of the country?

Senator NELSON. Does anybody else have a comment?

Senator ROTH. Let me pursue this a little further. We have heard a suggestion for some type of head tax. I suppose one of the failures of that approach would be the simplicity of it. But I have also heard other criticism of basing your premium on the unfunded vested liabilities. Nobody seems to know quite what that number would be.

Mr. CUMMINGS. Senator, it measures the premium by the risk. When you go by a head tax, you may be taxing a plan that is fully funded. I suppose some fundamental notion of justice says why should a plan have to buy an insurance policy when the plan is fully funded and has no risk? It is already insured. It is insured nothing.

Senator ROTH. Any other comments?

Mr. BERNSTEIN. I would like to make a comment. When you require premiums on the unfunded liability based upon degree of risk, what you are doing of course is putting the heaviest premiums on the weakest funds. I am not here to argue against reinsurance, but I think a realistic view must tell us that reinsurance is not the panacea that it has been made out to be. I think it is an essential part of a reform measure, but I also think it must be remembered that it may not work. I had one other comment, briefly, Senator Roth.

Senator Curtis raised the point before that perhaps the payout from insurance should be some multiple of social security benefits. I would suggest that the Senate Finance Committee of all committees, should recognize that the alternative to private pension plans, which are high cost and of dubious reliability, that the alternative is a much expanded social security system. I think that is a realistic alternative and I would further suggest on that point if this committee were merely to say that you questioned the continued justification for the favorable tax treatment that private pensions now receive and just let that shoe drop and hold the other—the private pension industry, which constantly tells us how difficult it is to do these things, would find a way.

Senator NELSON. That is too devious for us.

Mr. BERNSTEIN. Pardon me, I didn't hear that, Senator.

Senator NELSON. That is too devious for us I said.

Did you have any more questions?

Senator ROTH. A couple of brief ones.

People keep talking about the costs of the various proposals for vesting, insurance, etc. Has anyone made a study trying to show what the cost parameters are?

Mr. BIEGEL. We have two studies made, Senator. Professor Winglemost of the Wharton School, I think did this for the Treasury and I think a firm by the name of Grubb Actuarial Firm did it for one of the Labor committees and both studies are not inconsistent. They note the general parameters of the costs of vesting for instance. They show it in two ways. One in terms of the percentage of payroll and the various assumptions where a plan already has liberalized vesting and adopts some of the legislative suggestions, where it has moderate vesting and adopts any one of them, and where it has no vesting at all. And the costs varied widely, depending upon the particular status of the various plans. And as a percentage of plan costs, it becomes very significant.

I think all of that is in one of the papers submitted to your committee.

Mr. CUMMINGS. Mr. Grubb's chart, his study, is in my statement and page 150 of the committee's print. Now as you will see, the highest cost estimates for the worst plan under S. 4 is 1.4 percent of payroll.

Mr. BIEGEL. What is it of plan cost?

Mr. CUMMINGS. Now it is true you can come up with a figure which perhaps might in some plans even reach 50 or 100 percent of plan cost, provided the plan cost at the present time is trivial, but let me put it to you this way, that 50 percent of a triviality is still a triviality.

Mr. BIEGEL. No, it is a 50-percent increase. You can't slough it off that way, Frank.

Mr. BERNSTEIN. I would agree with Mr. Cummings that it is a triviality. When you find a plan whose costs are going to increase 53 percent because of the very modest, extremely modest, improvements by S. 4 you've got a plan that costs next to nothing to begin with. In terms of dollars a year, if you figure what it costs an $8,000-a-year member, a 53 percent means you are going up roughly from 1 percent of payroll and in terms of the $8,000-a-year man, that is very little money.

Senator ROTH. What do you estimate it would cost the Federal Government?

Mr. BERNSTEIN. Pardon?

Senator ROTH. What do you estimate it would cost the Federal Government?

Mr. BERNSTEIN. Very, very little for the simple reason that the impact overall on plan cost would be very, very slight. When you take a look at Mr. Cummings' figure, for all plans the cost of S. 4 vesting in its present form would be from zero—because on a liberalized vesting plan it would have no impact—to perhaps 53 percent, and that is overall. But if you were to average that overall of the plans, it would be closer to the zero because most plans already have liberal or moderate vesting.

Senator ROTH. Mr. Cummings?

Mr. CUMMINGS. If I could interpret those figures, now if you look at that chart——

Senator ROTH. What page was that again?

Mr. CUMMINGS. It is on page 150 of the committee print and also in my prepared statement. There are two "line two's," the first "line two" is a percentage of payroll and the second "line two" is a percentage of plan costs. You will notice that, for example, for all plans, which is the right-hand column, that shows a spread from zero to 1.4 percent of payroll; and for percentage of plan costs for all plans, it shows a spread of from zero to 53 percent. What that means is that the worst plan, which suffers a 53 percent increase in pension costs, also suffered a 1.4 percent increase in pension costs as a percentage of payroll.

So what you are really saying is, yes, if you are contributing next to nothing you will now have to produce 1.4 times next to nothing, which is still going to be very close to nothing.

Now you shouldn't laugh off any costs, and no corporation will laugh off any cost, of the magnitude of 1.4 percent of payroll, which after all is the worst impact in this study—and by the way I didn't write this study. But in an economy in which wages have been going up 6 or 7 or 8 percent a year for as long as most of us can remember, a statute which says to the employer: "next year instead of raising wages 7 percent, raise them 5.6 percent and put the other 1.4 percent in pensions, and you comply with our bill—or if you insist on doing both, this is going to cost you an extra 1.4 percent of payroll." A statute like that is not unreasonable.

That is a substantial expense, but it is not a barrier or even in my judgment a factor which this committee of the Congress ought to consider as a deterrent to providing pensions where they are now most negligible.

Senator ROTH. Or deterrent to creating new pensions?

Mr. CUMMINGS. I wouldn't think it would be a deterrent to creating new pensions either.

Senator Roth. I believe you mentioned engineers in your statement.

Mr. Cummings. That is a client of mine.

Senator Roth. Now how would that work? If you were an engineer working for a corporation with a reasonably good plan, would you be free to decide whether to go with the "plan" or not?

Mr. Cummings. Any time you draft a bill, you are trying to draft it to deal with the most general problems. There are always going to be people you don't deal with, though. Notwithstanding the fact that I represent a segment of the engineers, this bill wouldn't help them at all, and the reason is that they work 4 or 5 years in a company and then must go to another company. They are not going to vest in any plan.

So what they want is to set up their own plan and have all of the money, which the employer now contributes to his corporate plan, be contributed to an immediately vested engineers' plan. Then they will decide what to do with it.

In the alternative, they desperately want the feature of Senator Curtis' bill and Senator Bentsen's bill which permits the individual retirement account where, in the absence of a plan that does the employee any good, at least the employee can get a tax deduction for his own contribution for his own retirement account. They want that without some of the limitations that are inherent in the administration's bill, to wit: A reduction of employees' permissible contribution based on how much the employer put in. The reason they don't like that is because they start with $1,500 as the limit of their contribution, and that is nice; but the trouble is that every time the employer puts in a dollar, that is one dollar less they can put into their plan, and the employer's dollar isn't vested, so it doesn't do them any good it just reduces the amount they can contribute.

They would like a flat amount, a substantial amount, and no reduction for the employer's contribution. They would say to you, Members of the Congress and the Senate, "let me do my own pension planning. I am not such a fool. I can do my arithmetic. I want to save, and I want the tax benefits, which normally accrue to other industrial people. I want to defer paying taxes on this money until I retire, and then I will have the dignity of living on the money that I earned. That is what pension planning is all about."

Senator Roth. It sounds a little bit like some of the arguments against social security.

Mr. Cummings. Except that social security isn't geared to the level of income that a man or woman is used to. It is essentially an insured type of—I hate to say it—of welfare, but that is really what it is.

Senator Roth. I was only making reference to the argument they could do better with their own investments.

Mr. Cummings. That is right. They feel, let us do our own pension planning and we will do a very good job.

Mr. Lesser. I would say on that everybody can do better if they are young, but somebody has to take care of the older people too. That is where you get the whole past service cost and that is where a good deal of the cost of social security is going, which is a good argument for this committee to adopt a general revenue share to the financing of social security—as I know Senator Nelson has proposed—that is a good argument.

Senator NELSON. Does anybody else have any observations they wish to make on the issues?

Mr. BERNSTEIN. I would like to make one point that I think is implicit in the cost figures and that is that the improvements of any of the pending measures, the improvements that would be made by vesting are very slight and they would leave out the bulk of those who lose——

Senator NELSON. I didn't hear the first part of your sentence. Would you repeat that?

Mr. BERNSTEIN. Yes. The cost figures that Senator Roth and primarily Mr. Cummings have been talking about indicate how the slight improvement, the infinitesimal improvement that would be effectuated by any of the measures before this committee in salvaging pension rights works two ways: One, where vesting is already extensive, that the difficulty is it doesn't set in early enough in one's working life to actually salvage benefits. None of the proposals make any substantial improvement upon the "when." And in addition all of the proposals that would improve upon the length of time possibly required for achieving vesting, both S. 4 and Senator Bentsen's bill generate benefits that are tiny.

If you take, for example, a benefit of $5 a year per year of service and you multiply that by 8 years, that is a benefit of $40. However, under S. 4 only 30 percent would vest—the retiree would have a benefit of about $12. In addition that vesting takes place when a person is perhaps 45 years of age and that benefit isn't payable for 20 years—and you might apply over a 20-year period a modest assumption of inflation of 3 percent—then you have a benefit that is not worth talking about. What all of these bills do is leave out most of the pension losers. When they do salvage something they salvage it in terms that are practically useless in terms of incomes for retirees.

People can't get by on a $12 benefit three-fourths of which has been eroded by inflation. You really have to do better than that if you are going to have anything that merits the name of reform.

Now we have heard again and again this bugaboo of costs. Cost is not a real hurdle to pension reform. It is demonstrable that if we had immediate vesting—this is something that is demonstrated in my book—immediate vesting for a population which was taken at random—and it happened to be a manufacturing company with 26,000 people—if you were to immediately vest all of their credits and if that was the rule of the road for the entire economy, the yearly cost would be one-third the cost of 10-year vesting provision.

Now that is the difference between a system that effectively accumulates retirement savings for everyone and a system that puts most of the burden upon the last employer, which is the system we have now.

Senator NELSON. I must be misunderstanding you. Are you saying that if you provide for immediate vesting that would be one-third of the cost of 10 years vesting provision?

Mr. BERNSTEIN. That is correct, for the reason, that each year for everybody's working life would generate savings. I am not saying the cost to the economy would be one-third. It would not. It would be more than the system we have. But it would come in units that are much more manageable. It is the yearly cost that everybody worries about and not their lifetime costs.

If every employee worked under a plan in which all of his credits vested and you did it at a unit cost spread over his life the cost for that one employer—and it was not an unusual employer—would be about one-third of what a system of a plan for 10 years vesting would be where——

Senator NELSON. Excuse me, you mean a yearly unit cost per employee, not the absolute cost?

Mr. BERNSTEIN. No, I mean the absolute cost per year of that company.

Senator NELSON. You must be dealing with a new math, then.

Mr. BERNSTEIN. No, it is not a new math, Senator, because what happens is that instead of the employer paying the whole cost of the pension, every year that an employee works, he effectively accumulates pension savings so that when the employee comes to that employer at age 28 or 25 or 32, he already has an enormous pension savings and, because those early years are worth much more than the late years, the employees who come bring the bulk of their pension savings with them.

Now if everybody in the economy has effective pension savings for each year of his working life, the unit cost is much less than if one half the employer's pay for all of it, Senator, for all of the costs are considered, for the 20 percent of the employers whoever happened to be in their employ.

In other words, it is a matter of spreading the costs over the entire economy and over a longer period of time, Senator.

Senator NELSON. I will have to look at that again.

Mr. BERNSTEIN. All right, it is summarized in my testimony, Senator.

Senator NELSON. All right. Anything further?

Senator ROTH. No.

Senator NELSON. Well, thank you——

Mr. COHEN. Mr. Chairman, may I just add one brief comment?

Senator NELSON. Excuse me. Go ahead.

Mr. COHEN. In referring to this accounting and legal question about the employers' liability, up to half of his net worth, I didn't mean to get into technical accounting matters such as whether it should be stated as a liability or stated in the balance that as a footnote. That is not my point.

I think this legislation in the form in which it is in S. 4 would mean that the company would be required to guarantee the funding ultimately of the employees' pension up to one half of the net worth of the company and we ought not to think that that is not a terribly important obligation; it is.

It may be a good deal more desirable than the present system, which we built up over the years, to have the companies say that we are not liable for this but we intend to continue funding the plan—and this is a statement of generally bona fide intention but reserving always the right to discontinue the contributions if the employer wants to.

Now, of course, that would change the deal and if you want to change the deal, I think one question would be whether we should change the deal with respect to benefits that have accrued up to now, where this has not been the deal. But I don't think it is a technical question. I think it goes to the heart of the issue as to whether you want to say to the employer, when you put in a pension plan—and no matter what you say in denying it—you lead the employees to believe that they are going to get full funding eventually of this, and therefore you will be responsible at least up to one-half of your net worth.

But if you don't come through with the full funding, whether it is because of loss in value of investments or actuarial assumptions, or you go out of business or sell the business or whatever, you will be liable. This is not just a matter of insurance, this is a firm change in the commitment that goes to the heart of the private pension systems. I think people setting up plans thereafter would certainly have to take that factor into account in determining whether they want to establish a plan or not or continue to maintain those in existence or not.

Mr. CUMMINGS. Mr. Chairman, could I add one word to that? I don't think Mr. Cohen and I are in disagreement at all. I think far too little attention has been paid to what really amounts to a constitutional question in the retroactive features of both S. 4 and Senator Bentsen's bill. That is not to say that Congress couldn't make a fair legislative judgment that it wanted to impose this liability, but I think that some one—presumably the Senate Labor Committee has done so—but someone ought to take a good hard look at whether or not it is constitutionally proper to pass an act of Congress which says to an employer and a union and a group of employees: "you made one contract but now not only must you amend your contract prospectively but we have just amended it retrospectively."

That may be wise, or it may not be wise. But it certainly seems to me to bring some kind of constitutional question in.

Mr. BERNSTEIN. I think on that point it is not any great trick to make an imposition conditional. The Congress would merely say that if for the future you wish to continue this kind of plan you have to do this to qualify.

Senator NELSON. As to future employees?

Mr. BERNSTEIN. No, no. That Congress could impose the requirement that all past credits vest, but it could only do so I think by saying this is the condition for continuing these plans in the future.

Senator NELSON. That is not much of a choice though if you have a plan and it is tax deductible and the employer says I really can't accept these additional obligations. So he has to abolish his plan——

Mr. BERNSTEIN. No, I don't think so because I think adopting the obligation isn't that onerous—the figures show that.

Senator NELSON. That is another question though. That is something else he will have to decide.

Mr. BERNSTEIN. But as a practical matter, you are talking in terms of the practical choice to be made, and the practical choice is not that difficult.

Mr. LESSER. I think every time Congress passes a tax law it makes an amendment to the tax code. They do it in terms of future, but if you happen to have an interest and bought stock and then you change the capital gains rule here in Congress, you bought it at a certain condition and they changed it.

Senator NELSON. But if you change the capital gains rule, Congress never says you still have to continue to make this investment even though you don't like the amount of capital gains tax.

Mr. LESSER. But what Congress is saying though is—in this particular case Congress is saying if you want a pension plan, they have changed the rules of qualification, for the future, but they are not changing the rules retroactively with respect to qualification of the plan in prior years or the legitimacy of the employer's tax deduction in prior years. But they are saying that for the future if you want a tax deduction this is the set of rules that are going to apply.

Senator NELSON. I think Frank Cummings was raising a little different question. It is one thing to say to all new employees this is what the plan will be but as to implying an obligation to people who are already under a plan that is a different legal question.

Mr. CUMMINGS. That is correct.

Mr. LESSER. I am saying from a constitutional point I don't think there is a difference. I think the important thing the Congress has to keep in mind in any of this is if you don't affect prior service then you are really legislating for people in the future. Now that may have to be done if it is a constitutional question, but I don't think it is.

I would like, if all you are worried about is future service credits for vesting or termination insurance, then I would like to make the point you are not dealing with people who are going to be affected in the next 10 or 15 years.

Mr. CUMMINGS. Senator, I didn't mean to dispute that, nor did I mean to introduce the constitutional question and answer it; I only meant to ask the question. It just seems to me that if you look at the way this bill operates, what happens is you have a plan today, you do nothing but let tomorrow happen, and when tomorrow happens you find you owe employees money which the plan didn't provide for; it simply wasn't part of the deal.

Now Congress has amended the deal.

If that is constitutional, it may very well turn out to be beneficial and wise, but it just seems to me we have to look at the question of retrospectively amending the deal.

Mr. COHEN. On that constitutional issue I am not an expert in constitutional matters, and would not try to give an opinion on this point, but it does seem to me that one thing that might save the constitutionality of it is the possibility the employer could terminate the plan before the new law could go into effect.

As I understand it, the law wouldn't be effective until 3 years after it is adopted and that might save the constitutionality of it, but that doesn't solve the practical problem, and that may be the reason why there is a constitutional argument. And that argument, as Mr. Cummings said, is because you are changing the deal, and it may have some adverse consequences if you force a termination of the plan before the law would go into effect.

Senator NELSON. But it is still a compulsory thing; you can't abolish pension plans.

Well, thank you very much.

[The prepared statements of the panelists and supplemental materail from Messrs. Bernstein and Cummings follow:]

THE OHIO STATE UNIVERSITY

Honorable Gaylord Nelson, Chairman
Honorable Lloyd M. Bentsen
Subcommittee on Pensions
Committee on Finance
U.S. Senate
Washington, D.C. 20510

Dear Senators Nelson and Bentsen:

During the panel discussion in which I participated before you last week, you each made somewhat similar statements upon which time to comment was not available.

Senator Bentsen commented upon the possibility of pension costs increasing so much that plan continuation or installation would be discouraged. At the close of the hearing Chairman Nelson raised the question (without using the precise term) whether extensive vesting as a condition of continued favorable tax treatment would not pose employers with a Hobson's choice.

These observations do not take sufficient account of the fact that tax-favored pension programs for executives, managers and stockholder-employees depend upon the existence of a non-discriminatory pension program for rank and file employees. Hence, the corporate officials with most of the effective power to decide on the institution or continuation of private plans have a powerful incentive to opt for installation and continuation.

However, mandatory vesting standards might also provide an incentive to shift non-negotiated plans to a Social Security offset arrangement--which discriminates in operation against rank and file employees. The details of this subject are dazzlingly difficult, but I know from discussions with staff members that they are fully cognizant of the problem. If the offset leak is not plugged, vesting reform would be jeopardized.

In this connection, I submit for the record an article which appeared in the May 27, 1973 Los Angeles Times by Ronald Soble: "Pension: U.S. Adds and Firms Subtract."

With all good wishes,

Sincerely,

Merton C. Bernstein

Merton C. Bernstein
Professor of Law

The Urgent Need But Poor Prospects
for
Private Pension Reform

Testimony

of

Professor Merton C. Bernstein

before the

Subcommittee on Pensions

of the

U. S. Senate

Committee on Finance

June 4, 1973

For release June 4, 1973

* Professor of Law, Ohio State University; author, The Future of Private Pensions (1964)--winner of the Elizur Wright Award 1965; formerly consultant on pension problems to the Department of HEW, Labor & Treasury; former Chairman, Advisory Committee on Research, Social Security Administration; former Secretary, Section on Labor Law, American Bar Association. Member(by appointment of Governor Gilligan) Ohio Retirement Study Commission. The views expressed are those of Mr. Bernstein. My book is cited herein as FPP.

BEST COPY AVAILABLE

INDEX

The Cost of Pension Plans - To Employees, Employers and the Treasury 2

Private Pension Coverage--Inadequate and Less Than Advertised 4

Expending Coverage--The Administration and Bentsen Proposals--and Real Reform 6

Basic Pension Plan Misdesign 8

Pension Plan Losers 9

A. Those Never Covered--Discrimination Against Young Employees 9

B. Job Losers 10

C. Women 11

Women--The Losers in the Past--The Losers Still 13

The Benefits and Costs of Various Vesting Formulae 15

Proposed Vesting Yields Meagre Improvement 16

Mandatory Vesting Cost Slight--Additional Proof of Inconsequential Impact 16

The Enforcibility of Mandatory Vesting 18

Need for Investigation of Keogh Vesting Provisions 18

The Pension Clearing House--Indispensable to Employee Protection--Bill Limitations Crippling 19

A Voluntary Clearing House Will Not Work 20

Needed--Clearing House Plan for Small Companies 21

Expanded Coverage and Immediate Vesting--Low Unit Cost 21

Fiduciary Standards--Proposals Inadequate 23

The Serious Problem of Shutdowns Without Plan Termination 24

The Treasury Termination Study--A Gross Understatement of the Problem 28

The Half-a-Loaf Delusion 31

The Committee's invitation to appear as a panelist with such distinguished colleagues is appreciated. Private pension reform is urgent--but measured by the proposals before Congress its present prospects are poor.

In 1962, Burlington Mills, Inc. of Burlington, Wisconsin established a pension plan for salaried employees. The corporation board appointed three trustees, one the corporation president, Richard Kinzer, who, with other immediate family members, owned 92% of the company's stock. In the years 1962, 1963, 1964, and 1965, the company made contributions to the plan that varied between $15,000 and $19,000. The last contribution--$800--was made in January 1966. In late 1965 the company decided to move operations from Burlington, Wisconsin to Danville, Kentucky. A few plan participants were offered jobs in Danville but without salary increases or moving expenses other than use of a company truck.

The last, quite small, contribution to the plan was made in January 1966 and on February 20, 1967 corporate minutes recorded that no further contributions would be made, but the plan was not terminated until late July 1967. In essence, the decision was made by Mr. Kinzer, the company president, plan trustee and controlling stockholder. A dissenting trustee was simply removed.

Meanwhile, the company fired some employees; others sought and found other jobs. The delay in terminating the plan meant complete losses to some participants but enabled President, Trustee, Principal Stockholder Kinzer to improve his share from $15,000 to $26,000--at the least. A state court suit proved totally unavailing.

This story illustrates several--but not all--of the serious shortcomings of private pension plans:

(1) Length of service eligibility conditions--supposedly justified as a means of retaining valuable employees--frequently defeat pension eligibility for employees who are denied the opportunity to comply;

(2) employer control of pension trustees; (in other situations union or unions and management may be in this position);

(3) employer domination of crucial decisions adversly affecting employees but favoring management;

(4) although § 401(a)(7) of the Internal Revenue Code mandates vesting of all pension credits when a plan terminates, IRS regulations and procedures do not protect employee interests this code provision (§ 401(a)(7) supposedly serves);

(5) the courts fail to protect employee interests against employer self-serving plan language and actions.

These themes will be developed in this presentation.

The Cost of Pension Plans - To Employees, Employers and the Treasury.

Whatever benefits a plan pays out over its life constitutes the cost of that plan. However, the out-of-pocket contributory costs will vary substantially depending upon the rate of funding and the rate of net earnings on plan reserves (the amounts not needed currently to pay benefits and hence available for investment). The larger the reserves at any given time the smaller will be the out-of-pocket expense. It follows that the larger the contributions made during the early years of a plan, the smaller will be the total contributions required and the greater the amount paid by earnings on reserves. Of course, there is an opportunity cost to be considered--the earnings from some other investment otherwise available.

However the tax free nature of earnings on plan reserves, which become available for more tax free investment, make the pension reserve investment advantageous. It has been estimated--by Professor McGill and Charles Trowbridge, I believe Dan has told me, that to equal the value of the tax-favored pension investment a non-pension investment would have to generate about twice the earnings.

That considerable advantage comes at a decided cost to the Treasury--and hence to all other taxpayers. Private plan reserves are estimated at $150 billion and their net receipts in 1971 put at $10.3 billion.* Assuming earnings of 5%, the $150 billion in reserves would yield $7.5 billion which if taxable at average corporate rates of 50% would generate $3-3/4 billion a year in taxes. Those taxes are not collected for considerable periods and when taxes are applied to pension benefits the rates will be much lower and in some cases nothing. These taxes foregone grow every year as the reserves are augmented. This subsidy--the equivalent of a $3.75 billion expenditure--can be justified only if it serves a high priority public purpose.

But we know that a higher proportion of better paying than lower-paying jobs have pension coverage* and that those who enjoy the steadiest employment are most likely to achieve pension eligibility. So, in sober fact, the subsidy mostly benefits those who are and will be best off. Yet those most in need of Social Security supplementation in retirement, low wage and salary earners who

SEC, "Private Noninsured Pension Funds, 1971", Release No. 2599, June 28, 1972.

Emerson Beier, "Incidence of Private Retirement Plans", Monthly Labor Review 37 (July 1971).

experience br^aks in unemployment are least likely to be covered and if covered are least likely to achieve benefit eligibility. That puts the justification for the subsidy into serious question.

In addition, those who are under plans but do not earn benefits or earn benefits less than long service persons that is,--the less fortunate--in effect transfer part of their earnings to the long term employees, frequently those with greater earnings,--that is, the more fortunate. It is an odd system, a very unfair system in which those with the least resources and the greatest needs transfer part of their earnings to those with more resources and lesser need.

(This assumes, as most economists do, that contributions for fringe benefits are compensation and that those for pensions are deferred compensation. No one cavils with that characterization for executives.)

What pension reform must do--or it is not reform--is to rectify that unfairness by effectively spreading coverage and effectively assuring that most participants obtain pension benefits for most of their work.

Private Pension Coverage--Inadequate and Less Than Advertised

The latest Social Security Administration report on "Employee Benefit Plans", a yearly affair, is strangely skimpy--and with good reason. It lacks data on plan coverage, explaining that past series probably overstate coverage. A 1972 survey's preliminary result "indicate the need for downward revisions in the [coverage figures in the] health insurance and pension series."*

Walter W. Kolodrubetz, "Employee Benefit Plans, 1971", 36 Social Security Bulletin (No. 1) 27, 28 (April 1973).

Now look at the purported coverage figures. In 1971, the private, non-farm, civilian work force numbered 69 million persons.

Estimates of private pension coverage ranged between 30.7 million* to 33 million by assorted enthusiasts. In the mid 1960's, the National Bureau of Economic Research estimated that in 1963 some 23.5 million participated in plans and that by 1970 the figure would grow to 34 million. (Actually Professor Holland of MIT made several different estimates but the one described became "the" estimate when it was adopted by the Cabinet Committee Report on Corporate Pensions. By 1980 some 42.7 million were to be covered--or 63% of the then private, non-agricultural work force.

That would be no smashing achievement given the universal need for Social Security supplementation. But it should be clear that the 1970 mark has not materialized--a good 13% off the mark, taking the inflated figures that Social Security now tells us must be revised downward.

Note that the President's 1971 message says that "only 30 million employees are covered by private retirement plans."*

But the Treasury-Labor Intern Report on Plan Termination tells it straight (albeit in a footnote). Private pension plan coverage, it found in an earlier unpublished study, is at the 23 million employee mark. Profit-sharing plans were excluded and with reason--their contribution to retirement income is unpredictable.

Like so much else in private pensions, coverage has been oversold.

Lack of coverage constitutes one major shortcoming of plans today. As noted, all need Social Security supplementation. Several

"Pension Coverage Up 3.2%", Pension & Welfare News 4 (May 1973).

Message, H. Doc. 92-182, 92nd Cong., 1st Sess. 2 (1971) reproduced in "Tax Proposals Affecting Private Pension Plans" Hearings before the House Ways & Means Committee, 92nd Cong. 2nd Sess. 7 (1972).

studies show that when production workers with pension-covered jobs lose those jobs, large proportions of them go into jobs with lesser status and pay in which pension coverage is sparse. Quite clearly, the larger the gaps in coverage, the smaller the chances of workers displaced from pension-covered jobs to obtain any pension or an adequate pension income.

Expending Coverage--The Administration and Bentsen Proposals--and Real Reform

A pension reform measure should contain affirmative measures to spread effective coverage. S. 4 does nothing to that end, except to exempt plans with fewer than 26 participants.

The Administration and Bentsen proposals (S. 1631 and 1179)* to permit voluntary tax-sheltered retirement savings, even by those with some pension coverage, will redound to the benefit of those who can best take care of themselves. Experience under foreign voluntary purchase plans show that the well-to-do buy in and the less fortunate do not and cannot. It is a dubious reform that offers yet another tax shelter to those with comfortable means.

The attached data on Canada's voluntary tax-favored Registered Retirement Savings Plans demonstrates that tax payers with higher income enjoy a disporportionate share of the benefits such a system confers. (In applying this experience to the United States it probably would be necessary to raise each category several notches to reflect the generally higher wages and salaries enjoyed "south of the border" as the Canadians say.)

So on Mr. Tanner's Table No. 5, (next page) 59.7% of all 1968 Canadian returns were for employees with income under $5,000 but

This discussion does not distinguish between them; their basic design on this subject is the same.

TABLE NO. 5

REGISTERED RETIREMENT SAVINGS PLANS IN CANADA

NUMBER OF PLANS AND ANNUAL CONTRIBUTIONS BY INCOME BRACKETS

Taxation Year 1968 Annual Income	Total Number of Income Tax Returns	Percentage of Returns in Income Bracket	Total Number of Income Tax Returns Bearing R.S.P. Contributions	Percentage of Returns Bearing RSP Contributions in Income Bracket	Percentage of All Income Tax Returns that Bore RSP Contributions	Total Amount of All RSP Contributions	Average Annual RSP Contributions	Average RSP Contribution as a Percentage of Average Income in Bracket
Under $5,000	5,074,929	59.7%	24,344	14.1%	0.5%	6,057,000	$ 248.81	10.0%
$ 5,000 - $10,000	2,789,[illegible]	32.8%	64,646	37.6%	2.3%	32,107,000	496.66	7.2%
$10,000 - $15,000	431,098	5.1%	34,659	20.2%	8.0%	29,639,000	855.16	7.2%
$15,000 - $25,000	141,760	1.6%	27,850	16.2%	19.6%	35,659,000	1,280.39	7.0%
Over $25,000	57,491	0.7%	20,395	11.8%	35.8%	39,258,000	1,924.88	4.6%
TOTALS & AVERAGES	8,495,184	100.0%	171,894	100.0%	20.2%	142,720,000	830.29	N/A
Taxation Year 1969								
Under $5,000	5,054,052	56.9%	24,185	11.7%	0.5%	5,319,000	219.92	8.9%
$ 5,000 - $10,000	2,996,659	33.7%	74,677	36.3%	2.5%	36,461,000	488.25	6.9%
$10,000 - $15,000	580,383	6.5%	46,090	22.4%	7.9%	39,506,000	857.15	7.3%
$15,000 - $25,000	180,547	2.0%	35,861	17.4%	19.8%	45,865,000	1,278.97	7.0%
Over $25,000	70,425	0.8%	25,066	12.2%	35.8%	51,431,000	2,051.82	4.9%
TOTALS & AVERAGES	8,882,066	100.0%	205,879	100.0%	23.2%	178,582,000	867.41	N/A

Notes:

1. Contributions to R.S.P.'s are based on earned income.

2. Based on Table 15 of "Taxation Statistics", Catalogue No. Rv.44 - 1970 and 1971, published by the Department of National Revenue, Ottawa, Canada.

N.H.T.
Sept. 15, 1972.

From Norman H. Tarver, "Personal Retirement Savings Plans", ALI-ABA Course on Pension, Profit Sharing and other Deferred Compensation Plans, October 1972.

less than 1% of all RSP contributions came from this group. But the .7% of taxpayers comprising the over $25,000 taxpayers accounted for 35.8% of returns reporting RSP contributions. Table 6. The 1969 figures are consistent.

When Mr. Cohen testified before the House Ways and Means Committee in 1972, he said that 70% of the benefit of the Administrations voluntary contribution would redound to the benefit of taxpayers with income under $15,000. If this were so (and it is debatable) 30% of the benefit would go to about 8-3/4% of the taxpayers.

But the Canadian data put that 30% figure into real doubt. In 1969, Canadians with over $15,000 income made contributions of $97.2 million to such plans; the far more numerous taxpayers with lower incomes put some $86 million into such plans. So, in raw contributions alone the over $15,000 group obtained more than half the benefit. But, in terms of taxes saved and deferred the advantage of such tax deductible savings to upper bracket persons is greater yet--roughly three times the savings for the $25,000 taxpayer as for the $5,000 taxpayer under effective United States rates.

Basic Pension Plan Misdesign

Although only a minority of plans now use the insurance vehicle, the basic principle of plans is that of insurance. Under the insurance principle, members of a sizable group subject to a common hazard each pay relatively small premiums to form a fund from which the few who actually experience the particular misfortune will receive relatively large payments to compensate for the loss. Fire insurance is the classical example. Many pay so that a few may receive. However, the hazards against which pension plans now purportedly provide protection--retirement from work because of age or disability, and even death after and before retirement--do not affect a small minority but will happen to every plan participant and affect their survivors. The insurance design of pension plans simply does not contemplate widespread, let alone universal, benefit eligibility. This aspect of plans, coupled with their spotty coverage to begin with, means that private pensions will provide only a minority of citizens with benefits in old age despite the fact that all need such benefits.

Pension Plan Losers

A. Those Never Covered--Discrimination Against Young Employees

A basic precept of the Internal Revenue Code is that pension plans qualified for favorable tax treatment must not discriminate in favor of highly paid employees. In aid of this policy, participation requirements call for at least 58% participation by potential eligibles. In fact, several permitted exclusions allow the coverage to fall below 50% of the groups involved without endangering qualification.

All of the bills under consideration permit exclusion of substantial groups in otherwise pension-covered employment. They all discriminate against young employees. Such a policy is both unfair and shortsighted. While young employees tend to more frequent job changing, they need effective pension savings just as much as older employees. Indeed most new plans provide for crediting all or some past service for employees still on board.

These excluded employees, if separated in their early 30's, may well experience many difficulties in achieving pension coverage thereafter.

It may be pesky to keep track of small amounts of service although Social Security does so by quarters of years for over 80 million people.

The pre-participation requirements make ostensible eight year vesting potentially into 15 year vesting requirements under S. 4 (the Williams-Javits bill) the effect upon one who begins work at age 18 of permitting exclusion of years prior to age 25; S. 1179 (the Bentsen bill) ostensibly begins vesting after five years of service; for an employer starting service at age 18--not a rarity in blue collar plans) it in effect requires 17 years of service, but requires counting only five; S. 1631 (the Curtis-Administration bill) permits excluding service prior to age 30 and so operates for younger employees much as the Bentsen bill does.

I urge the elimination of these long and discriminatory pre-participation exclusions. If excluding a year or so can be justified by administrative convenience, once that period is past those years should be included--much as waiting periods in workmen's and unemployment compensation are included for benefits once the waiting period is satisfied.

B. Job Losers

On April 1, 1971 America read that the day before Senators Williams and Javits released a study on private pension plan benefits and forfeitures. It reported (at page 5):

> "Out of a sample covering a total of 6.9 million [pension plan] participants since 1950, 253,118 or 4 per cent have received any kind of . . . retirement benefit . . . ."

That revelation shocked the American public into a demand for private pension reform. S. 4 is co-sponsored by dozens of senators because the public demands that private pensions pay off not to a mere handful but to most participants.

Last February the Senate Subcommittee on Labor released its Interim Report. It reported:

> ". . . 92% of all participants who left plans which required 11 or more years of service for vesting and 73% of all participants in the plans with 10 years or less for vesting . . . did not qualify benefits." (St. p. 15).

It should be added that the bulk of plans have vesting requiring 10 or more years of service.

The measures under consideration by the Committee would do little to remedy this appalling picture, as developed below.

While the Bentsen bill apparently would start vesting earlier--after 5 years---it permits delay in participation until age 30 so that for an employee with service beginning before that age the nominal vesting period in fact becomes longer. Moreover, a 25% vesting of 5 years of credits wouldn't amount to a hill of beans--especially after the attrition of inflation between the time of vesting and the time of pay out. Over a 30-year period the value of the vested benefit could be eroded 90%.

C. Women

It comes as no news that more women and a greater proportion of women work (for compensation) than ever before. Almost one-third of the work force are women (almost a million more than a decade earlier).

Quite clearly, single women who work need an income substitute as much as men do. Given the wage and salary discriminations against women, as lower income workers they need a higher percentage of replacement of earned income than do men. Divorced women frequently do not receive alimony and their retirement needs are at least the same as single women; the interruptions to work occasioned by family duties will, on the average, prevent their attaining equal Social Security benefits. Widowed women at work may be better or worse off, depending upon whether they have young children at home. The children probably would receive Social Security survivor benefits, but also make full-time work difficult. The categories single, divorced and widowed make up a bit more than a third of working women. (Table No. 346, 1972 Statistical Abstract of the United States 219).

The major new development in work patterns in the past two decades is that an even larger proportion of married women work. In 1971, of the almost 32 million women at work, almost two-thirds were married. And here are the amazing figures: among married couples, there are more families in which both husband and wife work than those in which only the husband works. (Table No. 347, Ibid.) Over age 25, age is not a significant factor in this pattern. Throughout the age 25-54 age groups about half the married couples had both husband and wife earners; only husband worker families varied from 47.4% to 24.8% (the remaining percentages are accounted by families in which the husband and another family member other than the wife works). Among blacks, the proportion of husband-wife worker families is even higher.

This means that in more than half the husband-wife families, the living standards of the family depends upon not only the husband's but the wife's income. One study several years ago reported that the median income of husband-wife families exceeded that of husband only worker families.* In most of these families, the Social Security benefit will depend upon the husband's

U.S. Dept. of Labor, 1960 Handbook on Women Workers, Women's Bureau Bulletin No. 275, p. 63 (1960).

BEST COPY AVAILABLE

earnings record alone so that a smaller percentage of income will be replaced than in husband only worker families.

These several factors make it mandatory that the private pension system provide an income substitute for working women. In fact, however, a smaller proportion of working women qualify for benefits than do men.

Women--The Losers in the Past--The Losers Still

Pension plan design now effectively excludes women both as potential pensioners and the surviving dependents of employees.

Typically women work for shorter periods of time than men, as the following tables show.

Median Years on Current Job

	All Persons	
Age	Men	Women
30-34	3.9	1.8
35-39	5.8	2.6
40-44	8.4	3.2
45-49	10.2	4.4
50-54	12.6	6.2
55-59	14.7	8.2
60-64	15.1	9.4

Median Years--Selected Occupations

	Men by Age		Women by Age	
Manufacturing	25-44	45 yrs. over	24-44	45 yrs. over
Durable Goods	4.5	14.3	2.4	8.3
Nondurable Goods	5.3	15.4	2.8	9.1
Wholesale & Retail Trade	3.3	8.8	1.5	4.9
Operatives & Kindred Workers	3.8	12.8	2.1	7.7

Source: "Job Tenure" Monthly Labor Review 18-19 (September 1969).

These data demonstrate why such a small percentage of women now qualify for pension benefits. They also show that S. 4 will do little to help them. In wholesale and retail trade where so many

BEST COPY AVAILABLE

women work, the prospects for pension eligibility are negligible. In manufacturing, it is better, but still the bulk of women workers will lose out. Pension plans discriminate against women; the bills before the Committee do little to remedy that discrimination.

Widows make up the bulk of the aged poor. Social Security provides their main money income. It needs improvement. It needs supplementation. But this is an area in which private pensions are dreadfully weak. Conventional vesting will not help them. Vested Clearing House credits could.

The Benefits and Costs of Various Vesting Formulae

Too much of the controversy over vesting has been abstract and overgeneralized. Much has been made of the potentially crippling costs of mandatory vesting. When reduced to concrete terms, the conclusions must be that the proposed vesting of the major bills would yield slight benefits and their costs would be neglible.

The Benefits of Williams-Javits, Bentsen and Curtis bills

The Williams-Javits bill would permit the exclusion of service before age 25. Hence it assures vested benefits for no employers younger than age 33. For employees who begin work before age 25, the vesting requirments are in fact that much longer than the minimum 8 years specified.

For those separated after 8 years credited service, the benefit vested equals 30% of the normal retirement benefit for 8 years under the formula existing at the time of separation. For an employee under a plan with a benefit of $5 a month per year of service (a moderately good plan in present day terms), the full benefit would be $40 payable at age 65; under S. 4, the same employee would be vested for a benefit of $12 a month--or a yearly benefit of $144. For an employee aged 40 at separation and assuming a modest 3% annual inflation, the purchasing power of the benefit would be equal to about $3 a month or $36 a year at age 65. To call such benefits paltry is to exaggerate their value.

Under either S. 4 or S. 1179 (the Bentsen bill) 10 years of credited service would yield a 50% benefit. Under a $5 a month per year of service plan, a regular retiree with 10 years service would obtain a benefit of $50--the 50% vested separated employee a prospective benefit of $25. If separated at age 40 and with

3% yearly inflation the purchasing power of the benefit at age 65 would be about $6 a month.

S. 1631's rule of 50 would operate in much the same way except that it would vest at later ages--and the attrition by intervening inflation would be proportionately less.

Proposed Vesting Yields Meagre Improvement

All of the major bills yield very little protection to employees with 10 or fewer years of service and they would vest benefits fully only at about 15 years of service. Most 15 year employees will attain normal retirement age. Roughly half the single employer plans already have 10 year vesting and almost all the remaining plans have 15 year vesting. (B.L.S. Study, Monthly Labor Review, July 1970, reproduced in "Study of the Cost of Mandatory Vesting Provisions, etc. U.S. Senate Subcommittee on Labor Committee Print, February 1973 at p. 45. As few such plans provide for vesting short of 10 years, the 5-10 year category really describes 10 year vesting plans; most plans in the 11-15 year category require at least 15 years. However, the age requirements would lengthen these requirements for some employees.)

Mandatory Vesting Cost Slight--Additional Proof of Inconsequential Impact

The cost of these vesting provisions according to the study done for the Labor Subcommittee would be slight--I really mean picayune. This is amply demonstrated by the summary of that study set out on its final page and reproduced on the last page of the Labor Committee's April 1973 Committee print on S. 4.

S. 4's vesting would increase the cost of a plan with 10 year vesting (classified as "Liberal") a grand total of 0.0%--yes, absolutely nothing. Why, because it would effectuate no anticipated measurable improvement over 10 year vesting. (Definitions are found on page 46 of the study.) A plan with a moderate present vesting provision (15 years service and age 45 required) would incur increased costs of from 1/10th of 1% to 3/10ths of 1%. For an employee making $8,000 a year ($4 an hour) that latter would come to $24 a year--a shade more than ten mills an hour--or next to nothing. Note that the same range registers as increases in plan costs of from 1 to 8%. And for a plan with no vesting, S. 4's required vesting would increase costs from .2% to 1.4% of payroll--for an $8,000 a year member that comes to from $16 to $112--or not very much--less than $10 a month for the maximum estimated increase. Note again that as a percentage of plan costs that range registers as a percentage of plan cost increases of 5 to 53%. That means, for the 53% cost increase, that the unchanged plan cost roughly 2% of payroll. Again for the $8,000 a year employee roughly $160--or very little as plan costs go.

Note that the rule of 50 generates increased costs that also are negligible. These formulae are negligible because they would preserve few years of credits and for those few credits salvaged would pay slight benefits.

Some will argue that too exacting a vesting formula simply would lead to more exemptions of plans under the S. 4 machinery for "variances." But the exemption process must be done on notice to employees. It would be salutary for employers and unions to have to declare for employees to see that their plan cannot meet legislated standards. Hopefully some would make the effort to avoid such a claim, whereas on overly modest vesting provision merely lets matters slide. Moreover, there should be a public record of the fact of inability to comply. If that inability is widespread enough, even more basic changes should be considered.

The Enforcibility of Mandatory Vesting

It is possible that only immediate vesting will work. The Labor Subcommittee's studies show that some employers will fire people to prevent the attainment of vesting. Employees not protected by collective bargaining agreements are quite vulnerable. S. 4 contains a provision (§ 610) declaring it unalwful to discharge a person "for the purpose of interferring with the attainment of any right under the plan [and] this Act . . ."; it is enforcible by civil suit and suit by the Secretary (§ 602 was not modified to conform to § 610 when the latter was added).

This protection is inadequate. The Secretary has been haggard in enforcing the LMRDA. Civil suit is too slow and expensive. The burden of proof would be upon the claiming employee and proof would be near impossible--unlike situations under the National Labor Relations Act where an employer has shown antagonism to unions.

Employees should have protection against discharge without cause, otherwise they will continue to be subject to firing to prevent vesting.

Need for Investigation of Keogh Vesting Provisions

Keogh plans must provide 3 year vesting. I keep hearing stories about secretaries being fired by doctors and lawyers before that third year is achieved. I earnestly suggest this Committee investigate the operation of the vesting provisions of the Keogh plans. Before liberalizing the limits for Keogh plans, Congress and the public ought to be informed what percentages of employee participants have anything to show for the experience.

Beyond that, if only a small percentage qualify, it may lead to the conclusion that only immediate vesting works.

The Pension Clearing House--Indispensable to Employee Protection--Bill Limitations Crippling

A Pension Clearing House is essential to effective employee savings under private plans. Without one control, record of all vested pension credits an employee and his dependents simply may lose track of his entitlements.

Only with a clearing house will those credits be useful to a separated employee. It must be understood that a vested credit under present arrangement has three basic limitations--the benefit is frozen as of the time of separation: the employee must survive to normal retirement age--and survivors have no rights; the credits are unavailable for disability purposes. A vested credit in a Clearing House would grow in accordance with growth in the economy; it would be available to pay benefits for survivors; it would be available to pay benefits in the event the separated employee became disabled.

Consider an employee separated at age 45 under a plan with a normal requirement age of 65. His vested credits would be frozen at benefit levels when he leaves the job--and subject to 20 years of érosion by inflation even before it reaches payment status. For the same years of service employees who stay on the job frequently receive increased benefits reflecting economic growth. Had this bill been in force in 1955 a 1972 retiree separated in that year would be stuck with benefit levels that are a fraction of today's--which are none to handsome.

Under a voluntary Clearing House the employer has no incentive to transfer the credit but has a powerful incentive not to do so. The reasons are technical--but very real.

For any unit of fixed benefit the cost is the benefit divided by the rate of interest. The lower the interest, the higher the out-of-pocket cost of the benefit. Actuaries tend to assume interest rates on reserves that are lower than the going and expected rate. As a result when an employee separates from a job, the cost of transferring the value of the vested benefit is higher than if the vested benefit is paid from the pension fund itself. As a result, employers will not voluntarily transfer the benefit. And by keeping the reserve for the vested benefit in its own fund, the employer can use that frozen reserve and make money on it to lower the cost of paying benefits to other employees. Such earnings make possible higher benefits--so a union will not seek to have transfers to a clearing house made. On the contrary, its effort to get better benefits for employees currently on the job will be enhanced by not making transfers.

A Voluntary Clearing House will not work.

Moreover, the proposed Clearing House, although authorized to operate its own pension fund, is limited in its investments as no other such fund is--it may invest only in bank and savings and loan accounts--with the limits in earnings that result. Moreover, in order to take advantage of FDIC insurance, the Clearing House would have to open thousands of accounts. It would fast run out of banks.

The Clearing House should be empowered to invest just as any trust fund may. Such a fund would constitute a yard stick for private fund performance--which would be very desirable as shall be shown shortly.

The transfer of credits from individual plan to individual plan, while feasible, is awkward, potentially more costly than transfer into the Clearing House Fund, and subject to abuse by the receiving fund.

Needed--Clearing House Plan for Small Companies

The gap in plan coverage occurs mostly in small companies. They cannot afford the charges and time for plan installation.. Many more could participate if they could buy into a reliable, low cost plan. The Clearing House should operate such a plan on a money purchase basis so that any level of contribution would be possible. The credits purchased would be immediately vested.

Enlarged coverage would produce--more persons eligible for benefits, higher benefits because more years of work would pay off and lower cost per year for any given level of benefits. All of these advantages flow from early vesting.

Expanded Coverage and Immediate Vesting--Low Unit Cost

As I pointed out in my book about a decade ago:

"A clearing house probably would effect economies in the administration of vesting. More importantly, if a clearing house was widely used, the cost of vesting could be reduced, perhaps substantially. Presently the cost of any vested rights conferred by a plan is borne by that plan alone. Whatever the pattern of employee turnover, under conventional vesting all the money is outbound. Under a clearing house (or mutual bilateral) arrangement some incoming employees would bring funds with them. Of course, the incoming employee would get the full benefit of any funds he brings and so there is no "profit" to the plan he joins on that account. But to the extent that employees arrive with money for credits, the receiving employer is required to contribute less in order to provide any given level of benefits. Therefore the receiving employer can base his plan on a longer period during which pension credits are earned.

"For example many plans limit participation to employees with specified age and/or service. In effect, this can and does exclude considerable periods of employment from pension credit. And, it excludes the earliest years whose contributions would be of the greatest value because they have compounded earnings for a longer period. (See in Chapter VI, under "When Should Coverage Begin?") In effect, under present practice the employer is financing each retiring or early retiring employee's benefits over a period of, say, 30 rather than 40 years. For any given amount of normal or early retirement benefit the employer must contribute more for that employee, and the contributions will have very substantially less earnings and less earnings on earnings--all tax free. Under clearing house arrangements, the older the incoming employee the less is the burden to the receiving employer of providing a decent benefit if that employee brings (in money) some or all of the pension credits he earned elsewhere.

"Some may say this is "taking in each other's wash"--that if each did his own it would be the same. The reply is that it would not be the same because under schemes contemplating the funding of every employees' benefits over a longer period, more of the benefit financing derives from earnings rather than contributions. And it is to be hoped that by reducing the cost of each year of plan coverage more employers would be able to provide plan coverage and transfer value vesting. The more plans utilizing the clearing house and providing transferable credits, the less expensive it would be for each employer to provide a unit of coverage.

"So, for example, the per capita annual costs of providing full vesting to an employee achieving pension credits under a universal transfer-value clearing house for every year of work between age 22 and 65 is less than one third the cost of a 10 year vesting provision as applied to the employee group in Table IX-2 (Chapter IX, with the other assumptions applied there). Obviously the savings for employees who are older when universal transfer-value arrangements are instituted would be less. And the problems of financing benefits for those near retirement would remain what they are today; decent benefits cost proportionally more for them. Quite clearly, however, the savings possible under a universal transfer-value clearing house system are substantial--indeed, dramatic. But, if they are to be gained the system must be put into operation as soon as possible. Of course, the aggregate amount required to finance pension benefits would be greater, but much of the increase would derive from fund earnings. And, as the earnings are tax free to the fund, they are commensurately more productive than if they were used for regular business purposes and put into pension plans later." (FPP pp. 273-274.)

Fiduciary Standards--Proposals Inadequate

The standards proposed are grossly inadequate to protect employee pension interests:

(1) The fiduciary standard is too lax--less exacting than the traditional trustee standard and than the standard prescribed by §501 of the Labor Management Reporting and Disclosure Act; the standard proposed--originating with the American Bankers Association --permits general practice to govern; that is too rubbery and probably too low;

(2) Permit self-dealing (transactions between the fund and the employer) up to 10% of the fund, which can be an enormous amount. Such dealings should be completely banned. Employee pension interests should not depend upon the same enterprise as his/her job. The temptations are too great. It is easier and more effective to ban self-dealing than to attempt to cure dubious transactions after the fact.

The Serious Problem of Shutdowns Without Plan Termination

Every day the newspapers report plant and unit shutdowns throughout the country. They occur in good times and bad as weapons, products and plants become obsolete. Defense cuts, changes in taste, and foreign competition all contribute to these occurrences. American industry and commerce frequently respond to these problems by closing down older units and opening up new ones, frequently hundreds of miles away. Decades ago plant locations were decided on factors that do not govern today. Rank and file employees seldom get the chance to follow their jobs and when they do the option is seldom picked up because of family and other local ties. (Executive and managerial patterns differ.)

In addition, since the close of World War II, company units frequently are sold off and acquired by other companies and new conglomerates. Often these changes are made to acquire tax losses, patents, trademarks, processes, and customers--but not a going conc^rn.

Quite often the shutdowns and transfers are preceded by large scale employee separations. These separations can and do generate what are called "actuarial gains" to the plans--i.e., the separation of employees relieve the plans of potential liabilities on a scale not anticipated in the original assumptions. This in turn enables the employer to reuse money already dedicated to pension purposes. And, if the timing is right from the employer's point of view, it can recapture the money in cash.

These matters are not small potatoes as several cases show. In one unit purchase by an aggressive conglomerate, about 500 of the 580 employees on board at the time of sale were separated in the ensuing 2-1/2 years. The returns applied in that period exceeded

$100,000. This plan had a "10 year vesting" provision (which required an additional five year's service before plan participation began) that benefited only four employees. (See for details FPP, pp. 90, 115-116.)

Reportedly during the death throes of the Saturday Evening Post "staff cuts . . . left a large surplus in the Company's pension fund" leading the financier in charge to announce: "I found ten million dollars . . . " Otto Freidrick, "I am Marty Ackerman," etc. Harper's Magazine 92 at 114 (December 1969).

The crucial point in these situations is that the plans did not terminate. Non-termination can be more deadly to pension credits than plan termination because under the Code and regulations plan termination is supposed to vest all credits whether or not the particular vesting provision of the plan does so. In the absence of a vesting provision or in the presence of a rigorous one requiring 10 or 15 years of service, employees can be separated by the droves with comparative impunity and without anything to show for their plan participation. But plan termination may salvage credits.

Treasury plan funding requirements not only do not require plan termination but delay it. A plan is regarded as terminated when all contributions cease or current costs and interest on unfunded liability are not met. But plan separations reduce liabilities and increase the level of funding, thereby delaying that situation even though the company may be unable to make any contributions. (That's what happened in Burlington Mills.)

The problem also is acute where one unit of several covered by a plan shuts down but the plan itself continues for the other units. Despite large scale employee separations and substantial "actuarial gains" there is no assurance that separated employees will not lose all value for their years of plan coverage.

Two recent revenue rulings (72-439 and 72-510) head in the right direction. In the first, 70% of the employees were excluded from a profit-sharing plan and IRS ruled that as to them there was a "partial termination", thereby requiring 100% vesting of all credits. In the second case, a shutdown of one of two units with 95 of the 165 (57%) plan participants constituted a "partial termination." The latter ruling, though more protective of employee interests, does not vouchsafe any sure guide as to when that protection will occur. It merely states that "a significant number of employees were discharged in connection with the winding up of part of the employer's business." No objective criteria of percentages and the length of time over which a winding up may be regarded as extending appear. Employees deserve more protection; employers deserve to know their liability more clearly.

The regulations on this subject are rubbery and their meaning elusive. IRS practice warrants inquiry. I urge that the Committee consider the dimensions and urgency of this problem which receives no treatment in any of the proposed measures.

Please note the following observation by the representative of the American Bankers' Association made in 1970:

> A more pressing need for vesting has been suggested in situations where the service of employees is involuntarily terminated because a company sells or shuts down a plant or operation. As you know, the Internal Revenue Code provides that upon the complete discontinuance of a plan, all rights of employees must be non-forfeitable and that no money can be returned to an employer until all the liabilities of the plan have been satisfied.
>
> There is no such requirement in the code for full vesting when a plant of operating division of an employer is sold or shut down, although regulations of the Internal Revenue Service indicate that such an event should be considered a partial termination of the plan.

BEST COPY AVAILABLE

> To effectively protect the interests of employees in such cases, an amendment to the Internal Revenue Code may be needed to require employers to provide in their plans that the sale or shutdown of a plant or operation must be considered a partial termination of the plan with resulting vesting in employees. This can be done without necessarily requiring vesting under other circumstances.

"Private Welfare and Pension Plan Legislation", Hearings before the General Subcommittee on Labor of the House Committee on Education and Labor (91st Cong., 1st and 2nd Sess., 789 at 795 (May 19, 1970)).

I would urge that objective criteria be employed to provide a presumption of termination; e.g., the separation of 50% of a plan unit participants so that the termination can reach back to the inception of the shutdown.

Several recent cases make the point that the Internal Revenue Code, regulations and rulings, directed to qualification for tax purpose, confer no rights upon employee plan participants. This probably is true, in spades, for the termination-vesting provisions of the Code where the plan has not been amended to conform to the statute. Where an employer would recapture substantial funds, the loss of qualification could be a slight impediment to ignoring the tax requirements, especially if the newly incurred tax liability should occur in years of little profit or losses--as often will be the case with firms in trouble that separate large numbers of employees.

Beyond that, as IRS operates, employees do not get notice of plan termination proceedings and consequently do not have the opportunity to present evidence and arguments in favor of an earlier termination date or some other protective action. The Code should require notification to employee and employee representatives of all filings by employers, unions and plan administrators under

BEST COPY AVAILABLE

the tax laws and have the standing of parties.

The Code should be declared to confer substantive rights upon employees enforcible by suit. For purposes of uniformity and efficiency, the Tax Court might be the proper initial forum for suit. The Tax Court procedures probably are adequate to allow employees to press their suit close to home.

The Burlington Mills case practically provides a check list of the inadequacies of present law and procedure.

The Treasury Termination Study--A Gross Understatement of the Problem

"The Interim Report--Study of Pension Plan Terminations, 1972" (February 1973) purports to show that the employee losses occasioned by plan termination are slight. Its conclusions--especially as reported in the pension and labor relations press--seriously understate the employee pension losses experienced.

Reportedly 683 plans terminated during the period studied, the first 7 months of 1972. These plans, the report states, "had a total of about 20,700 claimants. About 8,400 claimants in 293 plans lost benefits, or about 40 percent of all claimants in these terminated plans. Typically those who lost benefits lost over 50% of their benefits." (p. 18).

That's not a very reassuring picture. But here is the good news (according to the Report). " . . . about 23 million* workers are covered by private pension plans. Thus the 8400 workers losing benefits account for a very small fraction, four one hundredths of one percent, of all workers covered by such plans." (p. 18.) Thus: " . . . the risk of benefit loss over a 10 year period would be 1 percent and over a 30 year period 3 percent." (p. 33.) Before

* Not a typo. Treasury says 23 million; that excludes profit-sharing plans. Ibid. Note 1, p. 18.

there are huzzahs, that means--even if true--between now and 2003, some 750,000 plan participants will lose more than half their vested benefits from this one cause alone. (I suggest that passing the champagne glasses over the Report was premature.)

But these figures .04% and 3% are untrue. They grossly understate the losses sustained by employees under terminating plans. Because very large groups--the Report fails to give the numbers of people--were separated without vested claims in the years and months preceding termination. Their earned credits achieved nothing for them. Had plan termination occurred earlier (as it probably should have in many of these situations) many more persons would have been recorded as incurring losses. And, it is entirely possible--indeed probable--but the report doesn't enable us to judge, that under the plans with no reported losses those separated before termination was declared would have obtained benefits. The report does not tell us how many Burlington Mills and Griggs cases occurred among the 258 plans with no reported losses. Most of them must have had surpluses, due, to some extent, to those separations prior to termination, i.e., the employer had money returned.

Table 4-6 (attached) shows that during the two years preceding termination 26% of the plans with 40% of the participants experienced contraction in employee participation exceeding 25%. The numbers might be even more impressive. I urge the Committee to obtain these data and reanalyse the losses incurred by employees and the windfall recoupments by employers.

Further I urge the Committee to study the larger issue of windfall recoupments that occur when plans do not terminate.

Table 4-6

Changes in Plan Participation Prior to Termination*

(First 7 months of 1972)

	All Plans		Plans Showing No Decline **				Plans Showing Decline				Plans Showing Decline of at least 25%			
					Percent of Total				Percent of Total				Percent of Total	
	Total plans	Total participants	Number of plans	Plans	Number of participants	Participants	Number of plans	Plans	No. of participants	Participants	Number of plans	Plans	No. of participants	Participants
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Changes over 5 year period														
All plans	438	16,136	96	22%	662	4%	342	78%	15,474	96%	261	60%	9,369	58%
Plans with no losses	238	8,938	61	26	325	4	177	74	8,613	96	136	57	5,090	57
Plans with losses	180	7,203	35	19	307	4	145	81	6,896	96	113	63	4,530	63
Changes over 3 year period														
All plans	589	18,661	205	35	1,376	7	384	65	17,285	93	263	45	11,187	60
Plans with no losses	337	9,829	114	34	632	6	223	66	9,197	94	153	45	4,925	52
Plans with losses	252	9,032	91	36	764	8	162	64	8,268	92	110	44	6,182	68
Changes over 2 year period														
All plans	632	19,189	332	53	3,485	18	300	47	15,704	82	167	26	7,738	40
Plans with no losses	356	9,864	187	53	1,551	16	169	47	8,313	84	94	26	3,610	37
Plans with losses	276	9,325	145	53	1,854	20	131	47	7,471	80	73	26	4,128	44

Office of the Secretary of the Treasury
Office of Tax Analysis

February 1973

* Participant figures in the table are for the last year of plan operation. The sum of "plans with losses" and "plans with no losses" will not equal "all plans," due to a small number of plans not being included where the benefit situation was unknown.

** None of these plans experienced an increase in participation of 10 percent or more over any of the time periods shown.

Best Available Copy

The Half-a-Loaf Delusion

The May 1973 issue of The Pension and Welfare News (the major monthly of the pension industry) contains a remarkable editorial which calls for the enactment of private pension reform legislation on fiduciary standards, compulsory vesting, extension of coverage and improved disclosure, and--I deduce--funding and reinsurance. This is a startling and courageous stance for a trade journal.

It notes that "Williams-Javits [i.e., S. 4] has been criticized as not going far enough in reform. The criticism is valid if reform stops with the Williams-Javits bill and goes no further in the next few years . . . ." It concludes: "The momentum for pension reform and for spreading pension coverage to all privately employed people should not be allowed to slacken. Any unfinished business left for this session should not wait five years, much less ten. Employees have waited too long already."*

Editorial: "Politics is the Art of the Possible", Pension & Welfare News, p. 2 May 1973).

"Half-a-loaf is better than none" and "The best is the enemy of the good" are folk wisdom that also work handily to excuse getting less than is needed. In the case of pension reform, if S. 4 is the "half-loaf" the slogans work to excuse legislation that is inadequate and less than can be attained. Even more importantly, the argument that S. 4 is only a beginning that can be improved upon soon is a dangerous delusion.

Popular support for pension reform is massive. Three national television programs have been devoted to the subject during the last two years--their message of frustration, failure and unfairness have taken root.

Pension reform factors are approaching a critical mass. Once legislation results, that mass will be dissipated. As no national pension reform group exists, an entirely new mass will have to be built--without the presence of the few unions (the only organized groups supporting S. 4) seeking reinsurance. Members of Congress know from their own experience that organized anti-reform forces greatly outweigh pro-reform forces. Only embarrassment and conscience--weak enough in the political arena--dictate some action soon.

Assuming enactment of a pension reform measure in 1974, it will have been 16 years since the last reform measure--the Welfare and Pension Plan Disclosure Act (amendments to it have been picayune).

Add to that the fact that the vesting and funding provisions of S. 4 would start to operate only in 1977 thereby delaying any significant experience under the measure until the close of this decade.

The present push for reform is about a decade old. Congressional efforts in this round began with the Joint Economic Committee hearings in the 89th Congress. Here we are in the 93rd, hopefully on the brink. Another such effort--and the same ingredients are not at hand--would take a decade, a decade, that is, after the new law proves to be as inadequate as analysis now reveals it will be. Moreover, when it comes, reform. legislation takes years more to put into effect and more years yet to affect plan operations.

Realistically, follow up reform could be expected no sooner than a decade after enactment of S. 4--and in all likelihood at least another 16 years may be required. In sum, 1990 is the earliest time to expect follow up reform. By then most of us here (without Congressional pensions) will be in rest homes damning the 93rd Congress for a half-baked half-a-loaf.

In the final acocounting, it is not what we appear to have done that counts. When our terms of office and our terms of life are over, we will not be remembered. Only what we actually did will count.

#

Statement to Pension Subcommittee of the
Senate Committee on Finance

June 4, 1973

PRIVATE PENSION AND PROFIT SHARING PLANS

Legislative Issues Involving
Vesting, Funding, Termination
Insurance, and Portability

Herman C. Biegel

I. Introduction

The purpose of this paper is to discuss proposed legislation to regulate private pension and profit-sharing plans in the following four areas:

(1) Vesting: the right of an employee to benefits under a retirement plan if he terminates service with his employer before his "normal" retirement date (usually age 65);

(2) Funding: the level of amounts to be contributed and held under the plan to fund the rights accruing to the covered employees;

(3) Termination insurance: a program to insure payment of certain benefits if a pension plan is terminated by plant closing or otherwise; without sufficient funds to pay those benefits; and

(4) Portability: a centralized publicly operated mechanism to keep track of an employee's vested pension credits as he moves from one employer to another, and for payment of those credits upon his retirement.

For several years, Congress has also been considering two other areas of legislation affecting private plans:

fiduciary responsibility and disclosure. While this paper does not discuss those matters in detail, reference should be made to them at the outset.

The core of the fiduciary responsibility proposals is a Federal "prudent man" standard of conduct for those responsible for plan operation, and for the funds held under them. Strict limitations are imposed against the avoidance of that standard by means of "exculpatory provisions" in the plans. The standard would require diversification of fund assets, and prohibit many party-in-interest transactions, including dealings between an employer and its pension fund. Exceptions are made for a level of investment in employer stock, and plans that specifically provide for such investment are not limited to any particular level.

It should be emphasized that, by and large, these proposals are very much in the public interest. Adoption of such standards will do much to correct abuses by some plan administrators, and will increase the confidence of millions of employees that their plans are being operated honestly and competently.

Under the pending proposals for additional disclosure, plan administrators would be required to furnish substantially more information to the Government and to participants about the substantive provisions of their plans, and about the financial operation and level of funding under those plans. Again, without discussing these measures in detail, two points should be made: First, more disclosure is indeed desirable, to increase confidence in the operation of our private system, and to avoid the disappointment and hardship that can result when participants do not understand the limits on the rights provided in their plans. Second, in pursuing this objective, however, Congress must avoid any tendency to require excessive detail and paperwork, particularly in the area of financial data, which would burden plan administrators severely, and would not contribute useful information.

As a background to a discussion of vesting, funding, insurance and portability, it might be helpful to consider the present law, the current legislative consideration of these subjects, and the development of the private pension sector during the last decade.

II. Present Law

At present the tax law provides the only rules for vesting and funding. There are no requirements for insurance and portability, and no major governmental bureaucracies in this area.

Full vesting must be provided when a participant retires, or upon termination of a plan. The other requirements also derive from the rules set forth in Section 401 of the Internal Revenue Code, for "qualification" of pension and profit-sharing plans. A qualified plan may not discriminate in favor of employees who are officers, shareholders, highly-paid or supervisory personnel. 1/ If it appears that the absence of vesting provisions, combined with a heavy turnover of employees, results in having a plan cover only highly-paid or supervisory employees, the Internal Revenue Service reserves the right to challenge the tax qualification of the plan. 2/

There is no statutory requirement that plan liabilities be __funded__ over any particular period. Ironically, the current rules tend to __limit__ funding, by complicated restrictions on the amount of pension contributions that may be deducted each year. As an administrative matter, the Internal Revenue Service does require that the cost of current benefits be funded, together with the interest on the unfunded past service cost, i.e., the cost of benefits for service before the plan was established or improved. 3/ Failure to meet these requirements does not result in the disqualification of the plan for tax purposes. Rather, such a failure is treated as a termination of the plan and the benefits must vest in the participating employees.

While this paper does not deal with problems of administration, it is important to note that the Internal Revenue

Service has developed a substantial capacity and expertise in analyzing the complicated actuarial and other issues that arise with respect to vesting and funding of plans. This expertise would constitute an invaluable asset in the administration of any new rules in those two areas. Also important is the fact that the tax law is largely self-enforcing. Unless the tax rules are met, plans cannot qualify for the special benefits set forth in Sections 401 through 404 of the Internal Revenue Code, or for the tax exemption of the plan funding mechanism, provided by Section 501(a) of the Code. This incentive, and the disastrous tax consequences of losing qualification, form an effective system of self-regulation without the need for a harsh and extensive enforcement bureaucracy, or new'mechanisms for insurance and portability.

III. Status of Current Proposals

In March, 1962, President Kennedy appointed a Cabinet Committee on Corporate Pension Funds to study private employee retirement plans. In January, 1965, that Committee made its public report. [4] The Committee focused on alleged abuses and deficiencies in pension plans and made recommendations with respect to vesting, funding, insurance, portability, and fiduciary standards. [5] Subsequently, legislative proposals began to focus on these areas. Such legislation has been introduced in every Congress since 1967. Hearings have been held in one or both houses of the Congress in each subsequent year. Hearings turned up instances in which employees had terminated after long periods of service but before retirement, forfeiting benefits they had expected to receive. The hearings also produced specific cases in which plans had terminated without sufficient funds to pay accrued benefits. Many of these problems resulted from dishonesty and lack of fiduciary standards, and would be corrected by measures that would improve those standards.

In this Congress, a number of bills covering one or more of the areas of vesting, funding, insurance and portability are pending. The three major proposals, upon which this paper will focus, are:

(a) A bill proposed by the Administration, hereinafter referred to as the "Administration Bill." (S. 1631)

(b) Legislation proposed through your Committee, the Senate Committee on Finance, by Senator Bentsen, hereinafter referred to as the "Bentsen Bill." (S. 1179)

(c) Legislation proposed through the Senate Committee on Labor and Public Welfare, by Senators Williams and Javits, hereinafter referred to as the "Williams-Javits Bill." (S. 4)

The provisions of these bills are discussed in greater detail in subsequent sections of this statement. In addition, the Staff of the Joint Committee on Internal

Taxation has prepared an excellent summary of these Bills, which was issued on May 16, 1973. The Williams-Javits Bill with its strong provisions for vesting and funding, as well as for new insurance and portability programs, is now pending on the floor of the Senate, having been reported favorably by the Labor Committee. 6/

The Senate Finance Committee has been vitally interested in legislation in this field because its subject matter historically has been handled through the tax laws. Last year, while approving the disclosure and fiduciary responsibility portions of the Williams-Javits Bill (then S. 3598), this Committee did not report favorably on the vesting, funding, insurance and portability features, because of inadequate time to consider them, and because of the view of the Committee, that further consideration must be given to "balancing two conflicting considerations." Specifically, the report stated:

> "It is...important to recognize that as desirable as strengthening requirements for pension and profit-sharing plans may be, these plans are essentially voluntary insofar as employers are concerned with the result that stronger requirements tend to discourage the widening of the use of private pension and profit-sharing plans. Therefore, a careful balancing of these two conflicting considerations is needed in considering recommendations to strengthen provisions relating to private pension and profit-sharing plans. 7/ [Emphasis added.]

BEST COPY AVAILABLE

This balance between proposed new restrictions on private plans on the one hand, and the danger of discouraging the widening use of such plans on the other, has gained substantial force in the Administration and in Congress, because broader problems have been coming to the fore: Namely, the facts that a large proportion of employees is not covered by any plan, and that the level of benefits under many plans is too low.

For example, the Staff Summary prepared for your use points out that one-half of all employees in private, non-agricultural employment are still not covered by pension plans. 8/ Recent studies indicate that the portion who are not covered may be substantially larger than one-half. 9/ A House Labor Committee Staff Report, for example, has also noted that for current retirees the benefit levels of many plans are modest, and that provisions for widows benefits are widely inadequate. 10/ An appreciation of these facts has led the Administration and Senator Bentsen to suggest a program of further tax incentives to encourage increased coverage, particularly in the small business area, where profits often are small. At the same time, these facts must continue to impress upon your Committee, and all of the members of Congress, the need for moderation

BEST COPY AVAILABLE

and restraint in the imposition of new standards upon a voluntary system that needs encouragement and expansion rather than restriction and additional burdens.

IV. The Growth of the Private System

During roughly the 10-year period since the Kennedy appointment of the Cabinet Committee, while legislation has been considered in an atmosphere of excessive criticism of the private pension system, that system has grown, and improved its performance on the two major points at issue; vesting and funding. Nothing is more important in the development of a perspective on this matter than the recognition of the fact that the situation is not static.

Between 1960 and 1970, the assets of private plans increased from $57.8 billion in 1961 to $138.2 billion in December 1970. [11] Those assets are now estimated to exceed $150 billion. [12] In the period between 1962 and 1969 there occurred what the Labor Department characterized as a "striking 29 percent increase" in the proportion of workers covered by plans with vesting provisions; plans with vesting or early retirement provisions covered 91 percent of all active participants in private retirement plans by 1969. [13]

The 1970 Study of Industrial Plans by Bankers Trust Company of New York contains some impressive statistics about improvements in vesting from the first half to the second half of the 1960s. The study covers 201 companies in 71 different industrial categories having between 200 and several hundred thousand employees.

Under the so-called "pattern plans" negotiated by international unions, the percentage of plans providing full vesting in 10 years increased from 10% in 1960-65 to 34% in 1965-70. Under "conventional" plans, the percentage with full vesting in 10 years increased from 12% to 21% in the same period. The worker who has attained age 40 with 15 years of service vested fully in 74% of the pattern plans, by the 1965-70 period. A worker meeting those requirements was fully vested in 48% of conventional plans by the 1965-70 period, up from 33% in the 1960-65 study. One hundred and three amendments to vesting provisions were made in the 1965-70 period in the covered plans considered in the study, and all but 6 liberalized vesting. [14]

Despite criticism of vesting provisions, the Social Security Bulletin for June 1971 (Volume 34, No. 6) shows that 58% of the individuals who were formerly employed, for wages or salary entitled to Social Security Payments at age 65, are also receiving second pensions from private pension plans. Private benefits paid in 1969 ($6.4 billion) were more than triple the 1960 figures ($1.8 billion). By 1971 that total had grown to $8.6 billion, and the average benefit payment was $1,730. In the same period, between 1960 and 1971, the number of beneficiaries almost tripled, from 1.8 million to 5.2 million. [15]

As to funding, a study of the subject for plans 10 years old or more, entitled "Inquiry Into The Status Of Funding Under Private Pension Plans In The United States" by Frank L. Griffin, Jr. (Vice President and Actuary, the Wyatt Company) and C. L. Trowbridge (Vice President and Chief Actuary, Bankers Life Company) was published in 1969 under the auspices of the Pension Research Council, Wharton School of Finance and Commerce, University of Pennsylvania. The Federal Government financed a substantial part of the cost of the study. The study found: A very high degree of benefit security has been achieved by the vast majority of plans included. Assets were sufficient on the average to cover approximately 95% of all accrued benefits under the plans with funding periods of 15 years or more. The ratio to vested benefits is even higher. The Staff Summary recently prepared for your Committee, and the Labor Committee statistics on which it is based, are somewhat less favorable, but even those statistics show very high levels of funding for plans in effect for reasonable periods of time. 16/ The evidence is overwhelming that sound financing has been the rule.

The real progress of the private system must create a healthy scepticism about whether new stringent Federal standards and new bureaucracies would help the situation or hurt it.

V. Vesting

A. Discussion of Proposals.

A discussion of vesting must center on specific proposals. Take the three major standards contained in the Administration Bill, the Bentsen Bill, and the Williams-Javits Bill: Under the Administration Bill, an employee must participate in a plan after the later of 3 years of service, or attainment of age 25. The Bill proposes a "Rule of 50" for vesting the interests of participants in qualified plans. Under this rule, an employee would have a vested right to 50% of his accrued benefits when the sum of his age and years of participation in the plan equals 50. This percentage would increase by 10% per year, to 100% over the 5 succeeding years.

The Bentsen Bill requires participation following the later of 1 year of service or attainment of age 30. A participant receives a 25% vested interest after 5 years of participation, plus 5% per year to 100% after 20 years.

The Williams-Javits Bill requires participation after the later of 1 year of service or age 25. The Bill requires vesting at the rate of 30% following 8 years of "covered service," plus 10% per year, to 100% after 15 years of such service.

The vesting schedule under the Administration Bill would be prospective (i.e., would only apply to benefits accruing after the effective date of the Act). The Bentsen Bill would apply retroactively to employees age 45 or over, and vesting under the Williams-Javits Bill would be wholly retroactive, applying to benefits accrued before the effective date of the Act.

B. Recommendations on Vesting.

A large segment of those who have considered the problem of vesting--including business, labor, the pension industry, and experts in the field--are now prepared to support reasonable vesting standards, despite the added burdens that such standards might impose, and the uncertain costs involved. One reason for this developing consensus is the need to establish Federal preemption and avoid the proliferation of varying State rules in this area. Of major importance in establishing those vesting rules, however, is a recognition that any legislation should set *minimum* standards to require improvement of plans that fall below a reasonable norm. In addition, the standards must be flexible.

1. Provide a Choice of Standards.

Employers should be permitted to choose among various approaches as long as the minimum level is provided. What is magic about any one of the approaches set forth in the pending bills; graduated vesting beginning after 5 years or 8 years; or vesting that reflects a combined age and service standard like the "Rule of 50"? As long as the plan's vesting schedule is designed to achieve substantially the same degree of vesting as the legislative standard, no change should be required in the plan.

The Williams-Javits Bill recognizes this problem, by granting the Government the power to waive the single statutory standard if the plan contains vesting provisions that are "as equitable as" the statute. This approach is helpful, but alternative standards should be set forth directly in the Act, with additional power for administrative waiver of those standards. The Williams-Javits Bill also contains a helpful special standard for thrift and savings plans, which contain vesting on a "class year" basis, i.e., separate vesting for each annual contribution by the employer. This standard would permit "class year" vesting schedules under which the employer contribution for a year would become vested after a period not exceeding 5 years. It is absolutely essential that flexibility of this kind be included in any final legislative product.

2. Provide Equitable Transitional Provisions.

It should be noted that the proposed bills do reflect a proper concern for easing the transitional period, setting reasonable effective dates, and granting appropriate waivers with respect to those dates. This concern must continue.

3. Define the Vested Benefit.

Again, the purpose of the legislation is to fix a statutory level of vesting in order to improve plans that are now below reasonable standards. I have suggested in the past that it would be appropriate to limit the statutorily imposed vesting standard to a benefit which when added to Social Security will equal 50% of final average salary up to the Social Security wage base. Even if such a limit is not imposed, vesting should not, as a matter of law, extend to pre-retirement death benefits, or require immediate payments upon early retirement. The legislation should clearly be defined, as it is in the Administration Bill, as a life annuity payable at age 65.

VI. Funding

A. The High Level of Funding.

Funding of pension plans is, of course, closely related to vesting. A vested benefit is of little use if it cannot be paid. But the problems of determining how to fund that benefit raise very serious issues of cost. What is involved is the manner of liquidating past service costs; i.e., costs for service rendered before a benefit is instituted.

As has already been indicated (at page 11) there is a very high degree of funding with respect to accrued benefits for plans in effect for reasonable periods of time. The funding level for vested accrued benefits is even better. Nonetheless, since the present tax rules require only that interest be paid on the past service liability so that it does not increase, it is apparent that any statutory requirement to liquidate that liability will constitute a change in the ground rules.

B. Current Proposals.

All three Bills continue the present requirements for funding future service benefits on a current basis. The Administration Bill would require that past service benefits be funded at the annual rate of 5% of the unfunded vested liability, plus interest on total unfunded past service liabilities. Under the Williams-Javits Bill, the unfunded liability for vested and unvested accrued liability for past service must be funded in equal payments over a period of 30 years from the effective date of the Act. Amendments to a plan that increase benefits substantially may be funded on a new 30-year schedule.

The Williams-Javits Bill also requires that any "experience deficiency" be funded over a period of not exceeding five years. An "experience deficiency" is any deficit occurring after the calculation of the initial unfunded liability when the plan is established or amended, except a deficit caused by a failure to contribute. For example, an adverse investment experience with respect to plan funds, or a major increase in compensation upon which benefits are based could cause such a deficiency.

The Bentsen Bill also requires funding all unfunded liabilities, vested or not vested, over 30 years. However, "experience doficiencios" are to be funded over the average working life of covored employeos.

C. Recommondation on Funding.

Again, after thorough considoration of this issue over a substantial poriod of time, some consensus--although woakor than with respoct to vesting--may be developing in favor of reasonable Federal standards for funding benofits under private pension plans. It is recommonded that any standard adoptod take the following into account:

. Tho funding standards should focus on the aggregato period for funding. For examplo, a 40-year or 30-year period for funding of total benefits might be acceptable. If funding is applied only to vested benefits, the period could be even shorter--perhaps 25 years. It is important to recognizo, however, that the Williams-Javits requirement to make up "experionco deficiencies" in 5 years, would raise gravo problems.

The plan's experience will not coincide precisely with actuarial assumptions at any particular point in time. The actuarial assumptions upon which employers fund their plans aro based on the average anticipated experience over a long period of years. An increase in pay, for oxample, coupled with a decline in the stock market, could produce an "experience deficiency" of immense proportions in the short term. To consider irregular variations in experience as creating "deficiencies" or "surpluses" on a short-term basis is a total warping of the entire process of funding on the basis of long-range actuarial assumptions. The simple fact is that short-run variations from the assumed averages in no way indicate a real shortage or surplus in the funds. For these reasons, the provisions in the Williams-Javits Bill for funding experience deficiencies over five years must not be enacted. This important point must be preserved in any legislation that is adopted.

VII. Insurance

A. Current Proposals.

The search for pension benefit security has led to proposals for insuring the promised benefit against loss in the event the plan is terminated. An important distinction must be made between insurance proposals and proposals for vesting and funding. Plan administrators and the Government have extensive experience with the operation of vesting and funding standards. By contrast, there is absolutely no experience in the operation of an insurance program of the sort contemplated.

The Williams-Javits Bill illustrates many of the problems. It provides for an insurance program within the Labor Department. The program insures unfunded vested liabilities incurred both prior to and after the effective date of the Bill. The Bill insures investment losses, since the lack of full funding may result from the performance of plan investments, as well as from the fact that past service liability is funded over a 30-year period. The program would insure against the loss of such rights in the event of complete or "substantial termination," as determined by the Secretary of Labor.

The rights of the participants would be insured subject to the following limitations:

> (a) The amount of insured benefit would be the lesser of (i) 50% of a participant's highest 5-year average monthly wage, or (ii) $500 per month.
>
> (b) No insurance would be payable unless the plan (or an amendment, if applicable) had been in effect for more than three years.
>
> (c) No insurance would be provided for shareholders owning 10% or more of the employer's stock.

Each plan in the Program must pay a uniform assessment covering administrative costs, plus an annual premium of .2% of the unfunded vested liability if (a) the plan was at least 75% funded during the five years preceding the effective date of the Act, or (b) the plan is a multi-employer plan. A single employer plan which was less than 75% funded would pay up to .4% of its unfunded vested liability incurred before the effective date of the Act, and up to .2% of its unfunded vested liabilities incurred after the effective date.

If the terminating employer is solvent, it would be liable to reimburse the Program for part or all of the amount disbursed to the participants. The liability is 100% of the unfunded vested liability, subject to a limitation of 50% of the employer's net worth. The employer's obligation to reimburse the fund becomes a lien on its property if it is not paid, and such lien follows the property into the hands of a successor. The lien is superior to everything except a Federal tax lien.

The insurance program under the Bentsen Bill is similar to that in the Williams-Javits Bill, with some important exceptions. For example, the program would not be administered by the Labor Department, but by a separate membership corporation entitled the "Pension Guarantee Corporation," with governmental, management, employee, and public representation on the Board of Directors. The guaranteed benefit would be the lesser of 50% of average wages or $1,000 per month, rather

BEST COPY AVAILABLE

than $500 as in the Williams-Javits Bill. In general, insurance would apply only after the plan has been in effect for 5 years before the insured loss. No reimbursement obligation is proposed.

B. Objections to Insurance.

The implications of the insurance provisions of the proposed Bills reach far beyond those with respect to vesting and funding, and are substantially more objectionable. At this point, it is appropriate to recall the discussion early in this paper of the remarkable growth of private pension plans, and the need to expand coverage and benefits under those plans. At the same time, Congress must not lose sight of the fact, which was emphasized by your Committee last year, that employers do not have to establish any plan or set any prescribed level of benefits. What are being discussed, therefore, are voluntary programs. Against this background, the following objections must be considered:

First. The need is not established. Do the facts support the risks and burdens of an insurance program, and the potential disincentive against establishing and improving pension plans? The Labor and Treasury Departments have issued an Interim Report under the Study of Pension Plan Terminations, ordered by the President in December 1971. That Interim Report produced no evidence

BEST COPY AVAILABLE

of a widespread problem. The Interim Report focused on the first seven months of 1972. Although the data covers only this short period, the findings essentially confirm earlier studies, such as the 1968 survey by the IRS and the Labor Department, which found that the exposure to loss of benefits through Plan termination is not very great:

The Staff Summary prepared for this Committee notes that for the seven-month period covered by the Interim Report, participants losing benefits constituted four one hundredths of one percent of workers covered by pension plans. 17/ Indeed, while your Summary noted that approximately 8,400 participants in 203 plans lost benefits, actually only 3,100 of these participants were retired or were fully vested before the plan termination, and only 2,700 would not be covered by a new plan, which might make those losses good. Again, this number is measured against the fact that, according to the Interim Report, there are now 23 million participants in private plans, and well over 5 million present beneficiaries. 18/

Your Summary points out that $20 million in accrued benefits were involved in terminations during this period. Indeed, of this relatively small amount, only about half represented fully vested benefits of long service employees of the sort that would be insured. 19/ Compare this amount to the fact that the reserves of private plans now exceed

$150 billion, and that $8.5 billion in benefits are now paid annually. 20/

There is every reason to expect that new funding standards would help to reduce the losses that are now being incurred. The issue, however, is whether the proposed remedy of a giant new Federally operated or regulated insurance program is the right solution when that program will affect virtually every pension plan in the country, will alter the private pension system as we know it, and will constitute a major deterrent to the establishment of new plans.

Many proponents of insurance admit that the problem is not widespread, and argue that for this very reason, a solution will not be expensive. Leaving aside the question of whether it is wise to support legislation because the need for it is relatively small, such arguments miss the essential point: The basic objection to insurance is not the initial premium cost, although in the case of new plans that cost could be very substantial indeed. The real concern is the potential for complete regulation of private retirement plans and the adverse effects that regulation would produce. The remaining portion of this section details these effects.

Second. A new bureaucracy would be needed. Federal standards would inevitably be prescribed for the valuation of plan assets, actuarial assumptions, definition of risk, computation of premium and--most insidious of all--rules regarding investment of plan assets. If the Federal Government is going to have a hand in insuring pension benefits to any degree, it stands to reason that the Federal Government is going to prescribe rules with respect to the underlying assets of the plan.

Third. The existence of an insurance pool to guarantee plan benefits would lead to pressure for increasing benefits beyond the financial capacity of an employer to pay for them. Benefit levels should be established in accordance with sound collective bargaining or management decisions free from the distortion which would be caused by a program funded by other employers to cover deficiencies.

Fourth. Such a proposal would encourage speculative investment of plan assets. The fact that a Federal pool would back up any losses would lead some plan administrators to take unwarranted risks in investments, leaving soundly managed plans to bail out the speculators. If their investment is successful, they will have reduced the cost of the plan to the employer. It their investment fails, the insurance pool will make up the loss. The cure for discouraging speculation would be worse than the disease. On the one hand, it would mean investment control by the Government. On the other hand, the danger of specualtion is one consideration that now leads some proponents of insurance to suggest that employers be required to reimburse plans for their insured losses.

Fifth. Proposals for reimbursement by employers of fund deficits are chilling indeed. Proponents of insurance programs say that it is necessary to place corporate assets behind the plan in order to protect against the kind of unreasonably risky results mentioned in Third and Fourth above. But here, again, the proposed cure would merely serve to magnify the basic problem of security for employees. After all, insurance becomes necessary only in cases in which an employer is in such financial difficulty that plan termination is required. Ironically, a liability to make up insured pension plan deficits out of corporate assets will add drastically to those very difficulties. It will reduce the company's access to credit at the time its very future is dependent on financial assistance. In short, it would tend to assure that the company could not continue in business. Some proposals also impose the employer's reimbursement liability as a lien on successors, hence, reducing the marketability of a troubled enterprise. In short, in addition to all of the other problems raised by insurance it would tend not to increase retirement security in the future, but to jeopardize the very jobs upon which that security depends by further adding to the problems of financially troubled employers.

Sixth. Most of the legislation recommended so far does not resemble true "insurance" in any sense of the word. The proposal simply assess sound plans to provide a pool for payment of losses of terminated plans.

C. Recommendation Against Insurance.

At the very least, such a program represents an effort to impose uniform Federal standards in an area that defies uniformity. Such a program would create a new bureaucracy, and would attempt to insure an almost indefinable risk, at a cost that is almost impossible to estimate. Particularly insidious is any proposal that will lead to governmental direction of plan investments, and to additional reimbursement liabilities upon employers and their successors.

VIII. Portability

The problem of portability derives from the fact that many employees work for a number of employers over their working lives. Present vesting practices do not envisage combining the vested benefits earned by an employee under one plan with those earned by him under a successive employer's plan. At present, an employee who reaches retirement with vested benefits under several plans will draw separate checks from each.

A. Current Proposals.

The Williams-Javits Bill contains a voluntary program, to be administered by the Labor Department, which would permit the transfer only of vested credits for employees who shift among employers who participate in the program.

The Bentsen Bill and the Administration Bill do not create a centralized agency. They would accomplish the same objective simply by allowing covered employees to transfer vested rights from one plan to another, free of tax, when they change jobs.

B. Recommendation Against Portability Involving a Centralized Agency.

The proposals for tax-free transfers among plans, such as those proposed by the Administration and Bentsen Bills, are highly desirable and should be adopted. More far-reaching programs should not be adopted. Surprisingly, the attacks against portability have come with equal force from representatives of Labor, Management, and Government. [21] Some of these objections are:

(1) If a vested benefit is transferred out of a plan, it would be done on a fully funded basis. However, if the plan as a whole is not fully funded, the remaining participants will be adversely affected because the movement of money out of the plan would endanger its adequacy for the others.

(2) Each plan is different; benefit structures differ; the actuarial assumptions are not uniform; and the methods of valuing assets vary. If a pension credit based on one set of assumptions is transferred to a plan using a different set of assumptions, how are the benefits to be computed?

(3) In view of the difficulty in attempting to exchange pension credits between plans which have different benefit features or different actuarial assumptions, or different investment policies, a demand for portability ultimately will be a demand for standardized, identical fully-vested plans--thus, completely eliminating the flexibility to tailor plans to the individual needs and capabilities of the particular company and its workers. It would mean that the private pension system will be converted into another form of Social Security, with the Government setting regulations on actuarial assumptions, investment policies, and other features of the plan.

(4). A voluntary portability system, although infinitely preferable to a mandatory system, just can't perform. It is voluntary as to whether the employer will join the program. It is also voluntary as to whether the employee wishes to transfer his vested credits from one member to another. Even if he does, the successor employer also must be a member of the system. Thus, unless all employers join, and all transferred employees consent to the transfer of their vested credits to their new employer, we would have a patchwork system that would make the current practices seem absolutely streamlined.

(5) The real fact is, however, that a mere record-keeping system is by no means what portability would ultimately involve. Originally, it would be limited to vested benefits. However, sooner or later, centralization of what is actually vested in an employee when he leaves an employer would not be enough. Instead, such a mammoth superstructure would be used to transfer service credits when an employee leaves his employer without a vested benefit.

In other words, portability would not be simply a means of collecting whatever is vested. Rather it would be a means for insuring that a vested benefit accrues with respect to all of an employee's service and with all of his employers. The result would be one or both of two things; first, substantially reduced benefits and a significant disincentive to the adoption of new plans, or second, a major increase in cost levels.

IX. Conclusion

(1) Any Federally imposed vesting standards should provide flexibility, reasonable transitional provisions, and careful definition of the vested benefit. That standard should preempt the adoption of varying State rules on this subject.

(2) If Congress decides to establish funding guidelines, the overall period for such funding must be reason-

able. The experience deficiency provisions in the Williams-Javits Bill, and the 5% annual schedule in the Administration Bill should not be adopted. The Bentsen requirement for correction of deficiencies over the average remaining funding period of covered employees is preferable.

(3) No insurance program should be enacted. Such proposals raise markedly more serious problems than either vesting or funding. The cases they are designed to cure involve a very tiny fraction of 1% of the employees covered. To set up a huge bureaucracy for so negligible a fraction of the pension universe would be foolhardy. Moreover, it would lead inevitably to standardization of actuarial assumptions and complete control of the investment of pension funds. No one has advocated these harsh results, yet without this control, the insurance risk could be varied at the will of the insured, and encourage unhealthy speculation.

(4) Portability is of questionable value and has been rejected by responsible officials of the Administration, Labor and Management. The desired result can be achieved by providing for tax-free transfer of vested amounts, as suggested by the Administration and the Bentsen Bills.

Footnotes

1. I.R.C. Sec. 401(a)(3) and (4).

2. "Guides for Qualification of Pension, Profit-Sharing and Stock Bonus Plans." I.R.S. Pub. 778 (2-72), Part 5(c).

3. Income Tax Regs. Sec. 1.401-6(c).

4. "Public Policy and Private Pension Programs; A Report to the President on Private Employee Retirement Plans" (hereinafter referred to as "Cabinet Committee Report").

5. Cabinet Committee Report, pp. vi-xvi.

6. S. Report No. 93-127, 93d Cong., 1st Sess., Committee on Labor and Public Welfare.

7. S. Report No. 92-1224, 92d Cong., 2d Sess., Committee on Finance, p. 3.

8. "Summary of Proposals for Private Pension Plan Reform," prepared for use of the Committee on Finance by the Staff of the Joint Committee on Internal Revenue Taxation (hereinafter referred to as "Staff Summary"), p. 3.

9. "Social Security Bulletin," Social Security Administration, April 1973, p. 28.

10. "Interim Staff Report of Activities of the Pension Study Task Force of the General Subcommittee on Labor," Committee Print, 92d Cong., 2d Sess., p. 15 ff.

11. "Social Security Bulletin," Social Security Administration, April 1973, p. 32.

12. Ibid.

13. U.S. Department of Labor Press Release, February 13, 1970.

14. "1970 Study of Industrial Retirement Plans" (1970), Bankers Trust Company of New York, pp. 7-12.

15. "Social Security Bulletin," Social Security Administration, April 1973, p. 32.

16. Staff Summary, p. 5.

17. Id., p. 7.

18. Study of Pension Plan Terminations, 1972, Interim Report, Departments of Treasury and Labor (hereinafter referred to as "Interim Report"), pp. 30-33; "Social Security Bulletin," Social Security Administration, April 1973, p. 32.

19. Staff Summary, p. 7; Interim Report, pp. 30-33.

20. "Social Security Bulletin," Social Security Administration, April 1973, p. 32.

21. Hearings on S. 3598 (Williams-Javits Bill in 92nd Cong.), Senate Subcommittee on Labor, 92d Cong., 2d Sess.; Statement of James Hodgson, Secretary of Labor (p. 99); American Bankers Association (pp. 254-55); Leonard Woodcock, U.A.W. President (p. 790); National Association of Manufacturers (p. 813); I. W. Abel, United Steelworkers President (p. 1160).

Statement to the Finance Subcommittee
on Private Pension Plans
June 4, 1973

Edwin S. Cohen

The issues which the Subcommittee has asked the panel to discuss today require a delicate balancing of many competing considerations. Much thought and study has been devoted to them by many talented persons, not only in the Congress and the Administration but also in the private sector. The diversity of views that have been expressed is a reflection of the difficulty and complexity of the problems.

I should like to say, Mr. Chairman, that I do not pose as a specialist, or even as an expert, in the field of pension plans. Yet for some thirty-five years in the practice of the law and in government service, I have been engaged intermittently, and at times with some frequency, in the designing, drafting and operation of pension plans. From 1970 to 1972, I participated in the formulation and presentation of—the Administration's pension plan proposals, though not in the supplemental recommendations made this year.

Before commenting on the specific issues, I would like to offer a few general observations:

1. In pension plans, as in so many other matters, we secure only what we pay for. A dollar paid into a pension plan will produce benefits which expert actuaries can estimate. To the extent that by law or regulation, or by design of the

plan itself, we require certain minimum standards of eligibility, vesting or other requirements, we must sacrifice other benefits, or else we must increase the cost of the plan. Increased costs for prescribed items mean decreased benefits to employees in other respects; or they mean increased costs to be borne by consumers in the price of goods and services, affecting the price level and our ability to compete in world markets; or they mean decreased return to investors, affecting the level of investment that is the source of job opportunities.

2. A most important feature of our private pension system is the flexibility that it permits to meet the special needs and desires of employers and employees in different industries and different businesses. Experience shows the need for increased minimum pension plan standards in a number of respects; but in fashioning the new law, if we were to set minimum standards too high, we would tend to limit the desirable flexibility of the private pension system because cost considerations would force reductions in benefits that would be beyond the required minimum.

In our discussion of what the law should require of pension plans, I suggest that we should avoid requiring by law what each of us might think reasonable for the average plan, but confine the law to what we think, at this time in our history, is a minimum standard of fairness for all employees. We should, I think, leave to negotiation more liberal provisions

BEST COPY AVAILABLE

that may be traded off against increased current wages or other employee benefits, including other types of benefits in the pen··ion plan itself. In particular, we should be cautious that we do not drive so high the costs of private pension plans as to impair the prospects of legislation for increased health insurance for employees.

3. In my experience, the pension field requires a great diversity of expertise on a variety of different subjects. It necessitates a merger, among other matters, of actuarial science, accounting, labor-management relations, tax law, trust law and labor law. When the respective experts have given their views, sometimes conflicting, generalists in the government and private sectors must ultimately absorb the analyses and make the ultimate decisions. The process is time consuming and unfortunately tedious.

In making the needed statutory changes, we should be careful that they are not so extensive that they exceed the capacity of government and private personnel to institute and administer the changes. Those that seem marginal or dubious could reasonably be deferred until the system has absorbed the essential changes and their effects can be weighed. To move too rapidly at one time on all fronts in the pension area could produce uncertainty and confusion that would be counter-productive.

With these general observations, I shall review briefly below the principal topics you have asked the panel to discuss.

1. Vesting requirements. Except with respect to certain plans created by self-employed persons, existing law contains no minimum vesting standards for pension plans other than such provision as may be necessary to prevent discrimination of officers, stockholders, and supervisory and highly compensated employees. While studies indicate that there has been a general upgrading of vesting provisions in recent years, I understand that only about 32 percent of participants in corporate pension plans now have vested benefits. Many of these participants without vesting are young persons without substantial periods of service with their employer; large numbers of these employees will later qualify for vested benefits, either with their present or a future employer. But there is a large proportion of older workers who do not have vested rights and who, because they have fewer years remaining until retirement, are especially deserving of increased vesting protection. If older workers terminate employment, they will have less opportunity than younger persons to accumulate pension rights with other employers.

Accordingly, it has impressed me as especially disturbing to find that only some 40 percent of participants over the age of 40 have vested benefits, and only some 46 percent of those over age 60 have vested benefits.

My study of various minimum vesting standards that have been suggested for legislation has led me to the conclusion that the so-called "Rule of 50," proposed by the Administration, is the most satisfactory. Under this proposal, when the sum of an employee's age and years of participation in the plan equals 50, his benefits must be at least 50% vested. In the five years following, his vested portion must increase by at least 10% per year, until by the end of the five years he must achieve 100 percent vesting.

The Rule of 50 would, I understand, increase the total number of plan participants with vested rights from 32 percent to 61 percent. But an even more important effect would be that with respect to participants age 40 and over, it would increase the percentage with vested benefits from 40 percent to 92 percent. The rule when fully effective would essentially solve this problem of the older worker, and it is his problem that I think is more serious than that of the younger worker.

The data recently presented by the Administration indicates that enactment of the Rule of 50 as a minimum standard would increase overall pension plan costs by 2.4% in contributions, or 0.15% of covered payroll, or three-fourths of a cent per hour in wages. For those plans which now provide no vesting prior to retirement, the estimate is that the Rule of 50 would increase plan costs by 7.6% in contributions or 0.38% of covered payroll or 1.86¢ per hour.

I am persuaded to favor this proposal among those that have been advanced because the data indicates that in general it involves less additional cost than the others, but particularly because it concentrates protection on the older workers who, as I say, seem to me the most deserving of vesting protection.

Other vesting proposals that are most costly will reduce the level of retirement income that can be provided by the same funds for those who remain employed until they retire, and do not give special consideration to the greater vesting needs of the older workers.

The vesting proposals in S. 4 and S. 1179 are based exclusively upon years of participation by the employee, and give no consideration whatsoever to his age in the relative priority of vesting among employees. Age is a factor in determining eligibility for plan participation under all the pending bills, and it is generally used in determining normal retirement date and early retirement privileges and for other purposes. I do not think it wise for the legislation to rule out age entirely as a proper consideration in a vesting standard minimum for pension plans.

It is true that the Rule of 50 gives, in effect, an equal weight to age and years of participation in determining vesting. It would, of course, be possible to vary the formula, or to set a schedule based on age brackets, that would give greater weight to years of participation than to age. But to say that age may not be taken into account under any circumstances in the minimum standard of vesting seems to me inadvisable.

The objection that I understand has most frequently been made to the Rule of 50 is that it would tend to discourage the hiring of older workers by employers who have fixed benefit plans. In order to provide a fixed pension benefit at a normal retirement age of 65, the annual cost for a new older employee will be substantially higher than it would be for a younger employee. But this is true, regardless of the vesting provisions. It is particularly true because the older worker has a shorter period remaining before retirement, and hence the contribution will remain in the pension fund accumulating compound interest for a lesser period of time. The Rule of 50 would add relatively little to the annual cost of the pension of the older worker, either proportionately or in absolute amounts, and it is my view that it would not be a material factor in the choice between the hiring of an older or a younger employee.

For these reasons, if called upon to choose between the various vesting standards which have been suggested, I would be inclined to select the Rule of 50. On the other hand, I could not say that the vesting standards proposed in S. 4 or S. 1179 would not provide reasonable protection for employees as a group. I suggested earlier that the effort in the new legislation should be towards enactment of minimum standards of fairness rather than to legislate a single standard which we might consider appropriate, and that flexibility is important in the private pension system. Accordingly, it might well be desirable for the new law to accept as a minimum vesting rule any one of these three standards, or indeed any other standard which the federal administrative authority might approve as being equivalent in purpose and effect.

I think it fair to say that there is merit in all of the standards that have been proposed, and we have been debating for many months merely their relative merit. If the Congress selects a single standard, many plans now in existence that meet one of the other standards may have to change. There may, indeed, not be a sufficiently compelling reason to force such a change or to require a single vesting standard, particularly as to existing plans. It would be a major step forward if the law required plans to meet any one of the standards pending before you.

Another aspect of the vesting matter is the extent to which the legislative requirement should apply to benefits accrued prior to the effective date of the new law. The costs of granting vesting for previously accrued benefits as well as future accruals would be significantly higher than if the new requirement were made applicable only to future accruals.

Benefits under existing plans have been provided on cost assumptions that did not take into account the new vesting rules that would be enacted, and the additional cost of providing vesting retroactively for previously accrued benefits would have serious financial effects in some cases. This would be true to a large extent even if retroactivity were confined to employees over age 45, as in S. 1179. Accordingly, I am inclined to favor the Administration recommendation that service prior to the effective date of the law be counted with future service in determining when the employee satisfies the vesting requirements, but that the vesting apply only to benefits accruing in the future.

Still another significant question is the choice of a minimum standard of eligibility for participation in the plan. The proposals for corporate pension plans vary from one year of service and age 25 in S. 4, to one year of service and age 30 in S. 1179, and three years of service and age 30 in the Administration proposal (S. 1631). Because of greater turnover among young workers and the costs of including in the plan short-term employees who terminate employment, as well as my inclination to apply contributions to the benefit of older workers, I would favor the Administration proposal as an acceptable minimum for all types of plans. To some extent, the choice is affected by the vesting standard to be adopted.

Funding. All three of the pending bills would require an increase in the funding of deferred benefit pension plans by the employer. It is extremely difficult to weigh the effects of the several proposals upon the many different types of existing private pension plans. Once again, I would urge measured care in prescribing minimum annual contribution, so that the first step taken is not so large as to endanger the survivial of existing plans or discourage unduly the creation of new plans to cover the half of the work force that unfortunately today have no private pension plans. Once the first step has been taken and its results have been weighed, further legislation can be enacted with greater insight and foresight to increase the funding requirement.

Some of the proposals would require funding of past service costs, both vested and unvested. I would be inclined, at least in the first stage, to confine the funding requirement to the vested benefits, as does the Administration proposal. This would be somewhat comparable also to the accounting provisions in this respect in the Accounting Principles Board Opinion No. 8.

The Accounting Principles Board Opinion permits employers to choose between two alternative minimum standards of funding for the purpose of their financial statements. This suggests the possibility, in view of the apparent differences of view as to the most desirable single standard, that the new law stipulate not one, but two (or perhaps several) minimum funding standards, so that satisfying any of the minima would be considered acceptable. Such a solution might be especially useful with respect to existing plans that were established without knowledge of the new rules.

The requirements in S. 4 for funding "experience deficiencies" over a five-year period could produce substantial cost fluctuations and other serious difficulties and I believe require modification or should be deleted.

Portability. The issue of portability means many different things to many different people. If adequate minimum standards for vesting and funding are provided, much of the significance of portability would be eliminated, save perhaps as a convenience. The great divergence of the terms and degree of funding of private plans makes many types of portability impractical, and indeed could make it unfair to remaining employees when the plan is not fully funded.

The system that would be established under S. 4 is entirely voluntary in the sense that it would operate only if a pension plan applied for membership and if an employee participant terminating employment with vested benefits chose to use the system. It would at least establish a permissible system for those employers and employees who jointly wish to avail themselves of it. But, as I indicate, caution is needed that the withdrawal rights of a departing employee, or a group of them, do not damage the rights of remaining employees, especially when the plan is not yet fully funded. And care should also be taken that the time and attention of qualified personnel is not so consumed in the establishment and operation of this limited type of voluntary portability system as to impair institution of the other important innovations contained in the legislation.

A system could be devised with simplicity that would permit the Social Security Administration to serve as a vehicle to keep former employees and pension plan managers in contact with each other if they have changed address since the employee terminated employment. Together with adequate vesting and funding, much of the portability problem would be solved in this fashion.

The Administration's proposed amendment of the tax law to permit a "roll-over" of pension distributions received on termination of employment before retirement (i.e., impose no tax upon the distribution if the amount is promptly redeposited in another qualified plan) seems a desirable provision. Coupled with the other proposed amendment, which I would also favor, to permit an employee to establish his own qualified plan to which he can contribute when he is not covered by an adequate employer-created plan, the two provisions should prove especially helpful to persons changing employment.

Termination insurance seems a desirable objective but the difficulties involved are formidable. There are numerous questions as to the method of fixing and allocating the insurance premiums required. But I would express special concern about the provisions relating to recovery by the insurance program from employers for any insurance benefits paid by the program to the beneficiaries of a terminated plan. The Committee report accompanying S. 4 states (p. 26):

> "The Committee also recognized that some degree of employer liability was essential where the employer was not insolvent at the point of plan termination in order to preclude abuse by shifting the financial burden to the plan termination insurance program despite the fact that the employer had available funds to continue funding the plan."

Referring then to a concern for the "potentially enormous liabilities" that might be imposed on some employers if they were required to assume fully responsibility, the report then goes on to state:

> "Accordingly, the Committee endorsed a formula of employer liability which requires the employer to reimburse the plan termination insurance program for the total amount of insurance paid, but in no event greater than 50% of employer's net worth at time of plan termination."

Section 405 of S. 4 thus provides for recovery from the employer of "100 per centum of the terminated plan's unfunded vested liabilities" on the date of plan termination, limited to "50 per centum of the net worth of such employer." It creates a lien for such liability in favor of the United States on all property of the employer, except as against a lien for federal tax liabilities.

The issue of employer liability goes to the heart of the issue of feasibility of the insurance program, and deserves most careful consideration in view of the "potentially enormous liabilities" that may be involved. One question is whether those potential liabilities, up to half the employer's net worth, would have to be reflected as liabilities, or reserves would have to be provided, on the financial statement of the employer. This is essentially a question for certified public accountants, but I think it important to obtain a firm answer. There are many provisions in bonds, loan agreements, preferred stocks and important contracts which depend upon maintenance of certain prescribed ratios of assets and liabilities, or upon other tests in which the amount of liabilities are important, even if they are limited to half the net worth. If these large liabilities must be reflected or provided for, significant defaults could occur. But even if confined to a footnote explanation in the balance sheet, they could affect seriously both creditors and investors, depending upon judgment as to the degree of possibility of plan termination before funding is completed.

These problems are especially important because the liability would extend, as I read the bill, to vested benefits for service rendered before, as well as after, the effective date of the law.

The importance of the limitation of liability to half of "net worth" of the employer would indicate need for a definition of that term. While it is an expression frequently used in a general connotation, it gives rise to doubt as to its meaning in particular situations. It is more an accounting than a legal concept, but in the bill it would be used to define a legal liability.

The liability would be imposed upon a "successor in interest" to the employer, but that term is not defined. It might, for example, apply to a person who purchases for full value a part of the business of the employer (even though the employer's liability is limited to half its net worth). In that event it would affect the opportunity to realize on the value of the employer's assets, for persons would hesitate or decline to buy them.

Section 404(d) of S. 4 provides that "any person or persons who terminate a plan insured under this title, with intent to avoid or circumvent the purposes of this Act*** shall be personally liable for any losses incurred by the Pension Benefit Insurance Fund in connection with such plan termination." Section 3(11) of the bill defines the term "person" to include an individual. Thus, apparently an individual who is involved in the termination of the plan would be personally liable in potentially enormous amounts under a vague test as te whether he did so "with intent to avoid or circumvent the purposes" of the new law. It would be difficult to know which individuals would be considered to have "terminated" the plan, or to describe precisely the purposes of the Act that must not be circumvented by termination. The vagueness of the test and the magnitude of the potential liability seem to require further reflection.

The difficulties in these problems of termination insurance are not merely technical matters. However the technical aspects might be resolved, there remains the fundamental dilemma in termination insurance that substantial employer liability for vested benefits would be grave in amount and consequence, and yet insurance without such liability would furnish opportunity for abuse in the designing of plans and speculative investment of plan assets. To date I have seen no satisfactory resolution of that dilemma, though we should all continue to strive for a solution.

BEST COPY AVAILABLE

[From the Los Angeles Times, May 27, 1973]

PENSION: U.S. ADDS AND FIRMS SUBTRACT—SOCIAL SECURITY HIKE OFFSET BY SOME EMPLOYERS

(By Ronald L. Soble; Times Staff Writer)

NEW YORK—Millions of Americans upon retirement will not benefit fully from the big Social Security increases just voted by the Congress because their corporate employers will cut individual company pensions by an amount equal to part of the rise in the federal old age monthly payment.

The practice, although little publized and largely misunderstood by the public is entirely legal. Its proponents say it provides a generous retirement income consistent with the aim of federal and private pension plans.

Whether the practice is morally justified is questioned by union officials and public critics who contend that the action partially neutralizes congressional moves to offset inflationary effects on those with fixed retirement incomes. It also allows corporations to recoup partly their Social Security tax increases and to a degree subsidizes private pension plans.

Moreover, charge the critics, the practice mainly hurts lower-paid workers.

YEAR OF REFORM

Although this is supposed to be the year of pension reform in Congress, nowhere in legislation before either the House or the Senate is the issue of integrated or offset benefits touched.

Yet, declared Chic St. Croix, director of research for the Oil, Chemical & Atomic Workers International union, based in Denever, such plans are cheating workers out of benefits that Congress wanted them to have.

"We have very strong complaints on this issue," St. Croix told The Times.

Several executives interviewed, including some representing the nation's largest corporations, say such criticism is nonsense. They claim the practice has been generally accepted since Congress approved the Social Security Act in 1935.

Although there are no firm government statistics in this area, actuaries who design private pension plans estimate that perhaps as many as two or three million Americans will see up to one-half of the increases in their Social Security benefits whittled away through an offset in their private pension benefits.

And of the 35 million (in the 70 million U.S. work force) who have some sort of pension plan, actuaries estimate that as many as 20 million work for companies that use subtler formulas utilizing Social Security as a basis for calculating private pension plans.

Interviews with corporate officials and actuaries indicate the practice of integrating benefits most often applies to non-union workers.

Workers in the auto and steel industries, for example—two highly unionized sectors of the economy—have employer-contributed pensions which take no account of Social Security increases and which are paid in addition to full federal benefits.

COMMON IN OIL INDUSTRY

The offset method of calculation is common in the oil industry.

Exxon, the nation's second largest corporation in terms of sales, has an offset formula, as do Mobil, Standard Oil of California, Standard Oil of Indiana, Texaco, Skelly, Standard Oil of Ohio, Atlanta Richfield, Ashland, City Service, Continental, Marathon, Union Oil of California, Shell and Phillips.

The formula also is prevalent in the banking industry, for example, at Bank of America, San Francisco, the world's largest commercial bank, and the Bankers Trust Company New York, one of the nation's largest managers of pension and trust funds and one which has sought to be a leader in the fight for pension law reform.

International Telephone & Telegraph Corp. has an offset plan and General Electric and Westinghouse have variations of integrated Social Security-private pension plans.

How does the offset plan work.

TYPICAL PLAN

A typical example would be Mobil Oil Corp., said to have one of the oil industry's better retirement plans.

BEST COPY AVAILABLE

Mobils' final-pay benefit formula says that for each year with the company, a single employe receives 1.55% of his average annual pay during the highest paid five years of his or her last decade of service, offset by up to one-half of monthly Social Security benefits that the employe will receive directly from Washington.

Thus, an employe with 30 years of service averaging $10,000 a year and about to retire at age 62 (which Mobil allows with no loss of benefits) will receive a combined private pension—Social Security package approximating 64% of his final pay. If the employe is married, the pension will provide a little more.

A spokesman for Bankers Trust said this is a just formula because of the very large recent increases in corporate Social Security taxes, combined with the increased company cost of carrying private pension coverage.

A payout equal to 60% of an employe's top five earning years, less about one-half of Social Security benefits, "would be considered a generous plan," the Bankers Trust spokesman said.

Otherwise, he said, an employe could retire with more in pension payments than he had in working salary. Recent studies by Bankers Trust bear this out, he said.

A rule put into effect last year by the Internal Revenue Service, at the urging of Republican Sen. Jacob Javits of New York, the senior member on the Senate Labor Committee, now forbids companies to subtract from an individual's pension any Social Security benefit increases AFTER he has retired.

"STEP-UP" PLANS

Subtler ways of using Social Security involve 'step-up' plans under which an employer multiplies for example 1% by the taxable Social Security wage base plus, say, 2% by the excess of employe salary over the wage base, times years of service.

Actuaries say this is a common practice.

Merton Bernstein and Daniel Halperin, law professors at Ohio State and the University of Pennsylvania, respectively, recognized experts in the pension field, believe the step-up method discriminates against lower paid workers.

They point out that as Congress raises the taxable wage base, more and more lower paid workers are cut out of the 2% part of the formula.

Backers of the step-up plan say this is not so, since the formula is combined with full Social Security benefits.

Halperin, a Treasury tax official in 1966, noted that a move was made at that time by the then Treasury assistant secretary for tax policy, Stanley Furrey, to dilute this sort of integration formula.

But Furrey, then a leading advocate of tax reform, found himself faced with hundreds of protests from corporations, banks and actuaries.

Social Security taxes were raised by 20% last year, 10% in 1971 and by 15% in 1969.

The taxes to finance these increases are shared 50–50 by employe and employer. It currently stands at 5.85% of the taxable wage base (and is designed to remain at that level through 1976).

The present wage base is the first $10,800 of salary, scheduled to go up to $12,000 next year.

ESCALATION BUILT-IN

A new built-in cost-of-living escalator is expected to produce higher benefits by 1975.

Is this what Congress wanted when it passed the Social Security Act in 1935?

Much of the 1935 debate in the Senate centered on integration of public and private pension plans, said Murray Latimer in an interview.

Latimer, 72, was President Franklin D. Roosevelt's first director of federal old age benefits and is now a private consultant to the United Steel Workers Union.

He noted that the Senate wanted to allow private pension plans to take the place of Social Security if a company provided benefits at least equivalent to Social Security payouts. The House, however, never really debated this subject, he said.

Congressional intent was thus fuzzy when the first contributions began in 1937 and when the first monthly retirement benefits were paid out beginning on Jan. 1, 1940.

Corporate officials feel completely comfortable with the integration concept in devising retirement packages.

Frank Callicott, assistant vice president in charge of employe benefits for Bank of America, says that since the bank pays for one-half of Social Security benefits, "we feel that portion should be included in the formula which provides whatever level of benefit we think an employe should have."

MEANS TO AN END

Declared an Exxon spokesman, whose company, like B of A, has an offset formula: "(It's our) philosophy that we are establishing a target which is felt to be adequate for retirement purposes," and that the federal and private input into that equation is only a means to that end.

William Fellers, vice president of the Washington, D.C.-based Wyatt Co., one of the nation's largest actuaries, agrees that "the employer should take into account at least what he's paying for."

Given the expectation that Social Security benefits are expected to rise in future years, Fellers foresees a revival of the offset system, which had been diminishing in the past decade.

"The unions will probably kick like steers," he said.

A study last year by Bankers Trust of 84 of the nation's largest firms, indeed, showed that 47% had a formula like Mobil's, up from 43% in a similar 1970 study.

CENTRAL ISSUE

In a recent letter to the Internal Revenue Service on which pension concept should emerge in the coming years—plans which separate Social Security from private benefits like the steel industry's or plans which integrate the benefits as the oil industry—Fellers said the central issue becomes "who's going to provide pensions in the future"—the government or the private sector?

St. Croix of the oil workers union says the current system not only cheats the workers out of federally-approved pension benefits but allows the companies to recoup their Social Security tax contributions at the time the employee retires.

But C. Ashley Cooper, vice president of George B. Buck Consulting Actuaries Inc., a large New York-based actuarial firm, says, "The real issue of morality is whether the employe is properly informed about what you're trying to do."

On this subject of employe-employer communications, a congressional pension expert charges that "offset is a typical example of employers having pulled the wool over their employes' eyes. It is a disruptive device in the field of labor-management relations."

An executive with one of the nation's largest banks who will retire soon says the integration concept, particularly as used in offset plans, was wrong and had a "depressing effect" on employes about to face their retirement years.

"Social Security benefits should have no bearing on what a company will contribute," he says.

Ohio State's Bernstein points out the integrated pension issue generates little controversy because so few Americans understand it. Bernstein and others maintain, however, that notwithstanding the corporate posture—that it is a natural outgrowth of the original Social Security law—integrated pension plan benefits are one of the most important issues in the emerging debate over what is fair retirement compensation for the growing number of retired workers

THE OHIO STATE UNIVERSITY

Honorable Gaylord Nelson, Chairman
Honorable Lloyd M. Bentsen
Subcommittee on Pensions
Committee on Finance
U.S. Senate
Washington, D.C. 20510

Dear Senators Nelson and Bentsen:

The following should have been included in my letter of June 11:

The hearing did not address itself to fiduciary standards, although it was designed to do so and my statement briefly dealt with the subject.

It must be recognized that management and unions have interests in pension plans that frequently run counter to those of employee participants. Indeed, this is the situation in regard to most major aspects of plans.

By way of illustration, I call attention to the following passage from a Business Week article, "Are the Institutions Wrecking Wall Street" (June 2, 1973) page 58 at 60:

> Meanwhile, in their eagerness to contribute less of their earnings to their employee plans, corporations press their pension fund managers for pie-in-the-sky performance. In one tabulation of the instructions given managers by 40 corporations, 25 were insisting on "performance"; many ask their managers to outperform the S&P by 25% or more, a goal which would have called for a gain last year of nearly 20%.

A similar discussion can be found in the Wall Street Journal of March 13, 1973 entitled: "Companies Rely More on Gains in the Market to Finance Retirement." The descriptionsof "fast draw money managers" and "profit hungry [pension fund] investors" do not present a reassuring depiction of the impact of the drive to outperform the market that some commentators find foreboding. Indeed, this conduct calls into question one major justification for current pension fund reserves--their contribution to expansion of productive capacity. The "fast buck" mentality, which seems to be strong if not dominant, stems from management control over the bulk of private pension reserves.

Honorable Gaylord Nelson, Chairman
Honorable Lloyd M. Bentsen
June 12, 1973
Page 2

This risk-taking is at the expense of employee interests because most plans limit liability to contributions made or due according to the advice of actuaries--chosen by the employer trustees. Ensuing losses come out of benefits. The name of this game for employers is "heads I win, tails you [employees] lose."

Some of those risks would be shifted to the reinsurance program were one enacted. Whether or not reinsurance is adopted, pension reserves should be removed from the temptations they now present to employer and union officials. Illegality does not prevent high risk-taking. And even illegal transactions that are discovered do not result in adequate recovery. For example, in the United Mine Workers case, despite proof and findings of 20 years of improper trustee activity, relief was granted only for the three years preceding complaint.

Sincerely,
Merton C. Bernstein

Merton C. Bernstein
Professor of Law

MCB/bad

cc: Robert Willan, Esq., Staff, Committee on Finance, U.S. Senate
Richard Fay, Staff of Senator Nelson

[redacted]

THE OHIO STATE UNIVERSITY

Honorable Gaylord Nelson, Chairman
Subcommittee on Pensions
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Senator Nelson:

This letter supplements my statement before the Subcommittee on two points: (1) the appropriate agency to administer a pension reform measure and (2) the reduction in cost to current and new plans that could result from universal immediate or liberal vesting of all credits.

(1). The measures under active consideration, especially S.4, invest the administering authority with very wide discretion on crucial issues. For example, S.4 authorizes the Secretary to issue regulations defining units of service and to rule upon applications for the deferral of the vesting and fundings requiremen.s of the measure. If the extremely limited improvements of S.4 are to have any salutary effect at all, they will require administration in the interest of employee participants.

Neither the record nor the recognized constituencies of the Labor or Treasury Department fit them for the task. Labor's performance in the administration of the Labor-Management Reporting and Disclosure Act has been lacklustre, to put the matter kindly. Even under the administration of Secretary Wirtz, an individual dedicated to the highest standards of morality and individual rights, the indulgence of the Department toward union officials whose conduct proved culpable was nothing short of shocking. The sad history of the handling of the United Workers elections is only the most notorious case. Without impugning the bona fides of the great bulk of the Labor Department bureaucracy, the plain and indisputable fact is that organized labor has had a predominant influence in that Department for as long as any one can remember. Secretary Brennan's incumbency only emphasizes a long existing situation. The Labor Department's principle constituency has been and continues to be organized labor. Nor is it reassuring that the active support by three major unions for S.4 postdates the switch from the original Javits' bill's designation of an independent agency as administrator to S.4's designation of the Secretary of Labor.

For its part, the Treasury Department has not been a guardian of employee interests in pension plans. It is also a matter of history that the career lines of Internal Revenue Service personnel point directly at the private practice of law and accounting on behalf of the companies that constitute the employers under pension plans. The operations at district offices, in particular, are not subject to ready public scrutiny. The specialists in access to and dealings with IRS officials at all levels are the lawyers and accountants of employers.

In neither Labor nor IRS do I suggest corruption. Rather, the influence of constituency and career opportunities and the expertise of access built up over decades runs to unions at Labor and employers at Treasury. Hence neither is the appropriate agency to administer laws to protect employee interests against the subtle encroachment of union and employer interests.

A pension reform measure requires more independence from interest groups which only a new agency can achieve. I would suggest a three man board appointed by the President subject to Senate confirmation for long terms--say 10 years. Long tenure acts marvelously to make an individual independent, as the 15 year term of the Comptroller General of the United States demonstrates. One can recall that Comptroller General Campbell declared illegal the Dixon-Yates Contract for which he had voted as a member of the AEC. Indeed, serious consideration should be given to making the Pension Security Board a division of the General Accounting Office which has a great deal of investigatory, financial and statistical experience and sophistication. Beyond that, the statute should specify that the Board members should be independent of banks, insurance companies, employers and unions and would be prohibited from accepting any pension- or investment-related position in private employment for a period of 5 years after separation from Board service.

The independence of the staff is equally important. The agency must attract and hold experts who would not have an eye cocked toward private employment with the interest groups whose plans are regulated. To assure that, the statute should provide for a procedure akin to that employed by the Labor and Defense Departments in ascertaining prevailing wages--to periodically find out what comparable work done by various agency personnel pays in private employment and to mandate paying such amounts, including deferred compensation, plus a 5% amount in current salary. In this fashion, the career line would flow into the regulatory agency, attracting and holding the best people. This is not as expensive as it may sound when compared with current practices.

As it is, many government agencies, spend enormous funds on training personnel who aspire to private employment in the regulated industries, thereby causing some to seek to ingratiate themselves with prospective employers and also resulting in heavy government expenditures for training private employees.

(2). The cost of vesting constantly demands attention. My testimony contained a description of the savings that might be effectuated by immediate vesting where pension coverage is universal.

Let me supply another illustration. Assume a new company that hires a new complement of employees with, naturally enough, varying ages. Assume further that the goal of the new company's pension plan is to provide a benefit of $100 a month. Using the rates of a large insurance company (that are on the high side) the annual cost of such a benefit for an employee entering the new company's employ at age 45 would be $191.25. However, if the 45 year old came to the new company with 25/45th of the credits needed for a $100 benefit at age 65, the cost to the new employer of purchasing the last 20 units toward that $100 benefit would be $90.80. In other words, the effective crediting of yearly amounts sufficient to pay for a monthly benefit of $2.22 for each year of service beginning at age 20 substantially reduces the burden on the last employer in achieving a $100 monthly benefit.

It can readily be seen that a system of immediate vesting facilitates the establishment of a pension plan by a new company. (In contrast, a much higher cost of financing the full $100 now falls upon the new (the last) employer.) Vesting less liberal then immediate would result in similar savings but to a lesser degree. Early vesting also reduces the costs of extending a plan to a newly established unit of an existing company. Finally, universal, immediate or liberal vesting can reduce the annual pension costs of a plan for a going concern with a plan because the cost of vesting for separating employees is offset by the vested credits of incoming employees.

Hence, the estimates of vesting which do not take account of the potential cost reductions to new and existing plans due to the vested credits which new employees bring with them--that is, all estimates the Treasury and the Labor Committees of both houses have had made--overstate the cost of vesting because widespread vesting would enable each employer to plan upon providing not the full but only a part of the lifetime benefit.

Honorable Gaylord Nelson, Chairman
July 2, 1973
Page 4

Moreover, the Committees have not taken into account the very large amounts of actuarial gains made by existing plans during the several recessions of the 1960's which reduced expected plan costs. In sum, vesting costs are not the bugaboo claimed. More generous vesting than S.4 and the Bentsen bill contemplate are much more manageable than claimed. And more generous vesting is absolutely necessary if real reform is to be accomplished.

Sincerely,

Merton C. Bernstein

Merton C. Bernstein

MCB/bad

cc: Senators Ribicoff, Byrd, Bentson, Curtis, Dole and Roth

Law Offices of
Gall, Lane and Powell
1250 Connecticut Avenue
Washington, D.C. 20036

TELEPHONE
(202) 659-1600

JEROME POWELL
FRANK CUMMINGS
WILLIAM H WILLCOX
PETER F HEALEY
MAC S DUNAWAY
MARSHALL F BERMAN
BERNARD J CASEY

JOHN C. GALL (1941-1957)
JOHN F LANE (1941-1972)
WILLIAM F. HOWE (1943-1963)

JOHN CRIS POWELL
COUNSEL

The Honorable Gaylord Nelson
Chairman
Subcommittee on Pensions
Committee on Finance
United States Senate
Washington, D.C. 20510

Re: Supplement to My Testimony On Pension Plans
Delivered in Panel Discussion on June 4, 1973

Dear Sir:

At the close of the panel discussions before your subcommittee, you invited panelists to submit supplementary papers. On reviewing the supplementary paper submitted this week by John S. Nolan, I wish to add the following comments, in opposition to the suggestions made by Mr. Nolan.

Mr. Nolan makes two basic suggestions: (1) that employers meeting more rigid funding standards should not be subject to corporate liability for employee benefits in the event of plan termination, and (2) that fiduciary standards be weakened and made enforceable only by imposing on the fiduciary an excise tax similar to the one imposed by the 1969 Tax Reform Act on managers of private foundations.

I. With Respect to Plan Terminations

The only purpose in making the employer's general assets liable in the event of plan termination is to protect the central reinsurance fund, not to protect the employee (who is protected by the reinsurance fund in any event). So the question is: Is the scheme set forth in S.4 necessary to protect the reinsurance fund?

Mr. Nolan suggests that, if the plan is funding faster than S.4 requires (at 150 percent of the normal contribution), then the

The Honorable Gaylord Nelson
Page 2
June 27, 1973

employer's exposure should be limited to only 15 percent of benefit payments. That strikes me as unwise and unsound, for the following reasons. Whatever the plan's unfunded liabilities are, that is what they are. An old plan being funded at the S.4 schedule only, could be 50 percent unfunded. A young plan being funded at 150 percent of the S.4 schedule could still be 50 percent unfunded. If both terminated on the same day, both would be 50 percent unfunded. The employer under the old plan would have an exposure, under S.4, up to 50 percent of net worth; while the young plan would, under Mr. Nolan's proposal, have a lesser exposure -- provided he met all of the four conditions suggested by Mr. Nolan. But in either case, the exposure of the reinsurance fund would be the same -- 50 percent of benefits. I see no logical difference between the two situations which would justify a lesser exposure. The risk is the same. The premium for insurance is the same. And the subrogation should be the same.

Nor do I see any utility in the criterion suggested by Mr. Nolan limiting his proposal to plans terminated for "business reasons". Businessmen always have business reasons, and rightly so. The question is whether "business reasons" should justify a lesser liability to the reinsurance fund, to make up the losses of the fund. I fail to see the justification.

Moreover, if a terminating employer has a lesser liability to the fund to reimburse losses for unfunded benefits, the inevitable result will be higher reinsurance premiums for all other funds. The reinsurance fund, after all, is supposed to be "pari-mutual": if one employer pays less, another employer pays more. Why should employers who keep their pension promises have to pay higher premiums to make up for other employers who don't?

II. As to Fiduciary Responsibility

I believe Mr. Nolan's suggestion about fiduciary responsibility represents a fundamental diversion from the central purpose of a fiduciary responsibility law. He proposes that the enforcement mechanism for breach of fiduciary responsibility be an excise tax imposed upon the fiduciary,and leaves out the beneficiary. It doesn't necessarily restrain the fiduciary from breaching his responsibility; and it certainly doesn't restore the status quo ante. Instead, it simply makes the fiduciary poorer.

The object of a fiduciary responsibility law, however, is not to make the fiduciary poorer, but to make the fund securer. Under S.4, the controversy is between the fiduciary and the beneficiaries. They are the real parties. Unless that controversy is made justiciable as such, and unless the beneficiary can complain and obtain a remedy, fiduciary standards may well become a mere illusion -- as they now are, so often, under the "prohibited transactions" set forth in the Internal Revenue Code.

No effective pension remedy can be accomplished unless the beneficiaries themselves have direct standing to complain, and unless a federal agency can sue in their behalf. Tax penalties have their place, but after all, we do not enforce other forms of fiduciary standards that way.

We do not impose a prudent man rule on the executor of an estate by telling him that he may be subject to a tax if he abdicates his prudence. On the contrary, he is subject to the orders of a probate court. We do not tell the securities industry that it will be subject to a tax if it violates the Securities Act or the Exchange Act. On the contrary, we tell executors, trustees, brokers, dealers and insiders that they will be directly liable to private parties in the event of a breach. We do not tell bankers that they will be taxed if they violate banking laws. On the contrary, we tell them that they will be inspected and regulated directly by federal and state bank inspectors.

It is always painful to abandon an old scheme in favor of a new one. The pension sections of the Internal Revenue Code are an "old friend" -- they are familiar to tax practitioners and are even more familiar to a well-established branch of the IRS. No one is suggesting that these tax provisions, or the relevant bureau, be abolished. But they are not structured to deal with the problems covered by S.4.

A tax approach, as suggested by Mr. Nolan, would be most useful if Congress intends to substitute cosmetics for real pension reform. But if enforceable minimum pensions standards

The Honorable Gaylord Nelson
Page 4
June 27, 1973

are your objective, that can only be achieved by affirmative regulation, as in S.4, not by excise tax penalties, as proposed by Mr. Nolan.

With best wishes.

Sincerely,

Frank

Frank Cummings

lz

REFORMING PRIVATE PENSIONS

Testimony of Frank Cummings before a hearing of the
Committee on Finance
United States Senate
Monday, June 4, 1973

SUMMARY OF TESTIMONY

Page References

This testimony is in five parts, outlined in greater
ii-iii detail in the attached Table of Contents.

1-6 Part I is a general introduction, reviewing the principal complaints against the private pension system, the causes of those complaints (late-vesting, weak funding, ineffective fiduciary standards) and explaining why retirement planning as an individual-by-individual basis has failed.

Part II is a review of the current state of the pension
7-10 industry -- the statistical material on size, types of plans, benefit
11-20 levels, and forfeitures; the current legal framework and its weaknesses;
20-23 and the problems of the "professionals" who now work in the field
(lawyers, union leaders, corporate executives, accountants and actuaries
etc.)

Part III is a review of the current legislative proposals.
24-29 It includes, first, an analysis of "who should enforce pension
standards" and supports Labor Department enforcement; and it examines,
29-59 next, the various bills, concluding that S.4 is the preferable
measure as to vesting, funding, portability, reinsurance, fiduciary
standards, and enforcement. It also reviews the alternative proposals,
33-40 concluding that S.1179 and S.1631 are too weak to be effective, while
58-59 alternative "radical" proposals are both unrealistic and undesireable.

60-61 Part IV reviews possible costs, and concludes that the cost of any of the pending bills would be reasonably manageable.

61-64 And Part V concludes that while S.4 is not a perfect measure, its enactment is needed, but that it should be supplemented by tax measures (originating in the House) to allow individual tax-deferred retirement accounts.

BEST COPY AVAILABLE

TABLE OF CONTENTS

I. Introduction 1
A. Who Forfeits, and Why 1
1. Late Vesting 1
2. Weak Vesting 2
3. Some Sample Complaints 2
4. Fiduciary Standards 4
B. Why Individual Retirement Planning Has Failed 5
C. What is Needed: Comprehensive Re-Thinking of Our Approach to the System 6

II. The Current State of Things 7
A. Current Statistical Material 7
1. The Dimensions of the Pension Industry 7
2. Types of Plans 7
3. Benefit Levels 9
4. Forfeitures 9
B. Current Legal Requirements 11
1. Internal Revenue Code 11
(a) General Rules 11
(b) "Prohibited Transactions" 12
2. Welfare and Pension Plans Disclosure Act 13
3. Securities Acts 14
4. National Labor Relations Act 14
5. Other Statutory Provisions 15
6. Weaknesses in Ordinary Trust Law, and Enforcement Problems 16
C. The Weaknesses Inherent in the Current Dynamics of Private Pension Planning; the "Professionals" 20
1. Lawyers 20
2. Union Leaders and Corporate Executives 21
3. Actuaries and Accountants 22

III. The Proposals 23
A. Who Should Enforce Pension Standards, and by What Medium? 24
B. How the IRS "Enforces" the Code 25
C. Enforcement of "Requirements" (as Distinguished from Tax Qualifications) 26
D. A Choice of Agnncies 27
E. What Should the Standards Be? 29
1. Vesting 29
(a) Earning a Pension When You Are Young -- The Arithmetic of Vested Pension Accruals 29
(b) The Vesting Standards in S.4 32
(c) The Vesting Standards in the Administration Bill, S.1631 -- the "Rule of 50" 33

BEST COPY AVAILABLE

(d) The Vesting Standard in the Bentsen Bill -- S. 1179 34
2. Funding 35
(a) General Standards for Evaluating Funding Requirements 35
(b) The S.4 Funding Requirements 37
(c) The S.1631 Funding Requirements 38
(d) The S.1179 Funding Requirements 39
(e) A Comment on "Experience Deficiencies" . . . 39
(f) Current Funding Practices 40
3. "Portability" 40
4. Reinsurance 42
5. Fiduciary Standards 44
(a) Who is a "Fiduciary"? 44
(b) "Employee Benefit Funds" 44
(c) Trust Requirement 45
(d) The Prudent Man Rule 46
(e) Governing Documents 46
(f) Prohibited Transactions and Exceptions . . . 47
(i) Prohibitions 47
(a) "Party in Interest" 47
(b) Prohibited Transactions 48
(ii) Exceptions to Prohibitions 49
(g) Liabilities of a Fiduciary 51
(h) Co-Fiduciaries, and Allocation of Responsibilities 51
(i) Double Fees or Commissions Prohibited . . . 52
(j) Effective Dates 53
(k) Fiduciary Standards in S.1179 and S.1631 . . 54
6. Enforcement Provisions 54
7. Federal Preemption 56
F. Tax Deductible Contributions 57
G. A Comment on the More Extreme Proposals 58

IV. Costs 60

V. Conclusion 61

REFORMING PRIVATE PENSIONS

Testimony of Frank Cummings* before a hearing of the
Committee on Finance
United States Senate
Monday, June 4, 1973

I. Introduction

A. Who Forfeits, and Why

1. Late Vesting

Too few participants who work "under" private pension plans actually get a pension; and too many who work long years -- 10, 20, 25 or more years -- get nothing.

They get nothing, not because of evil men or bad motives, but because of badly designed plans, many of which fail to provide reasonably attainable vested non-forfeitable interests, or even provide no vesting at all even after long years of work, unless the employee actually reaches retirement age in the employ of the same employer. And Americans no longer typically do that -- instead, they are mobile, moving from job to job, and forfeiting pension after pension along the way.

*Mr. Cummings is a partner in the Washington, D.C. law firm, Gall, Lane & Powell, and a lecturer at Columbia Law School, Columbia University, New York City, and a Public Member of the U.S. Labor Department's Advisory Council on Employee Welfare and Pension Benefit Plans. He was formerly Minority General Counsel of the Senate Labor and Public Welfare Committee.

That is the vesting side of the controversy.

2. Weak Funding

But there is also a funding side: There are too many plans in which the pension "promise" -- even if vested -- is so woefully underfunded that, if the employing enterprise should terminate, it might as well be no promise at all.

3. Some Sample Complaints

Here are some of the cases which keep turning up with increasing frequency. These are seven case histories quoted verbatim from a recent Report of the Senate Labor Subcommittee (S. Rep. No. 92-634, 92d Cong., 2d Sess. 87-88 (1972)):

"Case Number 1 -- Underfunding

> "A large steel mill engaged in the production of iron and steel materials maintains a pension plan with total assets of $19 1/2 million. However, its accrued vested liabilities are in excess of $66 million. In the event of plan termination, under its current financial structure, less than 1/3 of accrued vested benefits could be paid through available pension assets. This plan started in 1950, and the employer is funding only current benefits costs.

"Case Number 2 -- Vesting

> "This employer is a nation-wide department store whose pension plan contains no vesting provisions prior to qualifying for early retirement. Early retirement requirements consist of age 55 and 15 years of continuous service, or age 50 and 20 years continuous service. Under the terms of plan eligibility, any worker of the thousands employed who would terminate employment prior to attaining age 50 will forfeit all benefits, not withstanding the number of years of employment.

"Case Number 3 -- Vesting

"An aircraft manufacturer in the Midwest established a pension plan providing for vesting of benefits at a combination of age plus service to total 60. This results in a new employee, who begins to work at age 20, to be required to work 20 years to receive vesting at age 40. Conversely, an employee hired at age 50 would only be required to work 5 years to vest at age 55. This vesting formula is a deterrent to employers to hire older people because of the shorter vesting period required.

"Case Number 4 -- Portability

"Mr. X began employment for a Midwest meat-packing company in 1927, at one of the employer's two plants in the same city. During World War II, he was sent to work in the other plant in the city because of the need to fulfill government contracts. He remained there until 1965 when the plant closed. The employer would not permit him to transfer back to the former plant as a regular employee, but only as a casual and intermittent laborer at the former plant. When the plant was closed, Mr. X was paid a total of $231.55 for his accrued pension benefits, despite 38 years of continuous employment with the same employer. Since he was reemployed in his old plant as a casual laborer, he was not eligible for any pension benefits after 1965. In 1970, he was dismissed because he was overage at 65. He did not recieve any pension benefits. In sum, this employee was dismissed at age 66 after 43 years of continuous employment with the same employer and with no benefits to him except $231.55, paid to him in 1965. Had he been permitted to carry his pension benefits and credits from both plants with the same employer, which were located a few streets apart, Mr. X would have been eligible for a pension.

"Case Number 5 -- Vesting

"The pension plan of a large cotton-milling company provides for vesting at age 55 with 20 yaars of service. Although the accrued vested liabilities were less than $5 million, the pension fund contains over $30 million in assets. This obvious overfunding is attributable to the stringent vesting provisions which drastically reduced eligibility for benefits.

"Case Number 6 -- Overfunding

"This pension plan belongs to one of the largest retail food chains in the United States. As of December 31, 1969, the pension plan assets' value totaled $118 million, and total accrued vested benefits were $60 million. The plan's vesting requirement is age 50 and 20 years of service.

"Case Number 7 -- Vesting

"A large hardware manufacturer purchased a manufacturing plant in 1958 at Trenton, New Jersey. At the time of purchase, the plant maintained a pension plan to which the employer was contributing 18 1/2¢ per hour. The plan contained vesting provisions. The new owners negotiated a new contract with the union representing the workers and eliminating the vesting and fixed funding by the employer. In 1970, the company relocated the plant to the Midwest to cut production costs. None of the 333 employees were allowed to go to the new plant, despite the fact that some of them were within a few months of retirement eligibility. Of the employees, 8 were over 65 years of age and were permitted to retire. The remaining workers were dismissed and received no pension benefits whatsoever. Of these, 175 employees were over 40 years of age; 32 of them had in excess of 30 years of service. With respect to fund assets existing at the time of acquisition in 1958, the employer has consistently claimed that all rights by union and employees wree relinquished when the contract was renegotiated in 1958."

As you can see, these cases deal primarily with vesting and funding (and I include the subject of "reinsurance" as an aspect of any realistic solution to the funding problem).

4. Fiduciary Standards

The other side of the pension controversy has to do with fiduciary standards and the prohibition of unethical conduct and conflicts of interest in the handling of pension funds -- of which the most notable recent case history involved the deposit of vast pension reserves of The United Mine Workers Welfare and Retirement Fund in a non-interest bearing account in a bank owned by The United Mine Workers of America. Blankenship v. Boyle, 329 F. Supp. 1089 (D.D.C. 1971), 337 F. Supp. 296 (D.D.C. 1972).

B. Why Individual Retirement Planning Has Failed

Faced with these and certain other difficulties in obtaining real security from the private pension plan system, many employees have sought solutions on an individual basis, and on occasion, devices have been found which are of some help, but here the strictures of the Internal Revenue Code are sometimes less of a help than a hindrance.

A pension on an individual basis faces these alternatives: (1) if an employee contributes his own money, he loses the tax advantages of Sections 401-404 of the Code; (2) if the employer pays for it, it will most often be discriminatory in violation of Section 401, and so those advantages are likewise lost; (3) as of this year, the IRS is taking one more step to demolish an individual's option to do his own pension planning, by charging the individual with immediate constructive receipt of any compensation he elects to defer by using a "salary reduction agreement" providing for employer contributions to a pension plan in the same amount as the salary reduction (Proposed Treas, Reg., 37 Fed. Reg. 25938 (12-6-72)); (4) which still leaves the employee the option of a simple deferred compensation agreement, without tax deferral for the employee unless the plan is either unvested (which risks forfeiture) or unfunded (which risks non-payment) (Rev. Rul. 60-31, 1960-1, Cum. Bull. 174).

C. What is Needed: Comprehensive Re-Thinking of Our Approach to the System

So what is needed is some new, comprehensive, and humane re-thinking of our over-all approach to private pensions.

Doubtless there will be some cost in any new approach, but we already pay a substantial cost whenever we let a worker retire without adequate resources -- a cost in welfare and related programs, in loss of purchasing power in a significant segment of our economy, and in loss of morale and productivity. Surely there is some cost in pension reform, but it needs to be evaluated against the benefits to be gained as a result. And the cost need not be high.

But if we are going to pay any cost for reform of the private pension system, we ought to make sure we get our money's worth.

Before getting into the details of legislation, however, we ought to examine, first, where we are now: The dimensions of the pension industry (current statistical material), the current legal framework in which the industry operates, and the techniques and dynamics of the "professionals" in the field.

II. The Current State of Things

A. Current Statistical Material

1. The Dimensions of the Pension Industry

The size of private pension reserves, in the aggregate, is now in excess of $166 billion (SEC. Statistical Bulletin, Vol. 32, No. 8, 4/4/73), with another $148 billion in public pension funds. The growth of the private total has been in the neighborhood of 10% per year.

As far as I can tell, this represents the largest aggregate of essentially unregulated capital in the Nation.

2. Types of Plans

The Senate Labor Subcommittee completed, last year, a "Statistical Analysis of Major Characteristics of Private Pension Plans" (republished in S. Rep. No. 92-1150, 92d Cong., 2d Sess. 73-148 (1972)). The study itself was based on answers to a 32-page questionnaire sent out to a carefully-designed cross-section of the industry (a total of 1500 plans were surveyed).

The major conclusions were these (*id.* at 115-16):

> "1. Approximately one-third of the pension plans studied had both a minimum age and service requirement for participation in a pension plan. An additional 25 percent had a minimum service requirement only, and approximately 35 percent of the plans had no age or service requirements for eligibiltiy to participate.
>
> "2. The most common normal retirement age was 65 (occuring in almost 90 percent of the plans). In over half of these plans, a service requirement also existed, in a few cases as much as 30 years. In the

case of over one-fourth of all participants, attainment of age 65 and at least 15 years of service was required for a normal retirement benefit.

"3. About 13 percent of the plans studied did not provide for any vesting at all. For those plans which had vesting provisions expressed as a combination of age and service, the combinations most frequently encountered were in the range of from 40 to 44 years of age with from 15 to 19 years of service. However, more stringent vesting formulas were also encountered; 8 percent of the plans had both an age and a service vesting qualification which required at least age 50 and 20 years of service for a vesting right. In the plans where only a service requirement was established for vesting, over one-fourth of these plans required more than 15 years of service to qualify. Among pension plans containing vesting provisions, over 55 percent had only a service requirement.

"4. Over 30 percent of private pension plans were utilizing a deferred graded form of vesting, by which a certain percentage of a participant's accrued retirement benefit is vested initially, and the percentage increases periodically as the employee completes additional service. Profit-sharing plans utilize this type of vesting more frequently (over three fourths of all such plans).

"5. Information regarding the assets and liabilities of pension plans was reported inconsistently and incompletely by a sizable number of pension plans. However, of those plans which did report appropriately, over 45 percent had a ratio of assets (valued at market) to total liabilities of over 75 percent, and three-fourths of the plans had a ratio of market assets (valued at market) to vested liabilities of over 75 percent. While this finding established that a majority of pension funds are generally well-funded, the responses also revealed a significant minority of plans which were substantially underfunded. Over 10 percent of the plans reporting disclosed a ratio of assets (valued at market) to vested liabilities of 50 percent or less.

> "6. Only 40 percent of private pension plans had formal restrictions pertaining to investment of pension plans assets, and less than one-half of all plans required annual audits by an independent licensed or certified public accountant.
>
> "7. Over 35 percent of the pension plans studied, covering a similar number of participants, did not provide an opportunity for participants to request a hearing on claims; less than 30 percent of all plans provided for a written denial of such claims; and only 30 percent of all plans provided for review procedures with respect to denial of claims." (Emphasis added).

3. Benefit Levels

The Senate Labor Subcommittee also extracted, from the answers to the same questionnaires, benefit level data which was published in its 1971-72 Interim Report, S. Rep. No. 92-634, 92d Cong., 2d Sess. 26 (1972). The key result was the disclosure that the median normal retirement benefit level under private plans is $99 per month.

4. Forfeitures

What becomes of individual participants, working (and moving) within this system? No really comprehensive study has yet been made -- and perhaps none can be made, because of the difficulty inherent in tracing individuals as they move from plan to plan. The Senate Labor Subcommittee did do a limited study of 87 plans -- 51 with no vesting or late vesting, and 36 with vesting after 10 years of service or less. The Report contains the following summary (S. Rep. No. 92-634, 92d Cong., 2d Sess. 129 (1972)):

"1. Four percent of all participants since 1950 in the 51 no vesting or later vesting plans have received normal, early or deferred retirement benefits; eight percent of all participants in the 36 earlier vesting plans have received such benefits.

"2. Five percent of all active participants since 1950 who left the plans have received normal early or deferred retirement benefits; 16 percent of all active participants since 1950 who left the 36 plans have received such benefits.

"3. 70 percent of all participants since 1950 in the 51 plans have forfeited without qualifying for benefits; 38 percent in the 36 plans have forfeited without qualifying for benefits.

"4. 92 percent of all active participants since 1950 who left the 51 plans forfeited without qualifying for benefits; 73 percent of all active participants since 1950 who left the 36 plans forfeited without qualifying for benefits.

"5. Of the total forfeitures in the 51 plans since 1950, 85 percent were participants with five years service or less; of total forfeitures in the 36 plans since 1950, 80 percent were participants with five years service or less.

"6. In the 51 plans, for every two participants who has received a normal, early or deferred retirement benefit since 1950, one participant forfeited with more than 15 years service, for every one participant who received a benefit, one participant with more than ten years service forfeited, three participants with more than five years service forfeited, and 16 participants with more than five years service or less forfeited.

"7. In the 36 plans, for every one participant with more than 15 years service who forfeited since 1950, 24 participants received a normal, early or deferred retirement benefits; for every participant with more than 10 years service who forfeited, seven participants received such benefits; for every participant with more than five years service who forfeited, one participant received such a benefit; for every participant who received such a benefit, four employees with five years service or less forfeited." (Emphasis added).

We cannot say, of course, whether the employees who forfeited under these plans got other jobs with other employers under other plans and eventually earned a pension elsewhere. We only know they worked a long time for nothing under these plans.

B. Current Legal Requirements

1. Internal Revenue Code

(a) General Rules

The Code now grants three significant tax advantages to a "qualified" pension plan which, together, constitute a gigantic "bonus" from our tax laws.

The employer gets a tax deduction for his contributions to the plan (Int. Rev. Code §404).

The employee, for whose benefit the contributions are made, gets a tax deferral -- that is, he is not taxable on the money contributed on his behalf until a much later time when he retires (a time when his tax bracket is much lower) (Int. Rev. Code §§402, 403, 72).

And the trust fund itself may accrue income, dividends, and capital gains, without any tax whatever on its own income or growth. (Int. Rev. Code §§401, 501(a)).

All this the government grants to private pension plans because these plans serve a socially useful purpose.

But do they? Some do, but many do not, and they need not in order to remain "qualified" under the Code. For, absent special circumstances, the Code requires no vesting at all until the employee actually retires, and no funding beyond payment of current service costs plus an amount equal to "interest" on unfunded past service liabilities (he need never fund those liabilities at all) (Rev. Rul. 69-421, Part 6(d)). And so the irony is not only that the Studebaker plan could pay only 15 percent of vested benefits to employees when its South Bend plant shut down in 1964 (Federal Reinsurance of Private Pension Plans, Hearings Before the Committee on Finance, United States Senate, on S. 1575, 89th Cong., 2d Sess. 50 (1966)), but also that the very same thing -- and worse -- can still happen, without loss of tax qualifications, and no matter how "mature" the plan is. For Studebaker's plan had some vesting (10 years and age 40) (ibid.), and funding of past service liabilities over 30 years (id. at 112), but the plan was only 14 years old (ibid.).

Studebaker's plan had vesting and funding, but it need not have so provided, under the Code as it existed then, nor as the Code exists today. A plan may be 100 years old and still not have funded past service costs; it may provide no vesting at all; and in either event -- or both -- the plan may still remain "qualified" under the Code.

(b) "Prohibited Transactions"

The Code does touch upon fiduciary standards, in the sense that it contains a list of prohibited transactions (§503). But this does not prohibit the trust, for example, from investing in the securiteis of the employer, which results in subjecting

BEST COPY AVAILABLE

the plan to the same risks as if it were unfunded -- if the employer collapses, so does the plan.

And even if the Code did prohibit effectively all self-dealing, what would be the remedy? If a beneficiary complains and the plan is disqualified, the fund loses its tax exemption, and the employee loses even more of his retirement security.

2. The Welfare and Pension Plans Disclosure Act

Setting aside the bonding requirements (which were added to the Act after its original passage and have no real effect on "who gets what"), this law creates a whole set of disclosure requirements, and a whole agency full of files, but under it, a plan can do just about anything, so long as it is "disclosed" -- and believe it or not we have had Congressional investigations which turned up all sorts of misappropriations of pension funds, which were, in fact, "disclosed" in the sense that the actions of the trustees were duly filed under this act. Indeed, even when the Labor Department discovers inadequate disclosure in a case such as this, the remedy is simply to ask the plan to amend its disclosure forms to add additional information -- which in turn rarely does the individual pension participant any good. See Hearings Before the Permanent Investigations Subcommittee, U.S. Senate Committee on Government Operation, on Diversion of Union Welfare-Pension Funds of Allied Trades Council and Teamsters Local 815, 89th Cong. 1st Sess. 482 (1965) ; S. Rep. No. 1348, 89th Cong. 2d Sess. 27 (1965).

BEST COPY AVAILABLE

3. Securities Acts

Some time ago, there was a developing interest in pension plans, particularly profit-sharing retirement plans, insofar as they created "securities" under various securities acts. SEC v. Variable Annuity Life Ins. Co., 79 Sup. Ct. 618, 359 U.S. 65 (1959), reversing 257 F.2d 201 (2d Cir. 1958); Prudential Ins. Co. v. SEC, 326 F.2d 383 (3d Cir. 1964), cert. denied, 377, U.S. 953 (1964). But the inerest in pension plans has been somewhat diminished, with two exceptions, by later amendments. See Institutional Investor Study, Report of the Securities and Exchange Commission, Summary Volume, H. Doc. No. 92-64, Part 8, at 69-70 (1971).

Outside the area of registration requirements of the Securities Acts, there has been some litigation concerning the application fo fiduciary standards in these laws, and that controversy continues. See Local 734 Bakery Drivers Pension Fund Trust v. Continental Illinois National Bank, Dkt. No. 72 Civ 2551 (N.D. Ill. 1972); and the general discussion in Panel Discussion, Conflicts of Interest and the Regulation of Securities, 28 Business Lawyer 545 (1973).

4. National Labor Relations Act

Again, we have peripheral regulation, but not really affecting the central issues under discussion here. Pensions are a mandatory bargaining issue (Inland Steel Co. v. NLRB, 170 F.2d 247 (7th Cir. 1948), cert. denied on this issue, 336 U.S. 960 (1949), affirmed on other grounds sub nom. Communications Assn. v. Douds, 339 U.S. 382 (1950)), although recently the benefit levels of those already retired turned out to be only a permissive bargaining subject (Chemical Workers v. Pittsburgh Plate Glass Co., 30 L. Ed. 2d 341, 78 L.R.R.M. 2974 (1971))--a distinction which I suspect will turn out to be more technical than real.

We also know that a plan cannot, on its face, limit participation on the basis of union membership of lack of it (Kroger Co., 164 N.L.R.B. 362 (1967), enforced in part, 401 F.2d 682 (6th Cir. 1968), cert. denied, 395 U.S. 904 (1969)), but such a restriction is again more apparent than real, as one generally can limit plans to "hourly paid", etc., and get the same result.

The real discrimination -- against all but those employees who manage to stay with one employer until retirement age-- is not covered by the act.

5. Other Statutory Provisions

One could go on and on, reviewing what law there is on this subject. There is section 302(c) of the Labor-Management Relations Act, which exerts some limits on fiduciary practices, insofar as they fall within the context of "bribery" of a union official. There is title VII of the Civil Rights Act, which has generated considerable litigation lately concerning sex discrimination in the benefit structure of benefit plans (different retirement ages, discrimination as to maternity benefits in the context of disability insurance, etc.).

And there are innumerable State laws, and the State common law in every State, which have some influence in this area.

But I have yet to find any law now on the books which has any really substantial impact on "Who gets what, and when," i.e., on vesting, funding, reinsurance and fiduciary standards, so we are breaking new ground--at least in the United States, although there are other nations which are far ahead of us (see, *e.g.*, the Ontario Pension Benefits Act, 1965, c. 96, as amended).

6. Weaknesses in Ordinary Trust Law, and Enforcement Problems

Ordinary trust law ordinarily applies only to trustees in the classic sense, and key decisions in pension administration are often made by persons not holding the legal status of trustee. Pension administrators need not be trustees. Investment discretion may be vested in labor-management committees who are not trustees in the legal sense. All sorts of other persons -- investment counselors, actuaries, accountants, employers, unions, and others -- may effectively be making fiduciary decisions while not occupying the legal position of a fiduciary.

The lack of comprehensiveness in ordinary trust law once led a Senate Subcommittee to conclude that "the application of well-established doctrines of trust law to the field of employee benefit trust funds is a most difficult task". S. Rep. No. 1734, 84th Cong. 1st Sess. (1956). The American Bar Association's *Report of the*

Committee on Trust Administration and Accounting, Exculpatory Clauses/Their Legal Significance, Vol. I, No. 4, Real Prop. Prob. & Trust 530 (Winter 1966), observed: "Under the typical employee benefit trust agreement the beneficiaries (the employee participants) have very insubstantial enforceable rights." Thus, it has been possible for courts to hold that the exercise of rights reserved by the employer with respect to a pension plan conclusive "in the absence of fraud or such gross mistakes as imply bad faith or a failure to exercise an honest judgment", and evidence to sustain the burden of showing such fraud, bad faith, or mistake "must be more than a mere preponderance, it must be overwhelming." Menke v. Thompson, 140 F.2d 786, 791 (8th Cir. 1944).

Even the rights a pension participant has tend to be illusory when he tries to use legal processes which might seem, at a first glance, to be available to him. See generally Elliott, Federal Fiduciary Standards for Welfare and Pension Plans 366 (1968) (published by the Association of Life Insurance Counsel); Levin, Proposals to Eliminate Inequitable Loss of Pension Benefits, 15 Villanova L. Rev. 527, 566 (1970).

Consider the average problem faced by a lawyer when a potential client walks through his door and says either "they owe me a pension," or "they are misusing the money in the pension fund".

The lawyer asks, "Who are they?" How many employees know the corporate name of the employer, the exact name and location of the trust and trustees, the location of the bank holding the money, the name of the insurance company through which the plan is funded, if it is funded that way, the identity and addresses of the unions involved, including the international and local unions and their officers, and those of the officers who have been designated as trustees? How many employees even know the real name of the plan or the trust or its technical terms?

But assume, as you have no right to assume in most cases, that the employee knows the answers to all those questions. Then the legal problems have just begun. Whose law applies? The bank is in one state, the corporation in another state, the employees in several other states, the union in another state, and the contract may not specify a choice of law.

But even if you could decide (probably after costly litigation) which law applies, what court would have jurisdiction to serve process in all those states, and bring in all the necessary parties? I know of none -- and that includes any federal court, which, of course, can serve process only within the state in which it sits. Fed. R. Civ. P.4(f).

But assume further, as you have no right to assume in most cases, that you could find a court able to serve process on all the necessary parties. What would you sue for?

If you are suing not for a pension but to stop misuse of the money by the trustees, the recovery goes not to the plaintiff employee but back into the fund. It is essentially a derivative action, from which the plaintiff recovers nothing but increased security for his pension expectancy.

If, on the other hand, the employee is suing for a pension, the recovery is the discounted value of one pension (unless the plaintiff can put together a rare class action, or unless a union is financing the lawsuit at substantial expense to itself). Now consider the cost of litigating those very complex questions of law which I have just discussed. How much is the lawyer going to charge for this lawsuit? In most cases, even if the lawyer takes only a minimal fee for this elaborate lawsuit, his fee will necessarily far exceed the amount of recovery (the discounted value of one pension). And to compound the problem, keep in mind that most misdeeds by pension administrators are brought to light in lawsuits by employees who have yet to vest, so that even if you win, your client doesn't get the recovery, and he may not even get a pension either.

Of course, there are class actions, which work on occasion. There are lawsuits financed by persons other than individual pension participants (e.g., a union, by resort to its treasury), and so forth. But most pension claims, if they are for benefits, are unpromising. And if the action is simply to rectify a breach of fiduciary standards not involving an actual denial of benefits, the recovery, after all, goes back into the fund, not to the individual participant, and so the plaintiff is financing a lawsuit somewhat in the public interest -- at considerable (usually prohibitive) expense to himself. And if the plaintiff is already retired, he may not live long enough to enjoy the benefits of his recovery.

In short, private lawsuits, under existing law, do not provide a meaningful remedy for the employee in most pension cases. What is needed is a national law, with a national agency to enforce it, which will get this whole matter out of the area of ordinary, garden variety, litigation, which simply does not work.

C. The Weaknesses Inherent in the Current Dynamics of Private Pension Planning; The "Professionals"

A wide variety of professionals are at work in the private pension system. The key men are lawyers, accountants, actuaries, union leaders, corporate financial executives, and professional pension planners and consultants (who are often actuaries or lawyers -- but need not be).

1. Lawyers

First, a few words about the lawyers -- and what I have to say here is not absolute, and leaves room for many notable exceptions (hopefully including myself). Most lawyers working regularly in this feeld are tax lawyers, because the principal "rules of the game" are tax rules. The client is the contributing corporation, and the object is to secure tax qualification. That is certainly a legitimate and necessary objective, but, as noted above, it has little to do with the beneficiary's income security.

The rest of the legal profession -- labor lawyers included -- seems to have abdicated in favor of the tax lawyers. That, in my view, is a tragedy, because too often (though not always) no one is representing the interests of the beneficiaries at the planning stage.

2. Union Leaders and Corporate Executives

Our system of collective bargaining assumes -- correctly, I believe, in most cases -- that the union protects the employee's interests, and that the employer protects corporate financial interests, leading eventually to some viable compromise. Only rarely do we look behind the union's demands to see if individual concerns are being properly represented, e.g., Vaca v. Sipes, 386 U.S. 171 (1967), and bargaining is not even required as to pension rights of those already retired. Compare Allied Chemical Workers v. Pittsburgh Plate Glass Co., 404 U.S. 157 (1971), with Inland Steel Co. v. NLRB, 170 F.2d 247 (7th Cir. 1948), cert. denied on this issue, 336 U.S. 960 (1949), affirmed on other grounds sub. nom. Communications Assn. v. Douds, 339 U.S. 382 (1950).

But a union, after all, is supposed to be a democratic organization, and, if it is, most often it is dominated by its younger members who have little concern with pensions. Thus, many pension plans have developed with benefit levels which increase, year after year, but with vesting so deferred that only a few members ever actually receive those benefits. There are notable exceptions, of course -- for example, the Steelworkers and Auto

Workers. Those exceptions tend to occur in industries where strong seniority systems protect the older workers from layoff and permit the median age of the work force to rise. But, too often, unions (particularly those representing low wage workers) are either unable or unwilling to press for earlier vesting. See, e.g., Testimony of Andrew Biemiller for the AFL-CIO, in Hearings Before the Subcommittee on Labor, Committee on Labor and Public Welfare, on S.3598, 92d Cong., 2d Sess., part 3, at 1114 (1972).

Employers, on the other hand, cannot reasonably be expected to fight hard for a reallocation of dollars already spent. Once the bargaining process has settled on a dollar figure -- total increased labor cost to reach a settlement -- if the union wants X% of it in wages and Y% in pensions, no employer in his right mind would take a strike to force an increase in Y and a corresponding decrease in X, if the total is the same!

In short, the dynamics of collective bargaining simply break down -- not always, but often -- when it comes to pensions.

3. Actuaries and Accountants

Accountants audit, actuaries project. An accountant can tell you what your assets and liabilities are now, but a pension plan needs to know whether, 20 years from now, the plan will be solvent, after projecting over that period of time such variables as interest rates, contribution rates, employee turnover, life expectancy, and other factors which make up the lexicon of "actuarial assumptions."

The irony is that the accountants are licensed, but the actuaries -- who are the key men -- are not licensed in any state. Most actuaries are highly skilled professionals, but they need not be, and at least a significant number of them are nothing more than salesmen, who package and sell pension plans, tailored to suit the needs of "buyers" who want a decent benefit level at minimum cost (an easily obtainable objective if the plan is set up so that almost everyone forfeits his credits). Again, not all of the "salesmen" function this way -- but a substantial number do.

In sum, the professionals at work in this system give us no real assurance that the legitimate pension expectations of long-service workers will be realized.

What is needed is a new law.

III. The Proposals

Last year there were dozens of pension reform bills, but none passed, though one -- S.3598 (renumbered as S.4 this year) -- was favorably reported from the Senate Labor and Public Welfare Committee.

This year, we have roughly the same array of bills, and S.4 is once again on the Senate Floor Calendar.

Before getting into the vesting-funding rules, etc., however, some consideration should be given to the jurisdictional issues.

A. Who Should Enforce Pension Standards, and by What Medium?

The IRS collects taxes; it does not (cannot, will not) enforce private rights.

The Labor Department enforces employee rights; it does not (cannot, will not) collect taxes.

You may ask, if you wish, "Who should enforce pension standards?" But the question, standing alone, is meaningless, and no one is seriously asking that question.

No one has suggested that S.4 be amended by striking out the term "Secretary of Labor" and substituting, instead, the term "the Secretary of the Treasury". Indeed, if that were the only proposal, the Secretary of the Treasury would be horrified by the prospect, and he would be completely unequipped to deal with administration of S.4 -- just as unequipped as the Secretary of Labor would be if he were suddenly given responsibility for administering Sections 401-404 of the Internal Revenue Code.

The real question is not "Who should enforce?", but rather, "What kind of a law do you want?" Once you decide what kind of a law you want, the enforcement question almost answers itself.

The Internal Revenue Code asserts a hypothetical imperative: "If you want these tax benefits, then you must qualify under these standards."

S.4, on the other hand, asserts a catagorical imperative: "You must conform to these standards" (no "if's" about it).

B. How the IRS "Enforces" the Code

The IRS is not essentially an investigating and enforcing agency. The initiative ordinarily comes from the taxpayer. He claims the deduction, and the IRS then reviews his claim.

The controversy is essentially between (a) the person who files a tax return, and (b) the IRS who reviews it. Indeed, if a pension participant were to go to the IRS and complain, and if he were permitted to review these tax returns (as he may not be), he would only be cutting his own throat. The most he could accomplish would be to disqualify the plan, and if he did so, he would be, in effect, reducing his own pension.

I was counsel for the Labor Subcommittee just last year in hearings involving underfunding of a pension plan of employees of American Zinc Company. The attorney for those employees testified as follows:

> "MR. CUMMINGS: As far as you know, this is a tax-qualifed pension plan, is that correct?
>
> MISS HILLMANN: As far as we know, yes. We have been so informed by the company.
>
> MR. CUMMINGS: I take it you are aware that, at least under the present interpretations of the Internal Revenue Code, a continuing plan has the obligation to fund no less than current service costs, plus an amount equal to interest on past unfunded credits, and 1 take it that what you are saying is that they have not even complied with the requirements of the IRS; is that right?
>
> MISS HILLMANN: The information we have now leads us to believe so, yes.
>
> MR. CUMMINGS: Do you have any information which would suggest that the IRS ever took any notice of the fact that this plan was not complying with the code?

MISS HILLMANN: We have no such information, no.

MR. CUMMINGS: And I take it, finally, just to let the record show, that if you had known that it wasn't complying with the code and sought to enforce the code, you would have only cut the throats of your own members by disqualifying the plan?

MISS HILLMANN: Right. We are in a real bind here.

MR. CUMMINGS: So those requirements put you in a vicious circle, I take it, where the only remedy you get is to take money away from your own members?

MISS HILLMANN: That's correct."

(Private Welfare and Pension Plan Study, 1972, Hearings Before the Subcommittee on Labor, Committee on Labor and Public Welfare, United States Senate, 92d Cong. 2d Sess., Part 1, at 378 (1972)).

C. Enforcement of "Requirements" (as Distinguished from Tax Qualifications)

As to the catagorical imperatives of S.4, on the other hand, the enforcement structure is set up so as to invite pension participants to come in and tell the enforcement agency when the requirements of law are not being met. And if they are not met, the government is given the power, not to tax and penalize the fund (and thereby to deprive the participants of retirement reserves), but rather to bring an action in a federal district court to compel compliance with law -- payment of adequate contributions, proper conduct of the fund's affairs, and proper payment of benefits.

This is essentially a function of preserving the rights of workers -- a traditional function of the Labor Department. This is the same function which the Labor Department performs in so many

BEST COPY AVAILABLE

other areas. A worker who is not paid time and a half for overtime goes to the Labor Department, and the Labor Department has the power to compel that payment. We do not ask the worker to go to the IRS and insist that a tax penalty be imposed upon the employer for failure to pay minimum wage or time-and-a-half for overtime. There would be no reason for him to do that. The tax penalty, moreover, is least effective when it is most needed. The time when a company stops paying the usual pension contributions is when the company is losing money, has no profits, and doesn't need the tax deduction. So it defers payment of current service costs; it defers payment of interest on past unfunded liabilities; it defers payment of proper amortization of those liabilities. It takes no deduction. Why should the IRS complain? There is no deduction for the IRS to disqualify! But that is the very time when enforcement of funding standards is most necessary. That is the very time when the fund is in danger, the plan is in danger, and pensions are in danger.

D. A Choice of Agencies

Returning to my original hypothesis, would it make sense to give the IRS, or the Treasury Department, jurisdiction to enforce affirmatively the categorical imperatives in S.4? Who would do the enforcing? Certainly not the IRS. Certainly not the Treasury Department. They have no staff at all equipped to do that.

By this I do not mean to say that the Labor Department is necessarily the best agency for such enforcement. Far from it. After all, we are dealing with sophisticated financial institutions -- banks, insurance companies, brokers, actuaries, accountants,

BEST COPY AVAILABLE

and so on. None of these insitutions has any familiarity whatever with the Labor Department, and the Labor Department has even less familiarity with them.

Ideally, we ought to have an independent commission, like the SEC, which could consolidate the necessary expertise in all of these fields, as well as in the employee benefit and labor fields. That was the idea behind the original Javits bill (S.2 in the 92d Congress), which I drafted and which later formed the basis for S.4. Another advantage of that commission, I believe, is that it would make it possible to consolidate in a single agency all regulation of pension plans. The authority to determine tax qualification could be vested there; all the fiduciary standards, disclosure, vesting, funding, portability, re-insurance, and so forth could be vested there. And a fund, which is going to be subject to all of this additional regulation, could at least get the benefit of "one-stop service".

Proliferating bureaucracy is a horror, but consolidation is worthwhile. If the pension thrust branch of the IRS really has such extensive expertise, there is no reason whatever why the personnel of that branch could not be transferred, en masse, to such a commission. If there is expertise in the Bureau of the Labor Department which now administers the Disclosure Act, the personnel of that branch could be transferred there, to such a Commission. With a corps of personnel like that, drawn from the IRS, the Labor Department, and perhaps also from the SEC, the Justice Department and from State Agencies preempted by federal law, I would doubt very much that any great additional bureaucracy would be needed.

Such a consolidation, however, would become much more awkward in any of the *cabinet* branches. It is most unlikely that jurisdiction to make *tax* determinations could properly be vested in the Labor Department. And it is even more unlikely that jurisdiction affirmatively to protect employee rights could be vested (or would be accepted) by the IRS. These agencies are already too specialized in a particular approach.

But the commission idea was around for years, and no one seemed interested. I must say, I see no evidence of increasing interest in it now. That being the case, one is forced to choose between the options that remain -- the Labor Department, or the Treasury Department.

Choosing between thse options, one really has to abandon the notion that there will ever be decent consolidation of enforcement and one-stop service. The taxing power will remain in the IRS. Only the Labor Department is equipped to deal with employee complaints as such, and to try to satisfy them.

The upshot of all this is that, while the Labor Department is far, far from an ideal enforcement agency, once Congress accepts the principle that a pension reform law should give employees direct rights, enforceable by them, and enforceable in their behalf by the government, *only the Labor Department, of existing agencies, is equipped to undertake that task.*

E. What should the Standards Be?

1. Vesting

(a) Earning a Pension When you Are Young -- The Arithmetic of Vested Pension Accruals

One ought not to confuse the arithmetic of vesting with the computation of the amount vested.

It is true that an employee who enters participation in a plan at the age of 48 under the so-called "rule of 50" will be 50% vested in a year -- his age (49) plus his credited service (1) will equal 50 -- and five years after that he will be 100% vested (an additional 3-year pre-participation period of exclusion is allowed by S.1631, and is not factored into this calculation).

But vested in what? One hundred percent vested in 6 years of accruals. But the odds suggest that he will have no accruals for the 23 years he worked from the age of 25 until age 48 when he joined this, presumably his last, employer.

Three hypothetical cases should demonstrate the difference. In each of these cases I use the following assumptions:

a. Uniform contribution rate of $1500 per year (the maximum allowed, for example, under the "individual retirement account" proposed by the Curtis bill, S.1631).

b. An arbitrary rate of return fixed at 6% simple interest, compounded annually (obviously, it could be higher, but the higher rate would doubtless be discounted by inflation.)

c. A level payout, of principal plus accumulated interest on the principal balance, for 15 years -- from age 65 through 80, or the balance to a survivor (See. Treas. Reg. §1.72-9, Table 1).

Case A: Contributions from age 25 through 65 (40 years), fully vested. The total reserve accumulated during the 40 years would be $232,142. Payout in retirement for 15 years: $23,901 per year.

Case B: Full vesting from ages 48 through 65 (17 years). The total accumulation would be $42,339. Payout in retirement for 15 years: $4,357 per year.

Case C: The employee hired at 48 who vested 50% in 1 year (age 49), and 100% in five more years (age 54), and then lost his job. His 100% vesting in 6 years of accruals generates a reserve of $10,462 at age 54. By age 65 (10 years later) it would grow to $18,736. Payout in retirement for 15 years: $1,929 per year.

True, all three pensions were "100 percent vested." But the employee whose accruals began at the age of 25 found himself with a pension sufficient to provide a very comfortable life in retirement. The one whose accruals, though fully vested, began at the age of 48, and continued steady accruals until age 65, nevertheless found himself on the edge of poverty. And the one who vested only in the 6 years' accruals from ages 48 to 54 found himself with a "100% vested" pension of $1929 per year -- only $37.10 per week.

Vesting is fundamental, because an unvested pension accrual is often worthless. But vesting 100% of a pittance still produces a pittance.

The two keys to decent pensions are early vesting and lifetime accruals. Like a safety deposit box in a bank vault -- without both keys, it just won't work.

(b) The Vesting Standards In S.4

S.4 now pending on the Senate floor calendar (Calendar No. 119, S. Rep. No. 93-127) has 53 co-sponsors, and so I will take it up first.*

S.4 would require that every pension plan (with minor exceptions -- plans with less than 25 participants, public plans, Keogh plans) provide for vesting (non-forfeitability) on a deferred graduated schedule: after eight years of service, 30% vesting; and 10 percent more vesting each year until 100% vesting is required after fifteen years of service (§202).

Alternative vesting schedules found by the Secretary of Labor to provide comparable benefits for most participants are permitted, nevertheless (§202(c)), and one might assume that a flat 10-year vesting standard might qualify in some circumstances.

The computation of credited years is as fundamental as the vesting schedule itself. The bill provides that the plan may not require covered service to be "continuous" except that three of the first eight years may be required to be continuous -- otherwise, the bill is really based on "aggregate service" rather than the more common and grossly unfair concept of the "continuous

*For parlimentary purposes, it is worth noting that an identical bill, H.R.976, has been introduced in the House and has been referred to the Committee on Education and Labor. Neither bill contains any tax features. And S.4 could not constitutionally contain them, as the Constitution (Article I, Section 7, Clause 1) provides that tax measures must originate in the House. Short of purely tax features, the vesting provisions of S.4, like the other provisions of S.4, are the most comprehensive of the pending bills.

service" now used in most pension plans. Frankly, I see no logical basis even for the three year continuous service requirement now appearing in Section 202(b)(1) of S.4.

The bill also prohibits a preparticipation period beyond the age of 25. Again, I see no basis for allowing any preparticipation period, but certainly this preparticipation period is minimal (§202(b)(2)).

The bill provides vesting with respect to covered service "both before and after the effective date of the title" (§202(a)). The objective is laudible, and the cost, according to the actuarial study accompanying the bill, is relatively low. If it can, constitutionally, be done, it ought to be done, in my judgment, but I do not believe sufficient attention has yet been paid to the constitutional question of what may amount to a retroactive amendment of contractual obligations.

(c) The Vesting Standards in the Administration Bill, S.1631 -- the "Rule of 50"

Of course, the most fundamental difference between S.1631 and S.4 is that the vesting provisions of S.1631 are not requirements at all, but only conditions of tax qualification (a weakness discussed in greater detail above).

Setting aside the enforcement mechanism, however, and addressing oneself solely to substantive requirements of the Rule of 50, they are simply, that the employee must be 50% vested when his age and credited service equal 50, and must vest the balance over the succeeding five years.

S.1631 permits a greater preparticipation period than S.4. One need not count any service before the age of 30, nor need one count the first three years of service in any event (Section 2(a)(2)), and one need not count any service within five years of retirement age. The Rule of 50 system, therefore, is really a system to provide a means whereby an older man can earn a pension while he is an older man. For the reasons supplied in greater detail above, it puts all the burden on the last employer, and provides a minimal pension at best.

It has been argued by the supporters of the bill that the Rule of 50 would not be an incentive for age discrimination, but it seems self-evident to me that the cost of hiring a man in his late 30's or early 40's must be higher than the cost of hiring a man in his 20's under this bill, because a 20-year old would vest nothing for 15 years, and a 45-year old would vest 50% in three or four years.

(d) The Vesting Standard in the Bentsen Bill -- S.1179

This bill, like S.1631, is primarily a tax bill, and suffers from all of the weaknesses inherent in that enforcement device, explained more fully above.

The vesting schedule begins earlier than any other bill (25% in five years) but ends later than any other bill (100% only after 20 years).

Obviously, the fashioning of the vesting schedule is a matter which is subject to fair legislative judgment, and Congress will have to reach that judgment. Five years to begin vesting strikes me as a most reasonable schedule; 20 years to complete vesting strikes me as grossly unreasonable in this day and age.

In any event, the bill permits exclusion of all years under age 30, which again is unwise.

One ought also to note that this vesting schedule uses the retroactivity feature in last year's version of S.4 (applicable to prior service only for employees over the age of 45). As mentioned above, there may be a constitutional questions inherent in any legislation with respect to service before the effective date of the new law. But if application to prior service is constitutional, then I see no reason to limit the application of this feature to persons over the age of 45 -- why not go the whole way, if the cost is manageable?

2. Funding

Funding schedules raise several associated questions which ought to be discussed in a general way before getting into the arithmetic.

(a) General Standards for Evaluating Funding Requirements

First, if one is talking about a system incorporating federal plan termination insurance ("reinsurance"), then the funding is there primarily to protect the reinsurance fund rather than the participant -- and that is the case under S.4 and the other bills providing for reinsurance.

If, on the other hand, funding is provided without associated reinsurance, then the funding schedule is a direct correlary of the vesting schedule -- it determines "who gets what". In that sense, any funding schedule which does not distinguish the various "layers" of benefits is really a distribution scheme.

For example, in the Studebaker case so familiar to this Committee, the plan was fifteen years old, and was on a 30-year funding schedule. Why, then, did employees with over 40 years of fully vested service forfeit 85 percent of their vested benefits? The reason was that each time benefits were increased, the additional unfunded past service liability was simply added on to the original past service liability, increasing the total, as a lump sum. When the plan was finally terminated, the priorities of distribution resulted in most of the reserve going to retirees and practically none of it being given to unretired vested employees, even those with over 40 years of service. In short, that funding system had inherent in it a judgment as to the priorities of distribution of a fund not sufficient to pay all vested benefits.

In my judgment, it would be fairer to treat each substantial increase in benefits involving an increase in past unfunded service liabilities as a separate plan, for funding purposes. Thus, an initial grant of benefits, required to be funded over a stated number of years (25, for example), would be fully funded after the expiration of 25 years regardless of how many other benefit increases took place in the meantime. Each separate benefit grant would likewise be funded over a new period of 25 years beginning on the date of grant. In the event of termination of the plan, an employee who was fully vested in any "layer" of benefits would be entitled to payment of the amount of money which had been funded for that layer -- and if it were fully funded, he would be entitled to it all, even though subsequent layers of benefits were not fully funded. That strikes me as a more equitable method of distribution of a funded plan than the current system which gives all the funds to the retirees, and only secondary rights to vestees, regardless of how old the vestees are and how many years of service they have earned.

The second imporaant factor to note with respect to funding scehdules is that, if one approaches the funding requirement on a declining balance basis, it will take an infinite period of time to complete the schedule. A requirement that a percentage of past unfunded service liabilities be funded each year will produce a declining contribution each year, as the unfunded balance declines, subject, however, to increases resulting from benefit increases.

With those standards in mind, one can approach the various funding schedules in the bill pending before the Congress and make some evaluation.

(b) The S.4 Funding Requirements

S.4 provides a 30-year funding schedule (Section 210(b)). That is, the contributing employer must pay all normal service costs currently, plus an annual payment sufficient to amortize past unfunded liabilities over a period of thirty years.

The bill also approaches the problem of "layers" of unfunded liabilities by providing that an increase in benefits resulting in a substantial increase of unfunded liabilities of the plan shall be treated as a "new plan" both for purposes of the funding schedule and for purposes of the reinsurance provisions of the bill (Section 210(b)(2)(B)).

(c) The S.1631 Funding Requirements

S.1631, the Administration bill, now provides for funding, but includes no correlative reinsurance provision. Accordingly, one must treat this funding provision not only as a means of obtaining security, but as part of the set of priorities for the distribution of benefits. In that sense, the funding schedule is barely adequate.

It does provide that, for pusposes of tax qualification, contributions each year must consist of the normal cost of the plan plus 5 percent of the unfunded liabilities for benefits. This is the "declining balance" approach to pension funding, which would allow an infinite period of time for full funding. No approach to the various "layers" of benefits is involved, and thus, inevitably, when the plan shuts down, the employees who are vested but not retired will experience some forfeiture.

One ought to keep in mind that the Studebaker plan was funded on a better schedule than that required by S.1631, and yet employees who were 100% vested and had accrued over 40 years of service forfeited 85% of those vested benefits.

(d) The S.1179 Funding Requirement

The Bentsen bill, S.1179, includes both reinsurance and funding, and so one can approach funding here as a means of protecting the reinsurance fund, rather than as the last resort of the participant himself. The 30 year funding schedule in the bill (Section 323) is adequate.

A weakness in the Bensen approach to "experience deficiencies", however, is that this bill permits a plan to fund such deficiencies over the working life of the employee, whereas S.4 requires a five-year make-up of such deficiencies.

(e) A Comment on "Experience Deficiencies"

Experience deficiencies result, primarily, from actuarial mistakes or bad investment experience. The rapid 5-year make-up schedule in S.4 functions not only as protection for the fund in the event of termination but also as a deterrent to risky plan management practices and unreasonable actuarial practices. What is the penalty, after all, for an investment gone bad, or for unreasonably optimistic actuarial assumptions? If the investments go bad or the actuarial assumptions prove preposterous, the resulting deficiency may be amortized, under S.1179, over quite a long period of time -- and under the Administration bill (S.6131) over an even longer period of time (an infinite period of time) at 5% of the balance per year.

Under the S.4 approach, on the other hand, a soundly financed plan based on conservative actuarial assumptions is permitted to take a full 30 years funding, but any experience deficiencies resulting from erroneous actuarial assumptions or arising from investments gone bad must be made up in five years. S.4 attempts to control actuarial assumptions, and its fiduciary standards attempt to control investment practices. But, after all, the real way to control both those practices is to impose a penalty for gambling, and the heart of that penalty is in the experience deficiency provisions.

Accordingly, I would think the experience deficiency provisions of S.4 are preferable to those in S.1179, and obviously preferable to the complete absence of such provisions in S.1631.

(f) Current Funding Practices

Most sound pension funds are funded substantially as well already. See Accounting Principles Board Opinion No. 8, of the American Institute of Certified Public Accountants (eff. 1/1/67). The minimum standard set by the Internal Revenue Code, however, permits a somewhat weaker funding schedule -- current service costs plus a sum equal to "interest" on unfunded past service costs. The difference, I believe, will not be a substantial cost problem, and, in consequence, there has been relatively little controversy concerning funding requirements.

3. "Portability"

While S.4 has a title called "portability," it is important to distinguish between the provisions of this title and the more widely heralded popular notion of "portability" which appears in so many political speeches.

BEST COPY AVAILABLE

More often than not, the word "portability" has been used as a shorthand designation for whatever solution is being currently advocated for the problem of pension forfeiture arising from labor mobility. As the rhetorical theory goes, people move from job to job, and their pensions ought to be "portable" so that they can take them along as they move.

That is not really what the portability title in S.4 is all about. On the contrary, the problem of forfeiture is dealt with primarily in the vesting title, or else it is not dealt with at all.

What, then, does this portability title do? It creates a clearinghouse for the transfer of the current discounted value of pension credits which are already vested. (§301(a)). An employee leaving a job having earned a vested pension credit would be entitled to transfer the current (discounted) value of that vested pension credit into a central federal clearinghouse, where he could leave it until retirement, or else, when he takes another job with a pension plan tied into the clearinghouse, that credit could be transfered to the new job, into the new plan, to purchase whatever credits that much money is worth. (§§302-05).

It is voluntary, under the bill, in two senses: first, the plan (that is, the company and/or the union) need not tie into the clearinghouse at all (§301(a)). Second, even if the plan ties into the clearinghouse, the individual participant in the plan is given the option of transferring credits through the clearinghouse,

BEST COPY AVAILABLE

or simply leaving his vested credits in the plan where he earned them. (§§302, 305).

In short, I see no sensible way to object to this portability scheme as written. If you don't like it -- forget it. It is not a panacea; it is a convenience.

4. Reinsurance

S.4 would create a federal pension plan termination insurance program to guarantee payment of vested pension rights, whether or not the fund has sufficient assets to pay them.

The classic problem, to which tiis title is addressed, is the famous (or infamous) Studebaker shutdown in South Bend, Indiana a decade ago in which long-service Studebaker employees with vested pension rights forfeited 85 cents on the dollar of their pension entitlements.

But that sort of collapse, while rare in percentage terms,is a disaster in human terms. A study published just this year by the U.S. Treasury and Labor Departments ("Study of Pension Plan Terminations", Interim Report, February 1973) discloses that in the first seven months of 1972, 8,400 persons lost benefits as a result of plan terminations -- benefits worth $20 million, or $2,400 per claimant . True, this represented only 0.04 percent of participants -- but it's 8,400 disasters nonetheless. And the low percentage merely proves the feasibility of reinsuring against these disasters.

While the bill undertakes to reinsure pension rights earned both after and before the effective date of the act (§401), the amount of reinsurance is limited to 50% of an employee's highest monthly wage, or $500 a month, whichever is less ($402(b)).

The bill sets the initial premium rate at 0.2% of unfunded vested liabilities ($403(b)(2)), subject to revision later on the basis of experience. ($403(b)(3)).

One might argue that this premium rate, which is only an initial estimate, will not be sufficient to cover anticipated pay-outs, because the reinsurance scheme is itself an invitation to set up "collapsible plans" and then have the reinsurance plan pay off. Another feature of the bill, however, ought to be a substantial deterrent to such a practice -- the bill contains a subrogation scheme. That is to say, when a plan terminates with insufficient funds to pay vested benefits, the reinsurance fund will pay the difference -- with no delay attendant upon any controversy over whether or not the collapse was a "sham". But once those benefits are paid, the reinsurance fund is entitled to recover from the general assets of the employer, based upon a formula set forth in the bill, a proporation of the benefits paid out, depending upon whether or not the employer was solvent, and the degree to which he was solvent, at the time the plan was terminated ($405).

The reinsurance provisions of S.1179 are similar, but I see no comparable subrogation provisions -- a critical defect, in my view.

And of course the total absence of reinsurance in S.1631 again reflects an unwillingness to deal with the one problem which caused the movement for pension reform in the first place.

5. Fiduciary Standards

There is no longer very much controversy over these provisions. Title V of S.4 is practically a carbon copy of a similar bill introduced on behalf of the Nixon Administration (S. 1557) and is in most respects just about the same as bills introduced by others in the House and Senate.

The approach of the fiduciary standards title of S.4 is as follows:

(a) Who is a "Fiduciary"?

The term "fiduciary" is defined in the Act to mean not just the traditional trustee but also

> "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."

I interpret this language to cover anyone holding decision-making power (whether he exercises it or not) with respect to investment of funds, determination of benefit eligibility, management of the plan, and so on. Thus, an investment counselor with a discretionary account would be a fiduciary; members of the labor-management "committee" would be ficuciaries; and even a personnel director certifying eligibility would be a fiduciary.

b. "Employee Benefit Funds"

This title applies not only to pension funds but also to all "employee benefit funds". The terms "employee benefit fund" and "employee benefit plan" are defined to include any plan or fund providing either welfare or pension benefits to employees, and would also include any "Taft Hartley" plan or fund permitted by Section 302(c) of the Labor-Management Regulations Act. In essence, the fiduciary standards of this bill would cover any plan (provided it is funded at all) which provides benefits of any kind to employees of a contributing employer. A quick rule of thumb would be that, if the plan is now required to file annual statements under the Welfare and Pension Plans Disclosure Act, it would be covered by the fiduciary standards in this act. But in addition to that, there does not appear to be an escape hatch for "unfunded" pension plans or retirement plans (unless any such plan is specifically exempted on other grounds), not because unfunded plans are covered, but because unfunded plans are now required to be funded.

c. Trust Requirement

The bill requires that every "employee benefit fund" be established or maintained pursuant to a duly executed written document setting forth the purpose of the fund and the "detailed basis on which payments are to be made into and out of such fund." The section also provides that "such funds shall be deemed a trust". The combination of these requirements requires that all pension funds be established pursuant to duly executed trust agreements and that the trust agreement provide, by its terms, the basis for determining both the contribution and benefit formulae.

d. The Prudent Man Rule

Any such fiduciary, under this bill, is required to discharge his duties with respect to the fund:

> 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".

I read this standard to be somewhat stricter than many current state laws which occasionally set the standard as "with the care exercised by a prudent man dealing with his own money." S.4, on the other hand, provides, in a sense, a "prudent expert rule": the bill refers to a prudent man "acting in like capacity" (rather than acting with respect to his own money); the prudent man must be "familiar with such matters" (so that he cannot plead ignorance or lack of expertise), and the standard is the one which would be used "in the conduct of an enterprise of like character and with like aims" (so that he cannot argue that he had no experience or knowledge of the standards accepted in the conduct of such an enterprise).

e. Governing Documents

A violation of the governing documents also is a breach of fiduciary responsibility -- which gives the federal courts (under the enforcement provisions of the bill) jurisdiction not only to enforce the specific fiduciary standards but also to enforce the terms of the plan itself. The bill requires a fiduciary not only to follow the prudent man rule, but also to discharge his duties:

> "...in accordance with the documents and instruments governing the fund insofar as is consistent with this Act...."

f. Prohibited Transactions and Exceptions

Section 15 (b) of the Disclosure Act, as amended by S.4, would prohibit a fiduciary from engaging in nine specific transactions, in many cases subject, however, to exceptions thereafter provided in Section 15 (c), and further subject to the right of the Secretary to exempt a fiduciary from a prohibition in a specific case or class of cases.

(i) Prohibitions

(a) "Party in Interest"

The prohibited transactions are keyed to the definition of a "party in interest". The statute defines the term "party in interest" to mean

> "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...."

The definition also requires that a person, to be treated as a "party in interest", must be "known to be a party in interest". A specific exception in the definition itself is that, if funds are invested in an investment company registered under the Investment Company Act of 1940, that investment shall not cause the investment company or its advisor or principal underwriter to be deemed to be either a fiduciary or a party in interest, except insofar as such investment company or advisor or underwriter acts in connection with an employee benefit fund as its investment advisor or underwriter.

The language is quite technical, but if one proceeds by analogy, one might conclude that, at the very least, most "insiders" under SEC rules would be parties in interest, and anyone employed by a plan or by a party to the plan would be a party in interest.

In short, once a person provides any service to the plan, the fiduciary should be on his guard against allowing that person to transact any business with the plan other than providing that service.

(b) Prohibited Transactions

The prohibited transaction provisions keyed to the foregoing definition of party in interest require that the 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."

(ii) Exceptions to the Prohibitions

Section 15 (c) of the Disclosure Act, as amended by S.4, lists eight exceptions to the prohibitions. These exceptions, moreover, are not merely exceptions to the prohibitons as such but are exceptions to any prohibition in the statute, so that if the exception applies, the condüct described in the exceptions is not only exempted from the list of prohibited transactions, but, presumably, also would not violate the general "prudent man" standard.

Generally these exceptions include the right to receive a benefit (if a fiduciary is also a beneficiary); the right to receive reasonable compensation for services rendered, and reimbursement of expenses (but note that a full-time employee of the employer or the union may not receive compensation from the fund, although he may receive reimbursement of expenses); the right to be an officer or employee of a party in interest, in addition to being a fiduciary; the right to purchase securities of a contributing employer up to a maximum of 10% of the market value of the fund, but only if the purchase is for no more than adequate consideration (the 10% limit does not apply to profit sharing, stock bonus, thrift, or similar plans which allow such investments); the right to purchase a security from, or sell a security to, a party in interest if the security is in a class which is listed on a National Securities Exchange registered under the Exchange Act, or which has been listed for more than one month by a national security association administering an electronic quotation system, but only if no brokerage commission is charged and adequate consideration is paid, and, if the investment is in securities of the contributing employer, the transaction has prior approval of the Secretary of Labor; the right to loan money to participants or beneficiaries, if such loans are available on a non-discriminatory basis and "are not otherwise inconsistent with the purposes of this Act" (presumably a reference to the prudent man rule); and the right to contract with a party in interest for office space and other necessary services.

(g) Liabilities of Fiduciary

The bill makes any fiduciary personally liable for any losses to the fund resulting from a breach of fiduciary standards. The real teeth in these standards are found in the enforcement provisions of the whole Act, however, as further described below.

(h) Co-Fiduciaries, and Allocation of Responsibilities

Sections 15(e)-(g) deal with the liabilities of a fiduciary for acts of another fiduciary.

Section 15(e) provides that when two fiduciaries undertake the exercise of a power jointly (or when they are required to by the governing instrument) each fiduciary has a duty to prevent the other from breaching his responsibility -- and so a fiduciary would be liable for failure to prevent the other from committing a breach. The statute provides for exemption from liability if the objecting co-fiduciary "objects in writing to the specific action and promptly files a copy of his objection with the Secretary".

Section 15(f) nullifies all exculpatory clauses by providing that "no fiduciary may be relieved from any responsibility, obligation, or duty imposed by law, agreement or otherwise." But Section 15(f) provides that fiduciaries may by agreement allocate specific duties or responsibilities among themselves by submitting to the Secretary contractual provisions to that effect, which become effective "unless specifically disapproved by the Secretary".

A fiduciary seeking to insulate himself from liability for the misconduct of another fiduciary, therefore, would do well to provide, in a written instrument, the limits of his own responsibility, and the specific allocations of various responsibilities among fiduciaries. This instrument should be submitted to the Secretary, and becomes effective immediately, unless the Secretary disapproves it.

Finally, Section 15(g) provides that the fiduciary has no liability for a violation committed before he takes office.

(i) Double Fees or Commissions Prohibited

A provision of the original bill (S.4) (deleted in Committce) expressly permitted a "party in interest" to provide multiple services to the plan. The following language from the Committee Report explains the deletion of that provision:

> "In this connection, the Subcommittee, after careful deliberation, deleted a prior provision, section 15(d), which expressly permitted a 'party in interest' to provide multiple services to a plan, regardless of whether the 'party in interest' was also serving in a fiduciary capacity and receiving fees or compensation for the performance of discretionary functions with respect to plan funds.
>
> "Section 15(d) had been predicated on the recognition that fiduciaries, subject to regulation ahd supervision under laws affecting banking, insurance and securities, performed a variety of services and functions, some customary and rooted in the historical development of the fiduciary's role, and some newly arisen as a means of strengthening the fiduciary's competitive position.
>
> "Many of these multiple services or functions are or could be rendered in connection with a variety of trusts or funds other than pension trusts or funds. Examples are widows' estates, mutual funds, college

endowment funds, variable annuity funds, etc. Because the fiduciary's conduct relative to the performance of multiple functions was subject to regulation under laws affecting insurance, banking and securities, the Committee originally took the position that additional regulation in this field should proceed sui generis under these laws. The Committee believed that the bill provided ample remedy in the event, for example, the fiduciary breached his trust by 'churning' pension fund accounts to generate profit for himself or ancillary activities under his control, or by channeling pension fund investment to shore up vulnerable investments made by a commercial adjunct.

"Upon review by the Subcommittee of section 15(d), however, a competing school of thought emerged, which emphasized the difficulty of securing an adequate system of control over fiduciary-commercial relationships in the context of pension fund management. It was argued that these relationships tend to subordinate the strict professionalism expected of fund managers to business pressures and that, inevitably, certain fund managers are bound to yield to these pressures and cause trust fund abuse in a manner which is not always accessible to timely discovery. Because the interests of pension fund beneficiaries deserve the strongest protection, it was urged that the Subcommittee adopt a rule which would bar a fiduciary from performing multiple business services for the pension trust unless, after application by the fiduciary, the Secretary waives the proscription on grounds that it is consistent with the purposes of the Act and is in the interest of the fund or classes of funds and the participants and beneficiaries."

(j) Effective Dates

While there is a three-year delay between enactment and the effective dates of some of the provisions of S.4 (e.g., vesting and funding), the fiduciary standards provisions in Title V become effective upon enactment of the Act, as do the enforcement provisions in Title VI.

Despite the immediate effectiveness of Title V, however, there is another three-year delay in that title with respect to disposal of assets held in violation of a fiduciary requirement. Proposed Section 15(j) provides that a fiduciary may in his discretion effect the disposition of an investment prohibited by the Act "within three years after the date of enactment of this Act", and further provides that the Secretary may by rule or regulation allow additional time.

(k) Fiduciary Standards in S.1179 and S.1631

Both these bills proceed in the traditional tax way -- violations of "prohibited transactions" would result in tax penalties. I cannot imagine this approach providing a decent measure of protection for beneficiaries -- indeed, the Administration concedes as much by its submission of S.1557 as a companion bill to S.1631.

6. Enforcement Provisions

The enforcement provisions of S.4 are as follows.

Section 601 permits the Secretary of Labor to bring a number of actions to enforce compliance with the registration requirements of the Act (aimed primarily at vesting, funding and re-insurance).

Section 602 provides that when the Secretary has "reasonable cause" to believe that a fund is being administered either in violation of the WPPDA or the fund's governing documents,

BEST COPY AVAILABLE

he may petition any U. S. District Court for appropriate relief, including an order requiring return of funds unlawfully transferred, payment of benefits, or restraining any conduct in violation of the Act, and may compel the removal of a fiduciary under appropriate circumstances.

Section 603 provides that actions of this kind may be brought in any state court or federal district court without regard to the amount in controversy or diversity of citizenship of the parties, and venue is laid in any district where the plan is administered, where the breach took place, or where a defendant resides or is found, and -- most importantly -- process may be served nationwide.

Section 604 provides that a participant or beneficiary may likewise bring suit under similar guidelines.

Section 605 permits the court in its discretion to allow a reasonable attorney's fee as part of costs to either party, and may require a plaintiff to post security for such costs.

Section 607 allows judicial review of any action of the Secretary.

Section 608 sets a statute of limitation of five years for a violation of fiduciary standards, except that, in case of fraud or concealment, the statute is tolled until date of discovery.

The enforcement provisions of S.1631 and S.1179, on the other hand, are essentially those under existing tax law --

BEST COPY AVAILABLE

a tax penalty to the violator, but few if any real remedies for the pension participant.

7. Federal Preemption

Section 609 of S.4 preempts all state laws dealing with the same subject matter as S.4 or the Welfare and Pension Plans Disclosure Act as amended; with certain stated exceptions. The operative language of 609 is that the provisions of S.4 and of the WPPDA "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 [S.4] or the Welfare and Pension Plans Disclosure Act...."

The exceptions are -- (1) plans not subject to S.4 or the WPPDA; (2) statutes regulating insurance, banking, or securities, or requiring the filing with a State of copies of reports filed under S.4; and (3) any federal statute not directly in conflict with S.4.

Obviously, if the States are to legislate in this field, only chaos can result, in the absence of preemption -- and one need only examine a recent New Jersey law on the subject to see a good example.*

The tax bills (S.1631 and S.1179), on the other hand, cannot reasonably be expected to preempt all State laws -- not

* H.B.1563, effective May 9, 1963. Under this new New Jersey law, the State imposes a tax upon employers closing plants in the State, the tax being, generally, an amount sufficient to pay off pensions for workers with 15 years of service, whether vested or not.

because preemption is undesirable, but because their enforcement provisions are so weak that preemption would leave a vacuum and would leave pension participants almost remedy-less, as they are today.

F. Tax-Deductible Contributions

Obviously, no tax features can be added to S.4, or to any Senate Bill, without making the bill unconstitutional (as tax legislation not originating in the House).

But there are tax features which ought to be enacted -- not as a substitute for S.4, but in addition to it.

Obviously, some treatment for the unjust lump-sum distribution treatment, which hits a pensioner withdrawing from one plan before entering another, is required.

More importantly, we need an expansion of Keogh, and we need it for corporate employees (common law employees) as well as for the self-employed.

These features of S.1631 and S.1179 are sorely needed, particularly by workers who have no pension coverage at all (50% of the work force, primarily in small business). But the $1500 limit on the self-employed is too low. I see no reason not to make both limits $7500.

And I see no reason for lowering the limit by the amount the employer contributes, when the employer's contribution is not vested, and the employee's is.

G. A Comment on the More Extreme Proposals

None of these bills is perfect -- none eliminates every possibility of forfeiture.

Any vesting standard makes a judgment: how long must an employee work before it would be unfair and unjust to allow him to forfeit because he changes jobs?

Of course it is always possible to go farther. It is possible to set up an immediate-vesting standard as a matter of law. It is possible, as one of my co-panelists has suggested, to take the private pension system and completely divorce it from the employer-employee context -- to set up a set of independent funds, regulated by the government, which would amount to a private social security system.

While that notion has a certain superficial appeal, it is, in my judgment, utterly preposterous, because it leaves out the most essential element -- business incentive. Why should an employer involve himself in a plan if he gets no credit for it, if he is not permitted to put his name on it, if he is not permitted to "tailor" it (within limits) to fit the special needs and desires of his own workforce and his own business? If we put this industry in a straightjacket, if we so standardize pension plans that no flexibility is left, we will most assuredly (and unnecessarily) kill, or at least mortally wound, the industry we are trying to improve.

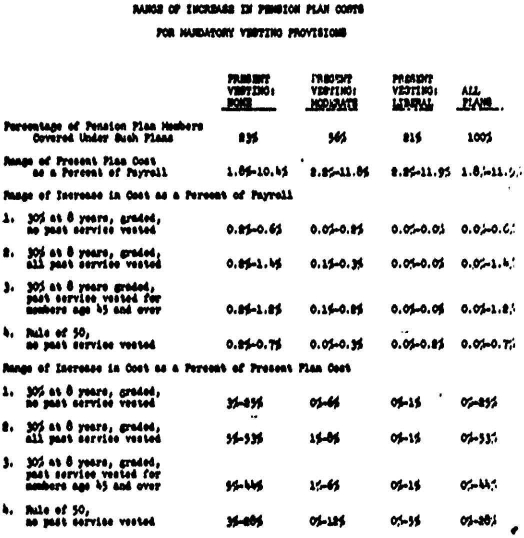
There will always be those who will find fault with any bill -- who will say "more" and "more", without regard to possible adverse side-effects. Indeed, there are those who have said that with respect to S.4, and even with respect to the more conservative bills.

But S.4 is a moderate bill -- it is compatible in all respects with the essentially private nature of the pension industry. The "radical" proposals (as I characterize them) are not.

IV. Costs

The Senate Labor Committee retained a Baltimore actuarial firm to analyze the potential cost impact of the various vesting formulae, and the results have been published. (S. Rep. No. 1150 92d Cong., 2d Sess. 149-150 (1972)).

The summary of these results, as they appear in the actuarial report, is as follows:



RANGE OF INCREASE IN PENSION PLAN COSTS
FOR MANDATORY VESTING PROVISIONS

	PRESENT VESTING: NONE	PRESENT VESTING: MODERATE	PRESENT VESTING: LIBERAL	ALL PLANS
Percentage of Pension Plan Members Covered Under Such Plans	23%	56%	21%	100%
Range of Present Plan Cost as a Percent of Payroll	1.0%-10.4%	2.2%-11.0%	2.2%-11.9%	1.0%-11.9%
Range of Increase in Cost as a Percent of Payroll				
1. 30% at 8 years, graded, no past service vested	0.2%-0.6%	0.0%-0.2%	0.0%-0.0%	0.0%-0.6%
2. 30% at 8 years, graded, all past service vested	0.2%-1.4%	0.1%-0.3%	0.0%-0.0%	0.0%-1.4%
3. 30% at 8 years graded, past service vested for members age 45 and over	0.2%-1.2%	0.1%-0.2%	0.0%-0.0%	0.0%-1.2%
4. Rule of 50, no past service vested	0.2%-0.7%	0.0%-0.3%	0.0%-0.2%	0.0%-0.7%
Range of Increase in Cost as a Percent of Present Plan Cost				
1. 30% at 8 years, graded, no past service vested	3%-23%	0%-6%	0%-1%	0%-23%
2. 30% at 8 years, graded, all past service vested	5%-53%	1%-8%	0%-1%	0%-53%
3. 30% at 8 years, graded, past service vested for members age 45 and over	5%-44%	1%-6%	0%-1%	0%-44%
4. Rule of 50, no past service vested	3%-20%	0%-12%	0%-3%	0%-20%

S.4, therefore, is assumed to increase costs for current plans with "moderate vesting" plans by about 0.1% to 0,2% or 0.3% of payroll (depending on the extent of retroactivity).

Obviously, in an economy in which wages have increased more than 5% per year in recent times, this cost is manageable.

There are some other substantial though less visible costs in the bill, however. It is no secret that many a conglomerate has gobbled up a smaller company and immediately dicontinued its pension plan, leaving vested and other benefits without adequate funding. The new bill has the effect of reinsuring the unfunded vested benefits of such a terminated plan, but of requiring a solvent company -- one which terminated a plan at its own convenience -- to refund the federal reinsurance benefits, based on a ratio between the company's net worth and the reinsurance benefits paid (§405). The effect is to force an acquiring or merging company to include unfunded pension cost in the calculus of assets and liabilities used to determine the selling price of an enterprise. In my judgment, that will be a "cost" only if the enterprise is not thereby deterred from arbitrarily terminating a plan. The deterrant effect, in my view, is substantial and worthwhile.

V. Conclusion

No law or amendment to law can solve all of the problems in this field. A bad law or a misconcieved law can make things worse -- either by deluding workers into believing they are protected when they are not (which would not be an improvement), or by so entangling pensions in bureaucracy as to deter private pension plan development.

What would a good law be? In my view, we need both substantive regulation, and new tax incentives.

I proceed on the following premises: (1) If you want to regulate, do it directly, by substantive regulatory control and not by tax qualifications; (2) If you want to create incentives for voluntary conduct, tax is an excellent vechicle.

Following those guidelines, I conclude that the current Williams-Javits bill S.4 is a workable regulatory structure for establishing minimum standards for private plans, and for protecting private rights -- rights in dispute between private parties -- under those plans.

Even so, tax reform in the pension field is needed -- sorely needed -- to solve critical problems which are beyond the scope of S.4 and can only be solved by tax incentives.

The two most serious problems beyond the scope of S.4 are: First, the 50 percent of the work force not covered by any pension plan; and second, the vast numbers of employees in high-mobilityemployment (such as engineers), who, although they are often "covered" by corporate pension plans, rarely vest and will not be helped by any pending vesting bill, because they regularly change jobs every five years or more frequently than that. The most promising solution to both problems is in the individual before-tax retirement act, such as is proposed in the features of S.1631 and S.1179 (other than those dealing with vesting and funding).

Let the high-mobility engineer, who cannot vest under his corporate pension plan, contribute his own money to his own "plan", and get a tax deduction for the contribution.

Let the employee of the small business without a company plan contribute his own money to his own plan on a deductible basis.

That is the only effective way to solve the remaining coverage problem.

Should it be done? Can the nation afford the revenue loss?

We are already paying the cost of wide-spread destitution in old age. We pay it in welfare costs and all sorts of public assistance to older people who worked hard during their earlier years, who had pride in themselves and in their abilities, but who nevertheless are unable to provide for themselves any longer.

Why not give them the *dignity* of being able to live in their retirement years on money *they earned*?

That is what we do, to a very limited extent, under Social Security, but we all know very well that Social Security, at best, will never provide much more than a bare subsistance income level.

Why should we condemn the typical middle-class American, who has lived his whole working life on a middle class income, to be thrown, suddenly at the age of 65, into the very bottom of our economic barrel?

There is no better, more fundamental, more humane allocation of our resources than this.

And whose resources are we talking about, anyway? This is not welfare -- reallocating money from the rich to the poor. This is simply giving a man the use of *his* money, which *he* earned, but giving it to him *when he needs it most*, and letting him pay taxes on it *then*.

The average American ordinarily hates tax "loopholes" because they offer him nothing but a reason to be angry at someone else -- the oilman, the securities investor, and so on.

But retirement is part of every American's expectations. In my judgment, our top priority should be to take some of the fear out of retirement, and to put some security and dignity into it instead.

STATEMENT ON PENSION PLAN
REFORM LEGISLATION

before

THE PRIVATE PENSION PLANS SUBCOMMITTEE OF THE
SENATE FINANCE COMMITTEE

by

LEONARD LESSER
June 4, 1973

This statement is submitted in response to the Committee's invitation to participate in this panel discussion on pending pension reform legislation.

It will not set forth the statistics to demonstrate the importance of private pension plans as economic or social institutions in American society today. This committee and the other committees in both the Senate and the House have over at least the past ten years received volumes of testimony to this effect.

This Subcommittee is also aware of the basic shortcomings of the private pension system. Too many workers who are covered by private pension plans do not and will not receive a pension from such plans when they retire.

S. 4 reported to the Senate currently by the Labor and Public Welfare Committee, S. 1179 introduced by Senator Bentsen, and S. 1631 introduced by Senator Curtis and others all propose a solution to those shortcomings.

Before discussing the substantive provisions on vesting, particularly, termination insurance and funding, I believe it is important to consider the approach of the various bills.

S. 4 would require all plans to contain minimum requirements on vesting, funding and termination insurance. S. 1179 and S. 1631, on the other hand, would only require it of plans where the employer wants the tax advantagos given to "qualified" plans. I believe the distinction is significant. It goes beyond the question of whether the requirements should be administered by the Department of Labor or the Internal Revenue Service. It goes to the heart of whether protection will be afforded to all workers or only those workers whose employers are concerned with current tax deductions.

There can well be cases where protection will be lost because the employer for tax reasons has no incentive to make either contributions to the plan or premimum payments for pension termination insurance.

Just as the applicability of fiduciary and disclosure requirements are not depêndent on whether the employer seeks tax qualification, so too should the protection of employees under the substantive regulations be mandatory plan provisions.Of course, such recommendations would not precludo that they also be a condition of tax qualification. The same government agency could make the determination for both purposes.

To make protection as broad as possible, I would suggest, however, that the coverago limitation to employors with 25 or more employees in

S. 4 be removed. The employees of small employers are most in need of protection -- particularly from the risks of insolvency of their employer. I do not believe the extension to small employers will be a serious deterrent to their establishment of plans.

While S. 4, S. 1179 and S. 1631 all propose minimum vesting standards, there is a basic difference of approach as to whether the requirements should be applicable to benefits accrued prior to establishment of a pension plan or the effective date of the new legislation.

S. 4 makes no distinction between service performed for an employer before or after the time a pension plan was established. The vesting and termination insurance requirement are applicable to all service. S. 1179 requires that credit be given for prior service at least if the employee is 45 years older on the effective date of the Act. S. 1631 would, subject to certain exceptions, make vesting requirements applicable only to service rendered after January 1, 1975.

It is obvious that a proposal which disregards prior service gives little protection to those who are closest to retirement age and are least able to accrue adequate benefits in the future.

The "Rule of 50" proposed in S. 1631 does not meet the problem. It only results in vesting after a short period of service; it does nothing to preclude the denial of benefits or assure the payment of benefits based on the full period of service required to accumulate an adequate benefit. Nor will the proposal to permit tax deductions (S. 1631) tax or credit (S. 1179) for employee contributions meet the problems for workers whose future years of work are limited.

I would therefore strongly recommend that the Congress, unless it intends to enact legislation which is meaningful only for those who will retire sometime in the future, require that full consideration be given to "past service."

Turning to the specific requirements for vesting, I believe that all employees who have had a significant period of service for an employer should be entitled to a pension based on such period of service. As indicated, I do not believe it matters whether such service is performed before or after the effective date of the pension plan. Similarly, I do not believe that service performed before a certain age should be excluded. For that reason, I do not believe the "Rule of 50" is sound since it would permit the exclusion of significant periods of service before age 40. This is particularly true since S. 1631 also allows all service prior to age 30, to be disregarded. The generation of relatively insignificant pensions for older workers with very short periods of attachment to a particular job hardly outweighs its disadvantages.

I believe that 10 years is a long enough period of service to acquire full vesting. Such a standard would be most understandable and would not lead to excessive increases in costs.

While S. 1179 provides for some vesting after 5 years of service, the percentage increase of 5 per cent a year requires that 20 years of service be completed before there is full vesting. If the percentage

BEST COPY AVAILABLE

were increased to 7½ per cent, the required period for full vesting would be shortened to 15 years, the same as in S. 4.

While all of the legislative proposals permit transition periods -- presumably to soften the cost impact of vesting requirements -- it should be recognized that any delay means that no protection will be afforded to workers who terminate their employment prior to the final date. Consideration might be given to use of the funding provisions to soften the cost impact rather than to delay the effective date of the vesting requirement. For example, the additional cost applicable to the vesting requirement during the transition period could be deferred for the period and then at the expiration of the transition period be considered a "past service" cost which would be funded over a fairly long period. I am certain that those with technical competence can devise other methods that will not require delay in the protection which workers so urgently need.

Closely related to the objectives of vesting is the concept of pension portability. Its basic purpose to protect employees against the forfeiture of pension rights is just as well met by adequate vesting, funding and termination insurance provisions.

While the consolidation of pension credits in a single fund which would result from a system of portability will reduce the possibility that a worker will forget to apply for a vested benefit accrued years ago,

BEST COPY AVAILABLE

this goal can be achieved without the transfer of funds or the establishment of elaborate procedures. All pension plans should be required to provide information on vested benefits to the Social Security Administration for inclusion in an individual's social security record. When the individual applies for social security he will be notified of his rights to vested benefits and how application should be made.

While the transfer of funds may help in protecting a worker against the erosion in the value of his vested benefits, such problems might better be met directly. Others have proposed the issuance by the government of purchasing power bonds, the value of which would increase to provide cost of living protection. The availability of such bonds would permit a pension fund to provide protection of this type to vested benefits.

While vesting is essential to protect workers of pension protection upon termination of a job, yet as Senator Bentsen stated in introducing S. 1179, "Pension reform without minimum funding standards and required insurance is really no reform at all."

Funding requirements are desirable to enhance the security of benefit expectations. Termination insurance, however, is essential to provide full assurance that all benefits will be paid in the event of plan termination.

It should also be recognized that while funding and vesting provisions can be improved by an employer alone or by the union and the employer if the plan is collectively bargained, legislative action is necessary to meet the problem of insufficient assets in the event of plan termination.

While increased funding will generate more assets, the ever-changing character of private pension plans makes it extremely likely that full funding will never be achieved. Every time a plan is improved to meet inflationary pressures or changing economic conditions -- and if private plans have a virtue, this is it -- additional past service liabilities are created and an additional 30 years is required to achieve full funding.

Since the introduction of the first proposal for pension termination insurance by Senator Hartke in 1964, the various proposals have been studied and restudied and the basis for opposition has shifted. It is now generally agreed that such a program is technically feasible. The basic objection now centers around the argument that the magnitude of benefit loss is not sufficient to justify the establishment of a program covering all pension plans; and that the establishment of a program will invite pension abuses.

While the recent Treasury - Labor Department Study of Pension Plan Terminations has been used as a justification by the administration to recommend further study of the problem, it does show that during the first seven months of 1972, 8400 individuals lost some $20 million in benefits. The average benefit lost was $2,400.

I would doubt that the percentage of banks that go out of business or investors who lose funds when brokers experience financial difficulty is any greater than shown by the study, yet the FDIC continues as a Congressionally mandated program and the Securities Investor Protection Corporation was passed by the Congress and signed into law by the President in 1971.

A worker whose savings for retirement are in a pension fund is as worthy of protection as the bank depositor or the stock market investor. His needs for protection are as great as the holder of a FHA or other insured mortgage who is protected against the inability of the mortgagee to make good on his obligation.

Rather than being an objection to establishment of a program, the small percentage of terminations or workers affected only demonstrates that the cost of preventing the personal tragedy suffered by those who are affected will be very low.

Both S. 4 and S. 1179 which wouldinclude termination insurance provisions, contain safeguards against possible abuse of the insurance fund. Neither Bill would insure liabilities created by increases in benefits which resulted from plan amendments occurring in the three year period prior to termination. S. 4 would also require an employer to accept some liability for losses resulting from termination of his plan.

Both S. 4 and S. 1179 also make a distinction between multi-employers and other plans in establishing a termination insurance premium rate. In view of the risks of individual employee terminations which are borne by multi-employer plans and the recognition which both bills also give to single employer plans who have previously exercised responsibility in funding prior service liabilities, I would support such distinction. At the same time I would strongly urge that any legislation not permit experience making -- that is variations from the uniform rates by individual plans whether they be single employer or multi-employer.

Let me conclude by urging this Committee to act promptly so as to facilitate the adoption by the Senate of legislation to improve the effectiveness of the private pension system in meeting the needs of covered workers.

As it makes its decisions, I would hope that the Committee, for the reasons I have indicated, will keep in mind:

1. the necessity for termination insurance in order to adequately protect the benefit rights of employees whose private pension plan is terminated;
2. the necessity for the vesting of benefits accrued by all periods of service -- regardless of whether performed before or after the enactment of legislation or the establishment of a plan.

Legislation along the lines of S. 4 which incorporates these principles togother with funding and disclosure and fiduciary responsibility requirements will represent a forward step in the necessary reform of the private pension system.

Senator NELSON. The last day of hearings will be on June 12. We will be hearing from Senator Williams and Senator Javits on S. 4.

Thank you.

[Whereupon at 1 p.m. the subcommittee recessed to reconvene at 10 a.m., Tuesday, June 12, 1973.]

PRIVATE PENSION PLAN REFORM

TUESDAY, JUNE 12, 1973

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

The subcommittee met, pursuant to recess, at 10:05 a.m., in room 2221, Dirksen Senate Office Building, Senator Gaylord Nelson (chairman of the subcommittee) presiding.

Present: Senators Nelson, Long (chairman of the full committee), Bentsen, Bennett, and Hansen.

Senator NELSON. The witnesses this morning are Senator Williams and Senator Javits, who are the authors of S. 4, which has been reported out of the Labor Committee.

You gentlemen may proceed however you desire. Your statements, of course, will be printed in full in the record. We would be pleased to hear from you.

STATEMENT OF HON. HARRISON A. WILLIAMS, A U.S. SENATOR FROM THE STATE OF NEW JERSEY

Senator WILLIAMS. All right Thank you very much, Mr. Chairman. I will read the shorter statement; the longer statement I will ask to be included in the record.

Mr. Chairman and Senator Long, first let me say that we appreciate so much the way the procedural aspects of considering pension legislation were worked out this year. It seems to me that this was the most expeditious and easily the most intelligent way to deal with this subject matter, coming to us as it does in a Labor Committee bill, and other legislation that is before the Finance Committee and I know how you have been under sort of the gun in considering the legislation here in your hearings, and I am sure those who will be beneficiaries of the legislation dealing with pension regulations will be most grateful, as we are, and the other sponsors of the legislation that we have reported from the Labor Committee. Again, we are most appreciative.

As you know, the subject we are discussing in the form of our Nation's private pension system is one to which I, as chairman of the Senate Labor Subcommittee, have devoted a great deal of effort in the last 3 years.

Today, I would like to outline what our Labor Subcommittee has done, the conclusions we drew, and the reforms we have recommended.

I know you have a heavy schedule so my remarks will be relatively brief. However, I do have a more lengthy written statement, which I would ask, Mr. Chairman, that it, together with the appendix that is attached to this longer statement, be made a part of your record if that is possible.

Senator NELSON. It will be printed in full in the record at the appropriate place.

Senator WILLIAMS. Thank you.

Mr. Chairman, the appendix contains an analysis of Federal regulation of private pension plans and the development of these regulations. I hope this subcommittee will find this background information useful during its deliberations. This discussion of Federal controls is also specifically responsive, Mr. Chairman, to your statement of May 1, inviting views on which Government agency is best suited to administer such regulations.

As you know, the Senate Subcommittee on Labor recently completed a detailed study of the private pension system in our country. As chairman of the subcommittee, as well as the full committee on Labor and Public Welfare, I directed that study from its inception 3 years ago and can say that our whole effort has been a bipartisan effort on the part of the committee. Certainly, ranking minority member, Senator Javits, and I have worked as closely as anyone could in the legislative effort.

Our study was the most recent—and I believe most comprehensive—in a series of inquiries into private pension plans by both the House and the Senate Labor Committees.

These Labor Commitee studies, which go back at least to the 83d Congress, have provided a history of our private pension system, and of Federal legislation affecting it.

And the conclusion which one must draw from an examination of all this accumulated evidence, is that pension legislation enacted thus far has been totally inadequate to the needs of workers.

These statutes were aimed in the right direction.

But, they have failed to assure American workers that their pension benefits are secure, and will be available when promised and due.

The inadequacy of existing law, and the obvious need for pension reform, has been recognized by the Senate during the last three sessions of Congress.

In 1970, 1971, and 1972, the Senate adopted resolutions mandating the Subcommittee on Labor to conduct a general study of pension and welfare funds in the United States.

Furthermore, on each of these occasions the Senate directed our subcommittee to place special emphasis on the need for protection of the 45 million workers covered by private pensions.

That study has been completed.

The methods of inquiry employed by the Labor Subcommittee and the evidence we gathered, are matters of record.

Our findings have been published in considerable detail in a series of reports during the past 3 years.

And the record we assembled presents, in my judgment, an indelible picture of serious and widespread shortcomings in private pension plans.

In our study, the Labor Subcommittee first addressed itself to how widespread the denial of pension benefits really is.

Having established that this problem exists to a shocking degree, we examined the reasons for denial, and the effects it produces.

We held hearings, of course, here in Washington, and in Newark, Philadelphia, St. Louis, Minneapolis, and Cleveland.

And throughout our study, we heard from all sides of the issue. We listened carefully to both employees and employers, and to both proponents and opponents of pension reform legislation.

Mr. Chairman, I will say from a personal point of view, these hearings were often cruelly disturbing. The painful descriptions of the inadequacies, I know, have been brought to this committee's attention also, and I need not enumerate or personalize any more on that at this time.

But it was most painful to come face to face with the tragic, true stories of men and women denied the retirement security they had been relying on.

Time and again, we heard from workers who had given a lifetime of loyal service to their employers, counting on the promise of future pension benefits.

But in case after case, the promises proved empty, and the dreams of economic security in retirement simply evaporated.

While the causes of these broken promises varied, the results were personal economic catastrophes.

We found that generally the causes fell into one or more areas, all of which were closely examined by our Subcommittee.

These areas are vesting, funding, portability, insurance and fiduciary conduct.

And we also found that most of these tragedies could have been prevented.

They could have been prevented by adoption of comprehensive nationwide, and vigorously-administered guidelines for private pension systems.

Accordingly, the Subcommittee on Labor recommended, in February 1972, six major reforms:

1. A Federal law establishing minimum standards of vesting.
2. A Federal law establishing funding requirements, accompanied by a program of plan termination insurance.
3. Uniform, Federal standards of fiduciary responsibility.
4. Improved requirements for disclosure, and communication of plan provisions to participants.
5. A program to develop portability and reciprocity among private pension plans.
6. Centralization in one Federal agency of pension plan regulation.

These recommendations for reform were embodied in the Retirement Income Security for Employees Act—S. 3598—which Senator Javits and I introduced just over a year ago.

That bill was carefully considered by the Subcommittee on Labor, and the full Labor and Public Welfare Committee.

We reviewed the findings of our study, and heard a great deal of testimony both pro and con on specific features of the legislation.

Let me say at this point that we gave specific consideration to the question of which Federal agency ought to be charged with implementing these reforms.

Our conclusion was that it must be an agency which workers will look to with confidence for help. It must be an agency which will restore their faith in the private pension system.

Only in this way can their faith in the reliability of private pensions be restored.

Accordingly, the Committee's judgment was that administration of pension plan regulation ought to rest with the agency which has as its primary mission, safeguarding the rights of working people—the Department of Labor.

As you know, Mr. Chairman, last year's bill was reported to the Senate, with a favorable recommendation, by unanimous vote of the Labor and Public Welfare Committee.

In the current Congressional session, Senator Javits and I reintroduced this legislation as S. 4.

This bill was again carefully considered by both the Labor Subcommittee, and the full committee, and additional hearings were held.

As a result of our additional consideration, some modifications were made.

And on March 29, the Committee on Labor and Public Welfare once again unanimously endorsed this legislation, and sent it to the Senate with a recommendation for passage.

S. 4 is now awaiting a vote by the full Senate.

I would point out, Mr. Chairman, that a total of 53 Senators have joined as co-sponsors of this measure.

Mr. Chairman, I know you agree with me when I say that there can be no doubt of the urgent need for comprehensive, pension reform.

I have noted that two of the most distinguished members of this committee, Senators Bentsen and Hartke, have underscored the necessity for pension reform by introducing thoughtful legislative proposals in this area. Their bills, I recognize, are now pending before this committee. Each of them would establish standards for the vesting, funding, and insurance of private plans.

The painstaking study by the Subcommittee on Labor provides a compelling case for such legislation.

Furthermore, it has shown us how the rights of workers can be effectively protected, while our system of private pensions is strengthened.

The bill our subcommittee developed—S. 4—is based on that study and tempered by two sets of additional hearings.

It has now been offered to the Senate as a realistic, workable, and effective means of reforming private pensions.

There can be no justification for further delay in enacting pension reform.

I honestly submit further delay in enacting pension reform would be very harmful to the country as a whole. Congress has already delayed too long and many workers have suffered as a result.

To let them suffer longer would be unconscionable.

Mr. Chairman, again, my thanks to you and the members of this committee.

This appendix——

Senator NELSON. Thank you. Your statement and appendix will be placed in the record.

[The material referred to follows:]

MEMORANDUM SUBMITTED BY CHAIRMAN HARRISON A. WILLIAMS, JR., AND JACOB K. JAVITS, RANKING MINORITY MEMBER, U.S. SENATE LABOR AND PUBLIC WELFARE COMMITTEE

THE CASE FOR PRIVATE PENSION REFORM AS A LABOR LAW

(In the consideration of pension reform legislation now pending before the United States Senate, a diversity of views exist on the issue of which federal agency shall be given responsibility for the administration and enforcement of pension reform enactments. This memorandum is an analysis of those arguments which support the designation of the Department of Labor as the appropriate agency.)

I. DEVELOPMENT OF PRIVATE PENSION PLANS

Although private pension plans were introduced in the United States before the turn of the century, their growth in coverage and assets has been most substantial during the last two decades.[1] This rapid development was due to several formative influences:

Tax inducements.—Tax incentives were granted to employers in the deductions provided for employer contributions to private plans;

Wage stabilization programs.—Wage freezes in World War II and the Korean Conflict encouraged the granting of fringe and retirement benefits in lieu of higher wages;

Collective bargaining.—Recognition of the pension benefit as a mandatory subject of collective bargaining under the National Labor Relations Act stimulated bargaining for private pension benefits;

Business necessity.—Employers hiring in a free competitive economy offer the pension benefit to meet the demands of the labor market.

While no single influence is responsible for the phenomenal growth of the private pension system, the major reason is that private pensions offer substantial advantages to both employer and employee.

Today, more than 35 million workers are looking toward a private pension plan as a major source of economic security for old age. Pension funds control assets in excess of $160 billion and this figure is increasing by more than $10 billion each year. Estimates indicate that by 1980, private plans will control $280 billion in assets and cover over 42 million workers.

Failure to realize expectations created by the pension promise have generated public concern for the adequacy and effectiveness of regulatory control exercised over pension funds. The need for governmental supervision over the private pension system has become a matter of increased debate and is now a crucial issue before Congress. The debate has ranged from the extremes of absolute control to minimal regulation.

The public interest in private plans, as identified in the reports of 1972 and 1973 by the Senate Committee on Labor and Public Welfare, is rooted in its effect on the incentives, the mobility and the employment prospects of the labor force. Work performed in reliance on the pension promise can be rendered but once in a lifetime. Once regarded as a gratuitous reward for long and faithful service, the pension benefit has now evolved into an important element of wages in the form of deferred compensation.

Congress has from time to time expressed concern for the operation of the private pension institution. Yet, legislative progress for reform has been slow and of questionable effectiveness in resolving the real issues within the system. Lack of protective legislation at the federal level has prompted individual states to attempt to fill the regulatory vacuum. An institution of this magnitude, therefore, demands effective federal legislation for establishment of minimum national standards which will protect the reasonable expectations of its millions of participants.

[1] See Interim Report, Senate Subcommittee on Labor, S. Rep. No. 92–634, 92nd Congress, 2nd Session, 1972.

II. EXISTING FEDERAL LAWS GOVERNING PRIVATE PENSION PLANS

A. Background of Labor Law Regulations Governing Private Pensions

Within the last 25 years, Congressional concern for some measure of protection for workers' private pensions has been expressed by enactment of labor law measures. A survey of existing federal jurisdiction over pensions was conducted by the General Accounting Office for the Senate Labor Subcommittee, as a part of the Subcommittee study, and concluded that:

> "Among the various agencies exercising legal authority and responsibility over private pension plans, *the Department of Labor has the most significant role.* Under the authority of seven different laws, Labor's responsibilities in the private pension area range from requiring disclosure of pertinent information on plans to preventing discrimination against various classes of workers."[2]

The National Labor Relations Act, as amended, (29 USC 141 et seq.) and the Welfare and Pension Plans Disclosure Act (29 USC sec. 301 et seq.) are the principal labor statutes exercising regulatory control over private plans.

The National Labor Relations Act, as amended, provided the impetus for the phenomenal growth of the private system in the last two decades, when the federal courts in the Inland Steel decision of 1948[3] recognized the pension benefit as within the purview of the "wages or other conditions of employment" as defined in the NLRA, thus making pensions a mandatory subject of bargaining.

In addition, the Taft-Hartley Amendments of 1947 to the NLRA set forth the conditions of administration for the jointly administered union-management pension funds. Subject to certain conditions, this Act allowed employers to contribute to welfare and pension plans administered by boards of trustees with equal representation of labor and management. The essential conditions required the pension agreement to be in writing, the funds to be used for the exclusive benefit of the employees, and an annual audit to be conducted.

Extensive investigations into the management of specific pension funds by the Senate Labor Committees in the 1950's led to the enactment of the Welfare and Pension Plans Disclosure Act of 1958. This Act required registration, reporting and disclosure of private pension fund transactions to the Secretary of Labor. It was amended in 1962 to make theft, embezzlement, kick-backs and bribery a federal crime if such activity occurred in connection with a pension or welfare plan.

At least seven other federal labor statutes also affect the operations of private plans (See Appendix). For example, the Fair Labor Standards Act regulates employer contributions to private plans in determining employee rates of pay and the Age Discrimination Act of 1967 provides that pension contributions cannot be used to discriminate against older workers.

It should be noted that none of the foregoing labor legislation affected the Internal Revenue Code directly or otherwise, nor required amendment to the tax laws. Since they consist of affirmative mandates directed to protecting the interests of workers in private pensions, Congress did not believe that these measures were either appropriate or necessary for incorporation into tax qualification statutes. Even though these laws have not achieved the degree of protection necessary to provide adequate safeguards for employee interests in private pensions, their very existence demonstrates a long-established and accepted pattern of Congressional determination to secure the public interest in private pension plans beyond the limited requirements attending tax benefits and considerations.

B. Background of tax law regulation of private pension plans

Under Seccion 401 of the Internal Revenue Code of 1954, tax exempt status is conferred on all pension funds which "qualify" for such benefits. The grant of "qualified" status results in tax advantages in that: (1) employer contributions into a pension fund are deductible as they are made, (2) profits made by fund investments are free from tax, and (3) employee tax liability on pension benefits is deferred until such time as the benefits are received by eligible participants.

To "qualify" for favorable tax treatment, a plan must be written, permanent and in existence during the year in which exemption is claimed. In addition, the plan must be "for the exclusive benefit of covered employees" and their beneficiaries and must provide benefits in a way which does not discriminate in favor of stockholders, officers, supervisors or highly paid employees.

[2] Interim Report op. cit., p. 91.

[3] 170 F. 2d 247 (7th Cir. 1948), cert. denied, 336 U.S. 960 (1949).

The early history of tax exemptions for private pensions goes back to the Revenue Act of 1926. Prior to the adoption of this statutory authority for tax exemption, the income of employee trusts was taxable either to the employer, employee, or to the trust itself, depending on the terms of the trust instrument. Amounts contributed by employers to such trust funds were generally taxable income to the employee at the time paid unless his rights under the plan were so contingent on future events that it would be unreasonable to impose a tax on the basis of currently realized income.

The tax exemption legislation of 1926 imposed no limitations on employer deductions and no special rules relating to coverage. Most of the restrictions currently existing in tax legislation were adopted in a series of tax bills between 1928 and 1942. Those of major importance include:

1928—provisions were added to tax laws which restricted employees contributions to a pension plan over a ten-year period. One of the main purposes of this provision was to prevent employers from concentrating pension deductions in years most advantageous from an income tax standpoint.

1938—provisions were added requiring that employer contributions be irrevocable with no use of funds permitted for purposes other than the exclusive benefit of employees. The purpose of this legislation was to prevent the possibility of pensions becoming a tax avoidance device whereby employers could set up funds in good years and later recapture them in years of financial distress.

1942—provisions were added establishing minimum coverage requirements; prohibition of discrimination in contributions or benefits in favor of higher-paid employees; deductions for employer contributions to fund past services extended to 10% of past service liability or an amount when combined with current service contribution would not exceed 5% of covered employee compensation; and capital gains tax treatment extended to lump sum payments to employees at termination of service.

1954—entire Revenue Code revised. It generally continued and strengthened the tax advantages existing previously. However, two major additions were made: qualified trusts were made subject to tax on "unrelated business income" and faced loss of exempt status if they engaged in certain "prohibited transactions". Again, the basic purpose was to prevent the trust from becoming an instrument for tax avoidance by subverting its objectives.

The changes made by the 1942 Revenue Act included restrictions and liberalizations of earlier tax provisions. The restrictions imposed (coverage and nondiscrimination requirements) were largely corrections of omissions in the original tax exemption law which had become obvious during years of experience with such legislation, and which had been accentuated by changing economic conditions. The absence of such requirements had led to the creation of some plans for the benefit of a few key individuals within companies which, in operation, were merely tax avoidance devices rather than bona fide retirement plans.

As early as 1937, the President informed Congress that attempts to encourage employee retirement plans through special tax treatment had resulted in tax avoidance and he requested remedial legislation. When Congress failed to enact coverage and nondiscrimination requirements in 1938, the Treasury Department attempted by regulation to institute standards of this nature to prevent tax abuses. In 1940, the Treasury Department was forced to rescind its regulatory authority in this regard because of lack of statutory authority and adverse decisions by the Board of Taxation.

Those who have advocated the use of Internal Revenue Laws to protect employee benefits have argued that the IRC was intended to provide adequate security to employee interests as a condition of obtaining tax benefits. However, after exhaustive analysis of this issue, Cardoza Professor Emeritus of Jurisprudence at Columbia University, Edwin W. Patterson (who was a Deputy Superintendent of Insurance in New York) in his book, *Legal Protection of Private Pension Expectations*, concluded that:

> "On the whole, the Internal Revenue Code of 1954 provides only limited safeguards of the security of anticipated benefit rights under private pension plans. It is primarily a law designed to produce revenue and to prevent evasions of tax obligations under the guise of recognized exceptions."
>
> "The inquisitional powers conferred on the service by the Code . . . and the keeping of records and the making of statements under oath when called for are limited to the objectives of the Internal Revenue Code, namely, to prevent tax evasion and discrimination."[4]

[4] Richard D. Irwin, Inc., Homewood, Ill., 1960, p. 97–99.

BEST COPY AVAILABLE

III. PROPOSED LABOR LEGISLATION FOR PRIVATE PLAN DEFECTS

A. Study of Private Pensions by the Senate Labor Subcommittee

Viewed from historical perspective, the recent Senate pension study has served as a successor to the investigations of the Senate Labor Committees, dating back to the 83rd Congress in 1954. Those investigations surfaced shocking abuses of internal administration and misuse of fund assets in a number of private pensions. Enactment of the Welfare and Pension Plans Disclosure Act of 1958 as well as the Landrum-Griffin Act of 1959, were direct result of these and related Senate investigations.

The latest Senate study of the private pension system was directed by three successive Senate Resolutions dating back to March 12, 1970.[5] Congressional concern was generated by the complaints and allegations that thousands of workers entitled to receive earned pension benefits were being denied their pensions. It is significant that each resolution contained a specific mandate to the Senate Labor Committees to conduct the study with "*special emphasis on the need for protection of employees covered.*"

These three charters manifest the continuing recognition by the Senate that the Labor Subcommittee was and is the appropriate Committee to define the pension problems of workers and to propose the legislative solutions which would adequately protect the pensions of workers covered. In pursuit of this objective, the Senate appropriated approximately $1 million in funds.

After three years of methodical and analytical study, the "Retirement Income Security for Employees Act of 1972" was introduced as S. 3598 in the 92nd Congress. This bill, with unanimous approval by both the Subcommittee and full Committee on Labor and Public Welfare, was not acted upon due to other priority legislation pending before the early Senate adjournment for national elections in 1972. However, the Senate leadership announced prompt consideration of this legislation if brought to the Senate Floor in the 93rd Congress. The RISE Act was reintroduced as S. 4 in the 93rd Congress, with the co-sponsorship of 53 Senators. S. 4 was approved unanimously by both the Senate Labor Subcommittee and Labor and Public Welfare Committee and has been pending on the Senate Calendar since April 18, 1973.

B. Senate Findings as the Basis for S. 4

To define existing problems, the Senate Pension Study undertook a meticulous investigation of the workings of the private pension system. Among the various studies, one utilized the Senate computer for the first time in preparing a statistical analysis of the provisions of 1493 private plans selected as a representative cross-section of plans and participants. Findings of this study were published in Senate Report 92-634 on February 22, 1972 and subsequent publications.[6]

Detailed analysis of many plan provisions produced disturbing results. While many plans were found to be administered and operated in a safe and equitable manner, substantial defects and inequities were discovered which evidenced sufficient proof that a number of workers were losing or being denied pension benefits. Testimony of workers in several major public hearings before the Senate Labor Committee confirmed the existence of serious shortcomings in the administration and operation of the system.[7] Since private pension benefits are governed exclusively by the rights and obligations specified in the pension contract, it was apparent that all defects were traceable either to the terms or non-existent provisions in the contract. The denial or loss of pension benefits to workers were principally attributable to:

The lack of effective centralized federal regulatory control over the scope of operation and administration of the private pension plan;

Inadequate or nonexistent vesting provisions which result in the denial of retirement benefits despite long years of employment;

Inadequate accumulation of assets in funds to meet obligations to workers entitled to benefits;

[5] S. Res. 360, 91st Cong., 2nd Sess.; S. Res. 35, 92nd Cong., 1st Sess.: S. Res. 235, 92nd Cong., 2nd Sess.

[6] See Preliminary Rep. of the Private Welfare and Pension Plan Study, (1971), 92nd Cong., 1st Sess.: Rep. of Hearings on Pension Plan Terminations, 92nd Cong., 2nd Sess.: Statistical Analysis of Major Characteristics of Private Pension Plans, 92nd Cong., 2nd Sess. (1972).
Parts I & II, 92nd Cong. 1st Eess. (1971); also, Hearings, Subcommittee on Labor, Senate

[7] See Hearings, Subcommittee on Labor, Senate Committee on Labor and Public Welfare, Parts I, II, III, 92nd Cong., 2nd Sess. (1972).

BEST COPY AVAILABLE

The lack of transfer mechanisms to allow workers to transfer earned pension credits from one plan to another;

Premature termination of pension plans with inadequate resources for payment of benefits due;

Lack of uniform rules of conduct for fiduciaries who administer the investment of pension funds;

Lack of adequate and comprehensive communication to plan participants of their rights and obligations under the contract.

C. Legislative Remedies Proposed by S. 4

The proposed remedies of S. 4 are directed to the specific documented findings of the three year Senate Study. They respond to the major defects identified which require reform if workers are to be protected.

S. 4 is intended to restore the credibility and faith of American working men and women in their pension plans. Simply stated, a pension plan is either a promise which an employer expects to fulfill and which his employees expect to be fulfilled, or a warranted expectation by them that they will receive pensions.

Any failure by the employer to carry out his part of the agreement, or any lack of faith by his employees in the willingness of the employer to pay in full their earned and reasonably expected pension benefit serves to defeat the combined labor, management and social objectives which the pension plan was established to serve. The failure of the pension promise produces irreparable injury to the interdependent relationship which must exist between employee and employer. Thus a major work incentive which is indispensable to the productivity of a sound economy is undermined.

The basic reforms approved in S. 4 by the Senate Committee on Labor and Public Welfare are as follows:

(1) Prescribes minimum vesting standards whereby employees, after 8 years of service would be entitled to a vested non-forfeitable right to 30% of his earned pension credits accumulating an additional 10% each year thereafter until 100% vested at 15th year of employment.

(2) Establishes minimum funding requirement for funding of all pension liabilities over a 30-year period.

(3) Establishes a voluntary program for portability of pension credits through a central fund, whereby employees of participating employers may transfer vested credits from one employer to another upon change of employment.

(4) Establishes plan termination insurance program to guarantee that vested pension credits of employees will be paid upon premature termination of a plan when there are not sufficient assets to pay workers' vested benefits.

(5) Establishes minimum rules of conduct for trustees and other fiduciaries in the administration and investment of pension fund assets.

(6) Requires comprehensive disclosure of vital financial data in reports to be filed with the Federal Government, and understandable explanations to workers of their rights and obligations under their pension plans.

(7) Makes it unlawful for any person to discharge, suspend, expel, fine, discipline or discriminate against participants in order to interfere with their rights under the plan or the Act, or for the purpose of preventing the attainment of their rights under the plan or the Act. It is made a criminal offense to use fraud, force or violence, or threats thereof, in this connection.

(8) Provides adequate remedies to both the Government and individual worker for judicial and administrative enforcement of the bill's provisions, including recovery of pension benefits due.

The underlying thrust of S. 4 is to protect workers' rights in and expectations in private pension benefits. It accomplishes this objective by establishing minimum safeguards which all plans must contain, independent of their taxable status at any particular point in time. This legislation is a minimum standard labor law based upon the constitutional authority to regulate interstate commerce, and industries and activities affecting such commerce.

The minimum proscriptions required by S. 4 are based upon the recognition that lack of adequate protection of workers' pension benefits results not from abuse or misuse of the tax advantages afforded to private pension plans, but from the inadequate provisions of the pension contract in the absence of mandatory provisions which would guarantee minimum protections.

Further, S. 4 acknowledges that the development of private pension plans involved considerations transcending tax incentives. Among the considerations are those relating to the conditions of employment, labor-management relations, worker productivity, management efficiency, and the social need for a pension plan as an integral element of retirement planning, with obvious concern for adequate economic security in retirement.

D. Analogy of S. 4 to Other Labor Laws

Labor laws for the protection of workers have generally followed the industrial development of the nation—and to meet their needs, public conscience at times demands governmental action where the private sector is unable to or is unwilling to meet such needs.

The first important labor law took the form of child labor legislation to protect the exploitation of children. Close behind came laws to protect women exgainst excessive hours of work and further safeguards against hazardous working conditions.

Subsequent federal legislation later recognized labor's right to promote its own welfare through mutual association. It guaranteed labor's right to organize, to strike, and to bargain collectively, and extended the help of government in promoting industrial peace and fair treatment through mediation and conciliation. More recent measures also included insurance against occupational accidents and disease, unemployment, or sickness, minimum wages, and prohibition of discrimination in employment because of race, creed, color, sex, or age.

Modern labor laws, while providing for corrective and protective measures, also assure certain basic rights of labor, and obligations of society as a whole to all workers.

Experience has shown that laws to protect workers are not self-executed. They are meaningless unless their provisions can be translated into actual benefits for workers through competent and adequately financed administration, by penalties for violation, and adequate remedies in the judicial process.

Labor laws are interrelated, both in purpose and effect on the worker and our nation's economic and social structure. This interrelationship for maximum benefit requires effective and efficient administration of the governing laws designed by a strong and competent administration of a co-ordinated agency, such as the Department of Labor, which has encouraged and understood the labor-management relationship.

There are at least seven significant labor laws affecting regulation of private pension plans which are administered by the Department of Labor. Thus, the addition of new regulatory measures protecting the interests of workers in pension plans as recommended by S. 4, can and should be logically and consistently integrated within the framework of other labor standard measures administered and enforced by that Department.

Equally important is the similarity of the approach to administration and enforcement for the reform of private pension plans, and the approach taken under such laws as the Fair Labor Standards Act, Occupational Health and Safety Act and the Age Discrimination in Employment Act.

Underlying the policy of all labor law is the effort to protect workers' interests. As the Senate Labor Subcommittee has demonstrated in its findings, lack of adequate safeguards in private pension plans require government action to protect workers' benefits. All too frequently, the pension promise is broken, and like substandard wages, unsafe working conditions, discriminatory employment and similar practices, it becomes a real and legitimate subject for labor law regulation. The same compelling reasons which require judicial enforcement of other labor standard laws, are equally applicable in the implementation of the minimum standards for private pensions.

It follows that the federal agency historically equipped to administer such protective pension legislation is the Department of Labor. The purpose of the Department as stated in 29 U.S.C. Sec. 551 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".

IV. S. 4 DOES NOT AMEND THE INTERNAL REVENUE CODE OR CREATE DUAL ADMINISTRATION

A. S. 4 Does Not Amend the Internal Revenue Code

The provisions of S. 4 make no direct or indirect incursion revision, or amendment of the Internal Revenue Code. The bill does not conflict with any statutory provision which governs grant or denial of tax deductions or privileges. The awareness of tax law aspects affecting private pensions is emphasized by the references to provisions in the IRC in the text of S. 4. The references are deliberate and indispensable for reasonable comprehension of S. 4 and intended to assure compatibility of administration and enforcement with appropriate IRC provisions.

On September 25, 1972, having requested S. 3598 (S. 4's predecessor) from the Senate Calendar for its consideration, the Senate Finance Committee filed a report reflecting its views of the bill. While the report made no attempt to pass judgment on its substantive provisions relating to coverage, vesting, funding, insurance or portability, it did contend that legislation such as proposed by the bill has been handled historically through tax laws and, accordingly, was outside the jurisdiction of the Senate Labor and Public Welfare Committee.

The objections, as reported by the Finance Committee, are essentially that:

(a) Its provisions attempt to revise tax laws without specifically amending them, and such effect would be inevitable because of S. 4's references to specific provisions in the Internal Revenue Code, and,

(b) Administration of its provisions would require enforcement by the Secretary of Labor, and this would result in dual administration and conflict with the Internal Revenue Service, both in regulation and enforcement of affected laws.

To these objections, it is noted that the references to the Internal Revenue Code do not incorporate into S. 4 any of the IRC provisions. They are instead used deliberately to specifically avoid complicated and unnecessary repetition in S. 4 and they serve to signal the limits of jurisdiction established by S. 4. The references further serve to assure compatibility in administration and enforcement of S. 4 provisions, with provisions of the IRC. As to the objections relating to dual administration, these are considered in detail in Sec. B.

B. S. 4 does not Create Dual Administration

It has been contended that the new substantive requirements in S. 4 regarding coverage, vesting, funding, fiduciary standards, would, if administered by the Department of Labor, result in dual administration of certain comparable requirements by the Internal Revenue Service.

Specifically, it is observed that the IRS has imposed vesting and funding requirements to secure protection against discrimination in favor of higher paid employees, and fiduciary standards under the prohibited transactions provisions of the Code in order to prevent pension plans from being converted into tax evasion schemes.

Accordingly, it is argued that enactment of S. 4 as a labor measure would result in problems of (1) dual staffs in two agencies, (2) dual reports, (3) differences in coverage, (4) conflicting requirements, (5) qualifications under one set of requirements and not the other, and (6) changes in enforcement procedures.

Vesting conditions administratively imposed by the IRS are greatly limited in scope and application; otherwise, the problems of non-existent or inadequate vesting provisions exposed by the Senate Labor Subcommittee would not have occured. In essence, the IRS may refuse to grant or continue tax privileges of a plan if the absence of vesting in such a plan would result in discrimination in favor of higher paid employees. This requirement is not specifically contained in the provisions of Section 401 of the IRC, but is an administrative policy of IRS which results from its construction of the anti-discrimination provisions of Section 401. The reason given for this construction is that in the absence of vesting for all employees in a small plan, only the highly compensated proprietors and managers of the enterprise are likely to have sufficient length of service to qualify for a pension.

Since S. 4 does not assume jurisdiction over small business pension plans, it is doubtful that S. 4 would interfere with, or impede, the administrative practice that IRS has made concerning the anti-discrimination provisions of the Code.

IRS also requires employers to fund current service liabilities of a plan and the interest on the past service liabilities. It does not require compulsory funding of all accrued past service liabilities, and this is the very core of the funding requirement in S. 4. As noted later, the inability of the IRS to compel employer contributions for sound funding renders the IRS impotent to assure promised retirement security for workers.

In addition, IRS administers a loosely defined and vague set of fiduciary standards through the so-called "prohibited transactions" provisions of the IRC. Essentially, these requirements permit conflict of interest investments and transactions if they are for "adequate consideration." It should be noted, however, that these standards relate only to the issue as to whether tax privileges should be withdrawn and not to fiduciary abuse. It is therefore universally conceded that these standards are totally ineffectual to prevent fiduciary abuse in private pension plans. IRS has testified to this effect before Congressional committee[8] and the Administration itself has endorsed a fiduciary bill (S. 1557) which ties administration and enforcement of fiduciary standards to the Secretary of Labor and court remedies, as in S. 4.

There is no valid reason why the "prohibited transactions" provisions of the Internal Revenue Code cannot be augmented by independent legislation, such as was done in the WPPDA Amendments of 1962, when kickbacks, bribery and embezzlement involving private pensions and welfare plans were made federal crimes under Title 18, USC. If the fiduciary provisions recommended by either S. 4 or the Administration's bill (S. 1557) were limited to enforcement under the IRC, the problems of fiduciary abuse would continue unabated since the IRS lacks powers to seek judicial sanctions. In addition, splitting off the fiduciary standards from the disclosure requirements of WPPDA (which is administered by the Labor Department) would seriously hamper effective implementation of fiduciary requirements since the disclosure provisions are designed to provide information that would assist in uncovering and preventing fiduciary abuse. Thus, for example, if reports to the Labor Department disclosed a serious conflict of interest on behalf of a fund administrator under S. 4, the Labor Department could move immediately to the courts to set aside the conflict of interest and require payment to the pension fund of any monies that were diverted by reason of such conflict. The IRS, on the other hand, would be limited to removing the plan's tax qualification or imposing tax penalties (assuming that information of the conflict had come to their attention), but could take no action to set aside the conflict and compel the return of diverted pension assets to the trust fund.

Arguments have been made that enactment of S. 4 would result in:

(1) *Dual staffs.*—To some extent, dual staffs now exist and are sanctioned by the Congress since the Department of Labor, as previously noted, is currently responsible for private pension regulation under seven different labor laws, including the WPPDA; and the IRS enforces the tax incentive provisions of the IRC. Since both agencies regulate private pension plans for different statutory purposes, such dual regulation is not anomalous. Such duality of staffing does not involve nor result in *duplication of regulation or function.* Regulation of vesting, funding, fiduciary standards, coverage, etc., is different in nature and purpose under S. 4 from any similar incidents of regulation performed under the IRC. The latter is designed to prevent abuse of tax incentives; the former is designed to safeguard the minimum retirement security interests of workers in private pension plans, *regardless of the plan's taxable status.*

(2) *Dual reports.*—It is argued that plan administrators would be required to file two different and separate reports relative to the same general area. *Dual reporting, however, should not be confused with duplicatory reporting.* In fact, dual reporting is now required of pension plans under regulations of the IRS and under the WPRDA. The reports serve different purposes in discharge of statutory responsibilities of two different agencies and to the extent duplication has been found to exist, it has been eliminated by agreement between IRS and the Secretary of Labor. (See Rev. Proc. 66-51 and General Instructions E to IRS Form 2950.)

If the substantive reporting requirements of S. 4 were incorporated into the Internal Revenue Code, they would require additional reporting to the IRS since the data necessary is intrinsic to the implementation of S. 4. The reports provided now to IRS in connection with tax deductions and the tax exempt status of a pension trust are not sufficient for comprehensive oversight of plan administration and operations. They do not, for example, enable IRS to determine the actuarial soundness of the pension plan's funding procedures, a matter vital to effective enforcement of new funding standards required by S. 4. If opposition to S. 4 based on dual reporting has validity, then logic and sound administration would require transfer of the current reporting and disclosure requirements of the WPPDA from the functional jurisdiction of the Labor Department to the IRS.

(3) *Gaps in coverage.*—The IRC requires certain qualification standards regardless of the number of employees covered by a plan, where a plan requests

[8] See Welfare and Pension Plans Investigation, Final Report, submitted to the Committee on Labor and Public Welfare by Subcommittee on Welfare and Pension Funds, U.S. Senate, 84th Cong., 2nd Sess. at pps. 59-60 (April, 1956).

qualification for favorable tax treatment. On the other hand, S. 4 exempts all plans with less than 26 employees. This size cut-off exemption in S. 4, however, reflects a conscious legislative policy to exempt small plans from the more stringent requirements in order to avoid inhibiting their future development. While the validity of such exemption may be arguable, it would have little relation as to whether private pension reform standards should proceed by way of amendment to the Internal Revenue Code or through enactment of a labor bill, S. 4.

(4) *Conflicting requirements.*—It has been asserted that S. 4 would create conflicting requirements because plans seeking tax qualifictaion would have to meet different standards under the IRC than standards required for registration under S. 4. There is no conflict since S. 4 does not infringe upon or impair IRS standards for qualification purposes; IRS standards remain intact for plans seeking to obtain or maintain tax privileges. S. 4 does impose different requirements which are totally unrelated to qualification for tax benefits. The approach of S. 4 is identical to the WPPDA. *The WPPDA which requires all pension plans (with certain exceptions not relevant here) to file plan description and annual financial reports with the Department of Labor, regardless of the plan's compliance with IRS standards for tax qualification.* There is no conflict between the IRC and the WPPDA; the statutes are designed to accomplish different purposes and the IRS and the Secretary of Labor discharge different but mutually compatible statutory responsibilities.

(5) *Dual investigations.*—It is argued that S. 4 would subject private pension plans to dual investigations from both the Internal Revenue Service and the Department of Labor, with the implication that such investigations would impose burdens upon the plans. Dual investigations currently are conducted both by IRS and the Labor Department on related subjects of inquiry without resulting duplication. The scope of the investigations though related are conducted pursuant to different statutory objectives. It must be assumed that with passage of S. 4, proper coordination would be required between IRS and the Labor Department in performing audits and investigations of private pensions. This is certain to result in more comprehensive and effective enforcement of each agency's different statutory responsibilities.

It is not uncommon today in the government for agencies with investigative responsibilities, e.g. the F.B.I., Narcotics, Labor, Secret Service, Customs, SEC, Comptroller of Currency, FDIC, etc., to have the same subject of investigation pursuant to each agency's statutory responsibilities. Each agency necessarily limits the scope and nature of its inquiry to its statutory limitations; however, by appropriate coordination, it not only eliminates any functional overlapping, but actually achieves better efficiency and effectiveness. For example, the Labor Department has already entered into enforcement-sharing agreements with the Department of Justice under the WPPDA to coordinate investigations in both reporting violations (Labor Deparment responsibility) and criminal violations of Title 18, U.S.C. relating to kickbacks, bribery, embezzlement and false statements (Justice Department responsibility).

(6) *Changes in enforcement procedures.*—It has been asserted that S. 4 is a departure from the traditional enforcement policy of the IRC, which is to remove tax privileges where a pension plan fails to comply with required standards. The weaknesses in relying on a tax penalty approach to enforcing S. 4 standards of vesting, funding, termination insurance, fiduciary provisions, etc., are described fully in Part V, *infra.* It is sufficient to observe that provision for administrative and judicial enforcement is indispensable to the achievement of the objectives of minimum safeguards for employee benefits. Moreover, no provision in S. 4 interferes with existing tax penalties for failure to comply with tax qualification standards. Again, the analogy is to the enforcement procedures of the WPPDA. Failure to comply with the WPPDA does not result in withdrawal of the plan's tax privileges. Instead, the provisions of the WPPDA are enforceable in the courts. With this precedent, it is evident that enforcement procedures governing pension plans have not been confined by the Congress to withdrawal of tax privileges. The same is true concerning enforcement of pension plan regulation under the Labor Management Relations Act, the Fair Labor Standards Act, the Davis-Bacon, the Age Discrimination in Employment Act, and other relevant labor measures administered by the Labor Department.

V. PENSION REFORM LEGISLATION SHOULD BE ADMINISTERED AND ENFORCED BY THE SECRETARY OF LABOR

Under S. 4, the Secretary of Labor is delegated overall authority for the administration and enforcement of the vesting, funding, plan termination insurance, probability and fiduciary-disclosure standards. The rationale for this delegation is based on logic and compelling practical considerations.

Logically, private pension benefits are a form of deferred wages for workers, and therefore, employee benefits. Employee benefits, whether derived from pension plans or minimum wage standards, occupational health and safety standards, wage and hours legislation, discrimination in employment laws, etc., have been given historically to the Secretary of Labor to administer. It follows therefore, that new legislative minimum standards to protect workers' pension benefits should also be administered by the Secretary of Labor.

There are other serious practical considerations which dictate the incorporation of these new reform standards into a labor measure appropriate for administration by the Labor Department. These concern the serious weaknesses and deficiencies in administration and enforcement which would result if the provisions of S. 4 were adopted as amendments to the Internal Revenue Code to be administered within the existing framework of IRS regulatory structure.

The incorporation of private pension plan reform standards into the Internal Revenue Code would frustrate the effectiveness of the legislation and deprive workers of rights and remedies which are vital to their retirement security needs under private pension plans because:

(1) *The Internal Revenue Code does not create any private rights.*—Neither the Internal Revenue Service nor participants can enforce their rights to vested benefits under the Internal Revenue Code. The only sanction under the Internal Revenue Code for the failure of a tax qualified pension trust to provide vested benefits in accordance with new federally imposed vesting standards is for the Internal Revenue Service to disqualify the pension plan for tax purposes, and if authorized to do so, impose tax penalties on the employer. The removal of the plan's tax qualified status will not necessarily result in participants securing their vested rights. By way of contrast, under S. 4, either the Secretary of Labor or a plan participant can proceed directly to federal court to enforce statutorily granted vested rights.

(2) *Funding standards cannot be enforced under the Internal Revenue Code.*—Under S. 4, the funding of private pension plans can be compelled by the Secretary of Labor through court action if the employer fails to pay the statutorily required contribution, or otherwise deviates from standards established to assure that the plan is funded on an actuarily sound basis. Because of the integration of S. 4's funding provisions with the federal plan termination insurance program established under the bill, in the event an employer deliberately terminates a private pension plan in order to avoid funding requirements, the employer is liable to reimburse the federal termination insurance program for up to 50% of his net worth for any vested benefit losses paid for by insurance.

None of these safeguards are available under the Internal Revenue Code. A failure to make a required funding contribution under the Internal Revenue Code will only result in loss of the plan's tax qualification, imposition of a tax penalty on the employer, deliberate plan termination by the employer, or possibly all three. The threat by IRS to remove a tax deduction is meaningless where the employer refuses to contribute to the plan and therefore claims no deduction. Loss of the plan's tax qualification for future tax purposes does not compel current funding and would undoubtedly result in plan termination. In the event of plan termination, the Internal Revenue Code would not create a contingent liability with respect to the employer's assets thus leaving no financial guarantee for the workers benefits unless plan termination insurance assumes the loss. Assumption of this loss by the insurance program where the employer has the means to continue funding of the plan is inequitable. If the employer was compelled to pay a tax penalty for refusal to fund the plan, the money would go into the U.S. Treasury, but not into the pension fund where it is needed. Funding standards, like minimum wage standards, can only be enforced affirmatively through the judicial process.

(3) *Administration of plan termination insurance through the Internal Revenue Code is anomalous and ineffective.*—Under S. 4 private pension plans are required to obtain and maintain plan termination insurance and to pay appropriate premiums to a federal insurance fund for this protection. It is clear that the establishment of this program to protect workers against loss of vested pen-

sion benefits owing to employer bankruptcy, plant closing, merger or a similar event at a time when the plan has not been sufficiently funded, is completely irrelevant to the tax qualification purposes of the Internal Revenue Code. Plan termination insurance is designed to protect workers against loss of vested pension benefits and this program is no more a revenue measure than FDIC coverage for banks, Federal crop insurance for farmers, Federal broker dealer securities insurance, etc. For the same reasons as to why funding standards cannot be effectively administered and enforced through the Internal Revenue Code, a plan termination insurance program is unenforceable through the Internal Revenue Code. Failure to pay required insurance premiums, for example, only results in loss of the plan's tax qualified status under the Internal Revenue Code or the imposition of tax penalties, etc., and these mechanisms do nothing to support adequate insurance protection to workers.

(4) *Fiduciary standards and disclosure for private pension plans are outside the scope of any revenue measure.*—From its inaction it is reasonable to infer that Senate Finance Committee recognized the underlying validity of incorporating fiduciary and disclosure standards into a labor bill. Abuses of trust are not curbed by removing a plan's tax exemption. A trustee committing a serious breach of trust cannot be removed or barred from holding a position in the plan simply by removing the plan's tax exemption. The proceeds of a transaction involving a breach of trust cannot be traced and trustees held personally liable for damages by removing a plan's tax exemption. There is a consensus that effective enforcement of the fiduciary and disclosure standards require provisions foi independent judicial remedies which are not available or contemplated under IRC.

Moreover, successful supervision of the vesting, funding and plan termination insurance requirements are intimately related to supervision and enforcement of the fiduciary standards. If the assets of a pension trust are mismanaged or wasted due to fiduciary misconduct, it has a critical bearing on the acceptable funding status of the plan as well as an intimate relationship to the degree of risk of exposure to the plan termination insurance program in the event of plan termination. If the investment policy of the pension trust is manipulated contrary to fiduciary requirements in order to minimize the necessity for funding contributions, it has a critical bearing on the effective implementation of the funding standards. Finally, if the procedures for processing and deciding on vested benefit claims are rigged in violation of the fiduciary requirements, it has an important impact on the implementation of the vesting requirements in S.4.

Thus, the enforcement of the fiduciary and disclosure requirements are intimately related to administration of the vesting, funding and insurance standards. If it is assumed that the appropriate agency to enforce the fiduciary and disclosure standards is the Department of Labor (as is the case under S. 4 and Administration proposal S. 1557) sound legislative judgment would require that effective administration of these integrated standards would be better achieved by giving responsibility to the Secretary of Labor.

(5) *Enactment of S. 4 into the Internal Revenue Code will deprive workers in unfunded plans of vesting, funding and insurance protection.*—If the vesting, funding and insurance requirements are placed in the Internal Revenue Code, then plans which are established outside tax qualification procedures of the Code will escape coverage of S. 4 requirements. Primarily these will be plans which are unfunded, i.e. the employer pays pension benefits out of his general assets and thus does not seek a tax deduction for contributions to a qualified pension trust. In short, the treatment of S. 4 as a revenue measure tied to tax qualification procedures under the Internal Revenue Code would create a loophope, depriving potentially millions of employees of the vesting, funding and insurance protections of S. 4. S. 4, it should be noted, requires all plans to be funded properly (i.e. no loop-hole for unfunded plans).

(6) *Treating S.4 as a revenue measure to be administered through the Internal Revenue Code will deprive 35 million American workers of an advocate in the government establishment which they need to protect their rights and interests.*—The primary historic mission of the Treasury Department and the Internal Revenue Service is protection of the revenues and collection of taxes. The tax qualification procedure established for pension trusts under Section 401(a) of the Internal Revenue Code is designed to provide tax incentives to encourage the establishment of private pension plans but subject to certain restrictions designed to protect against abuse of these tax privileges and subsequent loss to the revenues. The principal mechanisms in the Internal Revenue Code to prevent tax abuse in pension funds are the insistence that (a) such plans not discriminate

in favor of higher-paid employees because such discrimination would result in a tax loop-hole for the wealthy and (b) examination of the "reasonableness" of the tax deduction claimed for contributions. Virtually all IRS regulations pertaining to tax qualifications of private pension trusts are based upon these concerns.

It is apparent that since the primary mission of the Internal Revenue Service is to protect against tax abuse that agency's statutory obligation for the interests of 35 million American workers—covered by private pension plans—is minimal. The IRS is unsuited from both a theoretical and practical viewpoint for the mission of protecting adequately the interests of American workers. It is not structured to handle complaints of misconduct or abuse, or failure to pay pension obligations owed to workers. It lacks adequate background in the elements of collectively bargained pension plans and the related interests of unions, employers and sometimes the beneficiaries themselves.

For all these reasons, it is doubtful that the IRS can serve as an effective advocate for the rights and interests of 35 million pension beneficiaries as these rights and interests are set forth in S. 4. In recognition of the established need of 35 million American workers to have an effective advocate for protection of their interestss, the vesting, funding, insurance, portability, fiduciary and disclosure provisions should be put under the administration and supervision of the Secretary of Labor whose organic mission is defined as advancing and protecting the interests of American workers.

VI. CONCLUSION

The American private pension system is deeply rooted in our economy and intrinsically woven into our social fabric. The relationship of social and economic problems attending old age and the financial security necessary to our citizenry for dignified retirement are inseparable. If inequities and deficiencies exist in the system which produce irreparable harm to our workers, legislative reform cannot be delayed.

The hearings, findings and reports of the Senate Labor Committee sufficiently document the inescapable conclusion that workers are asking for and entitled to real and effective protection for their earned pensions. After long and exhaustive study, it is believed that the most effective and efficient remedy lies in the establishment of minimum standards and requirements, with their enforceability provided for administratively and judicially. These minimum benefits for workers and their protection and enforcement should be treated no differently than other minimum requirements enacted for protection of our workers by the federal government in relation to wages, health and safety, and various other measures intended for their benefit. Pension problems produce social ills and economic insecurity which disrupt the employee-employer relationship. Legislation must be directed to strengthen that relationship. Workers' faith in the private pension system can be restored by social reform, and a law to be enforced by a government agency which historically workers have looked to for protection of their benefits conferred by law and, more importantly, one in which they can place trust.

Appendix I

MAJOR CONGRESSIONAL ACTIVITIES AFFECTING PRIVATE PENSION PLANS 1921–1972

I. MAJOR LEGISLATION AFFECTING PRIVATE PENSION PLANS

Title	Committee	Dates of hearing	Effect on private pensions
Labor legislation:			
National Labor Relations Act (Public No. 198, July 5, 1935).	House Labor (74th Cong. 1st sess., H. Rept. 969); Senate Education and Labor (74th Cong. 1st sess., S. Rept. 573); conference committee (74th Cong., 1st sess., conference report No. 1371).	Mar. 11–Apr. 2, 1935; Mar. 13–Apr. 4, 1935.	Sec. 8(5) sets forth employer's duty to bargain with representatives of employees regarding wages and working conditions. In 1949, this was interpreted by Federal courts to include bargaining over terms of a pension plan (Inland Steel v. NLRB, 170 F.2d 247, certiorari denied, 336 U.S. 960).
Labor-Managemen Relations Act (Public Law 101, June 23, 1947).	House Education and Labor (80th Cong. 1st sess., H. Rept. 245); Senate Labor and Public Welfare (80th Cong. 1st sess., S. Rept. 105); conference committee (80th Cong., 1st sess., conference report No. 510).	Feb. 5–Mar. 15, 1947; Jan. 23–Mar. 8, 1947.	Sec. 302 regulates pensions financed by employer contributions to union-management pension plans, requiring that such plans be committed to writing, that funds be used only for paying benefits, and that management and union be represented equally in the operation of the fund.
Welfare and Pension Plans Disclosure Act of 1958 (Public Law 85-836, Aug. 28, 1958).	House Education and Labor (85th Cong. 2d sess., H. Rept. 2283); Senate Labor and Public Welfare (85th Cong. 2d sess., S. Rept. 1440); conference committee (85th Cong., 2d sess., conference report. No. 2656).	June 12-July 25, 1957; May 27-July 1, 1957.	Provided for registration, reporting, and disclosure of employee welfare and pension benefit plans.
Welfare and Pension Plans Disclosure Act Amendments of 1962 (Public Law 87–420, Mar. 20, 1962).	House Education and Labor (87th Cong. 1st sess., H. Rept. 998); Senate Labor and Public Welfare (87th Cong. 1st sess., S. Rept. 908); conference committee (87th Cong., 2d sess., conference report No. 1417).	May 24–31; June 1-28, 1961	Amended the Welfare and Pension Plans Disclosure Act of 1958. Designated certain acts of conduct as Federal crimes when they occurred in connection with welfare and pension plans. Amendments also conferred investigatory and various regulatory powers upon the secretary.
Equal Pay Act of 1963 (Public Law 88-38, June 10, 1963).	House Education and Labor (88th Cong. 1st sess., H. Rept. 309); Senate Labor and Public Welfare (88th Cong. 1st sess., S. Rept. 1409).	Mar. 15-27, 1963; Apr. 3–16, 1963.	Amends sec. 6 of the Fair Labor Standards Act. Prohibits discrimination on the basis of sex for any employer who is subject to the minimum wage provision of the law. Employer contributions to employee benefit plans are considered "wages." Differing benefits to men and women are not considered a violation as long as the employer's contributions for men and women are equal. Also, unequal contributions based upon the sex of employees will not be considered a violation of law, as long as the resulting benefits do not differ by sex.
Age Discrimination in Employment Act 1967 (Public Law 90-202, Dec. 15, 1967).	House Education and Labor (90th Cong., 1st sess., H. Rept. 805); Senate Labor and Public Welfare (90th Cong., 1st sess., S. Rept. 723).	Aug. 1–7, 1967; Mar. 15–17, 1967.	Act prohibits discrimination in employment on the basis of age. Sec. 4(f)(2) of the act provides that an employer would not be in violation of the law if he observes the terms of a bona fide employee benefit program, as long as it is not a subterfuge to evade purposes of the act. An employer cannot utilize benefit plans as an excuse for not hiring an applicant.

I. MAJOR LEGISLATION AFFECTING PRIVATE PENSION PLANS

Tax treatment of private pension plans

Prior to the Revenue Act of 1921, there were no specific statutory provisions dealing with the tax treatment of a pension, profit-sharing or stock bonus trust created by an employer for the exclusive benefit of some or all of his employees. Generally, however, early regulations provided that amounts contributed by an employer to a pension fund were deductible as ordinary and necessary business expenses. Employer contributions constituted income to his employees unless the contributions were under a plan where the eventual receipt was too contingent to be income constructively received. Income of a pension or profit-sharing trust was taxable either to the employer, the employees, or the trust itself.

Major provisions of acts affecting the tax treatment of private pension plans for employees are outlined below. Legislation affecting the tax treatment of retirement plans for the self-employed has not been included.

Title	Committee	Dates of hearings	Effect on private pensions
Tax treatment of private pension plans:			
Revenue Act of 1921 (Public No. 98, Nov. 23, 1921).	House Ways and Means Committee (67th Cong., 1st sess., H. Rept. 350); Senate Finance Committee (67th Cong., 1st sess., S. Rept. 275); conference committee (67th Cong., 1st sess., H. Rept. 486).		Provided that income of a trust created by an employer as part of a stock bonus or profit-sharing plan was exempt from income tax until distributed to employees, at which time it was taxable to them to the extent the distribution exceeded the amount paid in by the employee.
Revenue Act of 1926 (Public No. 20, Feb. 26, 1926).	House Ways and Means Committee (69th Ccng., 1st sess., H. Rept. 1); Senate Finance Committee (69th Cong., 1st sess., S. Rept. 52); conference committee (69th Cong., 1st sess., H. Rept. 356).		Extended the exemption from income tax to pension trusts.
Revenue Act of 1928 (Public No. 562, May 29, 1928).	House Ways and Means Committee (70th Cong., 1st sess., H. Rept. 2); Senate Finance Committee (70th Cong., 1st sess., S. Rept. 960); conference committee (70th Cong., 1st sess., H. Rept. 1882).		In the case of trusted pension plans, the employers' deduction fcr contributions for funding past service liabilities must be apportioned over a period of not less than 10 years. This act also provided that the amount contributed by the employer, plus the earnings of the fund, constituted taxable income to the participating employee for the year in which distributed to him.
Revenue Act of 1932 (Public No. 154, June 6, 1932).	House Ways and Means Committee (72d Cong. 1st sess., H. Rept. 708); Senate Finance Committee (72d Cong. 1st sess., S. Rept. 665); Conference committee (72 Cong. 1st sess., H. Rept. 1492).		Restored tax treatment prior to 1928 act that a distributee under an employees' trust was taxable only in the year amounts were distributed to him to the extent they exceeded amounts paid into the trust by him.
Revenue Act of 1938 (Public No. 554, Nay 28, 1938).	House Ways and Means Committee (75th Cong. 3d sess., H. Rept. 1860); Senate Finance Committee (75th Cong. 3d sess., S. Rept. 1567); Ccnference committee (75th Cong. 3d sess., H. Rept. 2330).		Established the nondiversion rule which provided that a pension trust has to be irrevocable and the funds had the be used for the exclusive benefit ofemployees.
Revenue Act of 1942 (Public Law 753, Oct. 21, 1942).	House Ways and Means Committee (77th Cong. 2d sess., H. Rept. 2333); Senate Finance Committee (77th Cong. 2d sess., S. Rept. 1631); Conference committee (77th Cong. 2d sess., H. Rept. 2586).	Mar. 3–Apr. 17, 1942: July 23–Aug. 14, 1942.	Provided broad revision of provisions relating to qualification of a stock bcnus, profit-sharing or pension plan, deductibility of contributions to the trust and taxability of amounts received by employees under the trust. This Act provided that the plan must include coverage and benefits which do not discriminate in favor of highly paid or stockholder employees. It provided that the employers' annual tax deduction for contributions not exceed stated limits. It provided that long term capital gain treatment be made available to lump-sum distributions from an exempt employees' trust paid to an employee in one taxable year on account of his separation from the service of his employer. The annuity treatment was applied to other types of distributions. The act also provided that employers' contributions under nonqualified plans were deductible only if the employees' rights were nonforfeitable at the time the contribution was paid. An employee under a nonqualified plan was taxable on employer contributions to the extent he had a nonforfeitable right in the contribution at the time made. If his rights were forfeitable, he was not taxable until he received a distribution or the funds were made available to him.

Title	Committee	Dates of hearings	Effect on private pensions
Revenue Act of 1951 (Public Law 183, Oct. 20, 1951).	Senate Finance Committee (82d Cong. 1st sess., S. Rept. 781) (supplemental report—82d Cong. 1st sess., S. Rept. 781); conference committee (82d Cong. 1st sess., H. Rept. 1179).	June 28–Aug. 3, 1951; Feb. 5–Apr. 2, 1951.	Provided change in the treatment of appreciation in securities included in a distribution from an exempt employees' trust. This Act excluded the net unrealized appreciation in securities of the employer corporation, or parent or subsidiary company, purchased with employee and/or employer contributions included in a total distribution from an exempt employees' trust, qualifying for the long-term capital gains treatment.
Public Law 589, July 17, 1952	House Ways and Means Committee (82d Cong. 2d sess., H. Rept. 2181); Senate Finance Committee (82d Cong. 2d sess., S. Rept. 1831).		Extends exclusion of appreciation in determining the distributive value of securities to any distribution of employer securities purchased with employee contributions only.
Internal Revenue Code of 1954 (Public Law 591, Aug. 16, 1954).	House Ways and Means Committee (83d Cong. 2d sess., H, Rept. 1337); Senate Finance Committee (83d Cong. S. Rapt. 1622).	June 16–Aug. 14, 1953; Apr. 7–23, 1954.	Classified exempt pension trusts with general group of exempt organizations. Provided that restrictions relating to prohibited transactions and unrelated income be applicable to pension trusts. Extended capital gains treatment to lump-sum distributions made by qualified insured plans because of separation of service. Also extended capital gains treatment to beneficiaries of employees who die after retirement.
Tax Reform Act of 1969 (Public Law 91–172, Dec. 30, 1969).	House Ways and Means Committee (91st Cong. 1st sess., H. Rept. 19–413); Senate Finance Committee (91st Cong. 1st sess., S. Rept. 91–552); conference committee (91st Cong. 1st sess., H. Rept. 91–782).	Feb. 18–Apr. 24, 1969; Sept. 4–Oct. 22, 1969.	Provided that part of a lump-sum distribution attributable to employer's contribution received from a qualified employees trust within 1 taxable year on account of separation from service be given ordinary income treatment instead of capital gains treatment. Modified the treatment of nonexempt trusts and nonqualified annuities to conform with the treatment of restricted property.

BEST COPY AVAILABLE

II. CONGRESSIONAL COMMITTEE HEARINGS ON PROPOSED PRIVATE PENSION PLAN LEGISLATION

Committee	Dates of hearings	Report	Substance of report or hearings
House Committee on Education and Labor, General Subcommittee on Labor (89th Cong., 1st sess.).	Aug. 5, 1965	None	Permissible uses of jointly administered union trust funds. Hearing on H.R. 7720 to amend sec. 302(c) of the Labor Management Relations Act to permit the participation of retired employees of certain self-employed persons to participate as beneficiaries of welfare and pension trust funds.
House Committee on Education and Labor, General Subcommittee on Labor (89th Cong., 2d sess.).	Aug. 22, 1966	do	Hearings on H.R. 11778 amending the Welfare and Pension Plans Disclosure Act, to eliminate or modify certain requirements with respect to the making of affidavits and the filing of copies of certain information.
House Committee on Education and Labor (90th Cong., 2d sess.).	Mar. 19–May 8, 1968	H. Rept. 1867, 1968	Report to accompany H.R. 6498—the proposed Welfare and Pension Protection Act of 1968.
House Committee on Education and Labor, General Subcommittee on Labor (91st Cong., 2d sess.).	Dec. 10, 1969–May 20, 1970	None.	Private welfare and pension plan legislation—hearings on H.R 1045, H.R. 1046, and H.R. 16462 to amend the Welfare and Pension Plans Disclosure Act; to provide additional protection for the rights of participants in private pension plans, to establish minimum standards for vesting and funding of private pension plans, to provide a system of plan termination insurance, to provide standards of fiduciary conduct and improved disclosure and financial reporting.
House Committee on Education and Labor, General Subcommittee on Labor (92d Cong., 1st and 2d sess.).	Apr. 21–28, 1971	Interim report, April 1972	Welfare and pension plan legislation—Hearings on H.R. 1269 (1) to establish minimum standards of fiduciary conduct for plan trustees and administrators, to provide for enforcement through civil and criminal means, and to require expanded reporting of the details of a plan's administrative and financial affairs; and (2) to improve the equitable character and soundness of private pension plans by requiring them to (a) make irrevocable (or vest) the accrued benefits of employees with significant periods of service with an employer, (b) meet minimum standards of funding, and (c) protect the vested rights of participants against losses due to essentially involuntary plan terminations. Interim report presents statistical data and draws some tentative conclusions about the data presented.
House Committee on Ways and Means (92d Cong., 2d sess.)	May 8–16, 1972	None	Tax proposals affecting private pension plans—hearings on the legislative proposal sponsored by the Administration (H.R. 12272) to (1) permit employees who wish to save independently for their retirement or who wish to supplement employer-financed pensions to deduct on their income tax returns amounts set aside for these purposes, (2) give self-employed persons who invest in pension plans for themselves and their employees a more generous tax deduction than they now receive, and (3) establish a minimum standard for the vesting of pensions.

BEST COPY AVAILABLE

II. CONGRESSIONAL COMMITTEE HEARINGS ON PROPOSED PRIVATE PENSION PLAN LEGISLATION—Continued

Committee	Dates of hearings	Report	Substance of report or hearings
Senate Committee on Labor and Public Welfare, Subcommittee on Labor (90th Cong., 2d sess.).	July 25, 1968	No report	Hearings of 4 bills including S. 3421 to provide additional protection for the rights of participants in private pension plans, to establish minimum standards for vesting and funding of private pension plans, and to provide an insurance program guaranteeing plan termination protection.
Senate Committee on Labor and Public Welfare, Subcommittee on Labor (92d Cong., 1st sess.).	July 27-29 and Oct. 12-13, 1971		Private welfare and pension plan study, 1971—testimony of employers and employees with respect to various inequities and hardships resulting to plan participants from nonexistent or defective provisions of private pension plans.
Senate Committee on Labor and Public Welfare, Subcommittee on Labor (92d Cong., 2d sess.).		S. Rept. 92-634, Feb. 22, 1972	Interim report recommended (1) minimum standards of vesting, (2) systematic funding of plan liabilities accompanied by a program of plan termination insurance (3) uniform Federal standard of fiduciary responsibility, (4) improved disclosure and communication of plan provisions to employees, (5) a program to develop portability and reciprocity among plans, and (6) centralization in one agency of all existing and prospective regulations.
Senate Committee on Labor and Public Welfare, Subcommittee on Labor (92d Cong., 2d sess.).	May 1-July 17, 1972	Committee print, September 1972	Private welfare and pension plan study, 1972—field hearings and report on plan terminations in 5 major cities. Disclosed the adverse effects resulting to participants from inadequate plan funding. Recommended remedial Federal legislation in the areas of funding, reinsurance, disclosure, and fiduciary standards.
Senate Committee on Labor and Public Welfare, Subcommittee on Labor (92d Cong., 2d sess.).	June 20-29, 1972	S. Rept. 92-1150, Sept. 18, 1972	Legislative hearings on S. 3598; report to accompany S. 3598 which provided (1) minimum vesting requirements, (2) minimum funding levels, (3) a voluntary portability program, (4) a plan termination insurance program, and (5) fiduciary standards and improved disclosure of plan operations.
Senate Committee on Finance (89th Cong., 2d sess.)	Aug. 15, 1966	None	Hearings on S. 1575—a bill to establish a self-supporting Federal reinsurance program to protect employees in the enjoyment of certain rights under private pension plans.
Senate Committee on Finance (92d Cong., 2d sess.)		S. Rept. 92-1224, Sept. 25, 1972	Report deleted all provisions except for the fiduciary and disclosure provisions of S. 3598 which was referred to Finance after being reported out of the Senate Committee on Labor and Public Welfare.

III. CONGRESSIONAL COMMITTEE INVESTIGATIONS OF PRIVATE PENSION PLANS

Committee	Dates of hearings	Report	Substance of report or hearings
House Committee on Education and Labor, Special Subcommittee on Investigation of Welfare and Pension Funds (83d Cong., 1st and 2d sess.).	Nov. 23-27, 1953, Sept. 22, Dec. 1, 1954.	Subcommittee report 1st sess., July 20, 1954, subcommittee report 2d sess., Dec. 31, 1954, committee print.	Investigation of welfare funds and racketeering—hearings and report pursuant to H. Res. 115 authorizing committee studies and investigations.
Senate Committee on Labor and Public Welfare, Subcommittee on Welfare and Pension Funds (83d Cong., 2d sess.; 84th Cong., 1st and 2d sess.).	March, April, July, November, and December 1955.	Interim reports, Jan. 10 and July 20, 1955, final report Apr. 16, 1956, S. Rept. 1734.	Hearings and report pursuant to S. Res. 225 (83d Cong.) and S. Res 40 (84th Cong.) giving the committee authority to investigate employee welfare and pension plans subject to collective bargaining. Disclosed a number of abuses in the administration of health and welfare funds. Found that there was a need for corrective legislation to insure more adequate protection of employee-beneficiary rights and interests; recommended that consideration be given to a Federal disclosure act embracing all types of employee benefit plans.
Senate Committee on Labor and Public Welfare, Subcommittee on Labor (91st Cong., 2d sess.).	July 29–Aug. 26, 1970	None	Hearings on the United Mine Workers welfare and retirement fund.

IV. CONGRESSIONAL COMMITTEE ECONOMIC STUDIES OF PRIVATE PENSION PLANS

Committee	Dates of hearings	Committee report	Substance of report or hearings
House Committee on Education and Labor (85th Cong., 1st sess.).		Committee print, 1957	Background material on the legislative history of the Labor-Management Relations Act, significant legislative proposals, 1948–56, designed to amend existing law or to provide new regulations governing the establishment or administration of employee benefit plans, a digest of testimony and a summary of previous reports and committee recommendations regarding the employment-benefit provisions of the LMRA.
Joint Committee on the Economic Report (82d Cong., 2d sess.)		Joint committee print, 1952	Pensions in the United States—a study prepared by the National Planning Association on the effects of public and private pension programs on the national economy as recommended in the final report of the Subcommittee on Low-Income Families.
Joint Economic Committee, Subcommittee on Fiscal Policy (89th Cong., 2d sess.).		Joint committee print, 1966	Materials prepared for the subcommittee on old age income assurance—an outline of issues and alternatives.
Joint Economic Committee, Subcommittee on Fiscal Policy (89th Cong., 2d sess.).	April 26–May 2, 1966	None	Hearings on private pension plan operations.
Joint Economic Committee, Subcommittee on Fiscal Policy (90th Cong., 2d sess.).		Joint committee print, 1967	Old age income assurance—a compendium of papers on problems and policy issues in the public and private pension system.
Joint Economic Committee, Subcommittee on Fiscal Policy (91st Cong., 2d sess.).	Apr. 27–30, 1970	None	Hearings on the investment policies of pension funds.
Senate Special Committee on Aging, Subcommittee on Employment and Retirement Incomes (89th Cong., 1st sess.).	Mar. 4–10, 1965	Committee report, 1965	Hearings and report on extending private pension coverage.
Senate Special Committee on Aging (91st Cong., 2d sess.)	Feb. 17–18, 1970	None	Hearings on the economics of aging—toward a full share in abundance. Pts. 10A and 10B—pension aspects.
Senate Special Committee on Aging (92d Cong., 1st sess.)		Committee print, 1971	Pension aspects of the economics of aging—present and future roles of private pensions.
Senate Committee on Labor and Public Welfare, Subcommittee on Labor (92d Cong., 1st and 2d sess.).		Committee prints—November 1971 September 1972.	Study of benefits and forfeitures in private pension plans and statistical analysis of major characteristics of private pension plans.

Senator NELSON. Senator Javits?

Senator JAVITS. Thank you very much.

STATEMENT OF HON. JACOB K. JAVITS, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator JAVITS. First, let me express my appreciation for the opportunity to join Senator Williams in this hearing. In addition, I wish to thank Senator Nelson who has personally accommodated my difficulties of scheduling. I want to express my gratitude to him and to the Chairman of the Full Committee, Senator Long and to the Ranking Member, Senator Bennett.

This whole matter was touched off about 7 years ago in the mind of a wonderful man in my office named Frank Cummings, who is now practicing law here in town. He was a labor lawyer who saw this problem and got me interested, and I got Senator Williams interested, and so here we are.

In the first place, as this is a Finance Committee hearing, I think the measure of the problem is a very important one to you. Private pension plans involves an enormous sum of resources; some $150 billion, increasing at the rate of $10 to $12 billion a year. These resources have been underutilized for a long time and all of us are aware in our individual States of grave complaints of the individual workers that social security just won't make it. On the other hand, we are also very familiar with the complaints of the younger workers; that is, you tried to raise social security taxes so that social security might make it in terms of a decent retirement income, these additional taxes would be very unacceptable to them, especially in those decades of their younger years.

So the private pension plan seems an ideal way out for a private enterprise system, but the insufficiency which has been demonstrated has been rather in the operation of the plans than in the idea of private pension plans.

I think the idea is a splendid one and I hope very much that as we regulate private pension plans, such regulatory efforts will be considered an affirmation of the private pension concept, and that the plans will grow in terms of the number of workers covered as well as the benefits provided.

The CHAIRMAN. Could I interrupt?

Senator JAVITS. Sure.

The CHAIRMAN. I was checking your prepared statement for the figures you just quoted. I don't see it. What was the figure you quoted as the amount of assets?

Senator JAVITS. $150 billion, growing at the rate of $10 to $12 billion a year with 35 million workers covered.

The CHAIRMAN. So it is now $150 billion set-aside in these private pensions?

Senator JAVITS. Right. Senator Long, you would be interested to know that one of our New York banks alone is said to have as much as $12 billion in private pension funds and that is the Bankers Trust Co. It handles the A.T. & T. pension fund which is supposed to have several billion dollars in it. It is interesting you asked me that question, because years and years ago I had a retainer from a major real estate firm that tried—and this was the first time I heard about this pension field—to shake loose some of these pension funds for FHA guaranteed mortgages. That turned out to be a monumental task because they were so timid about any investment other than legals. They relied on the strict definition of legals under the insurance laws, and so forth.

So then along came 1963 with the Studebaker shutdown and, as an aside, it always takes some kind of scandals or some great eruption of that kind to call our attention to what is happening in a particular field. With the Studebaker shutdown, 4,500 employees lost 85 percent of their earned pension benefits. Some committed suicide.

Walter Reuther was led to observe: "Studebaker made covered wagons. They celebrated their 100th anniversary a few years back and now they are part of history. But the workers? What happened to the workers?"

And the answer was the workers got "the pants taken off of them" in what they lost in these pension plans.

So, with the marvelous work of Senator Williams who has led the Labor and Public Welfare Committee in this matter for the last 3 years, and with the aid of $1 million from the Senate, we really dug into this to find out what was going on. I think, gentlemen, that whatever bill passes, whatever concept we all adopt on the Senate floor, one thing is sure: there has never been a better researched piece of legislation in terms of the factual background and the elements which should go into legislating than this one. It is a real triumph for the legislative process. This wasn't done by the Department of Labor or the Office of Management and the Budget. This was done by the Senate of the United States. So, as I say, whatever happens, whoever gets his bill passed, or what amalgamation of bills are passed, it is a tremendous tribute to the fact that we can do a job when we get our teeth into it.

Now, I think the real issue before us is this one; the private pension promise is all too frequently a broken promise. Question: Can we correct it?

The administration itself has estimated that somewhere between one-third and one-half of the workers covered do not collect anything. But our Labor Subcommittee analysis indicated that at best the rate is probably half of the administration's estimate. Our figure was that about roughly 16 percent got anything out of pension plans during a 20-year period going back to 1950. Now, I hasten to add at this time that, actuarially, private pensions wouldn't stand up if everyone was going to collect on a pension, regardless of how long he worked. That is what Ralph Nader is recommending: you pay in and you take out. That just can't be done. The pension plan has to be a premium for continuity of service in one form or another but the great deficiency is that it has benefited too few, and the result is these enormous reserves growing and growing. And growing toward what end? This is the problem we face. It is a very real economic problem.

Senator Nelson. I don't quite follow that. Are you saying that there are a number of pension plans that are overfunded?

Senator Javits. Presumably, IRS doesn't allow them to be overfunded. But the employer generally quits paying when he can no longer get a tax deduction for his contribution. What happens is the reserve system simply piles up, relative to the basic funding, because the fine print shuts so many employees out of the enjoyment of the plans. It just goes on and on and, in some cases, becomes a monster; there is no control valve. There is nothing to stop it.

Senator BENNETT. May I interrupt at that point? Are you suggesting these funds will never pay out as pensions and they are going to stay here in the economy floating around?

Senator JAVITS. They may, if you continue on the present path, Senator.

We have, for example, a situation which we discovered in the Government Operations Committee and I will give you the case history. This is a scandal where $4 million—I think that was the figure—$4 million was simply left for grabs. Nobody owned it. The fellow put it in his pocket and went off to one of the islands—I think it was Nassau or one of the others. My staff says Puerto Rico and Liberia. We will give you the details.*

Senator BENNETT. This is a pension fund?

Senator JAVITS. A pension fund which the workers had paid into, but nobody was there to claim it.

Senator NELSON. The workers paid into?

Senator JAVITS. Well, I mean, it had come about as a result of their work. The employers pay in as part of their compensation. We will give you that case, Senator Bennett. It was discovered by the Senate Investigations Subcommittee under Senator McClellan. It was another one of the things that stimulated me to the feeling you have to do something about this field. It simply can't be permitted to sit as it is.

Senator BENNETT. Let me ask you a hypothetical question. Company A has gone out of business. It has enough money in its pension fund to pay all of the pensions to its employees at the time it closes its business and it has $100,000 more than is required. What happens to that money?

Senator JAVITS. It depends on the contract.

Senator BENNETT. So there are conditions under what you would consider to be legal and normal circumstances where there could be accumulated pension funds to which nobody has a legitimate claim?

Senator JAVITS. That is exactly right.

Senator BENNETT. So we are talking about a situation, which can exist, and which can now be handled legitimately?

Senator JAVITS. As well as illegitimately.

Senator NELSON. Yes, can be handled illegally or legally.

Senator JAVITS. Exactly right.

Senator BENNETT. But your plan doesn't eliminate that.

Senator JAVITS. My plan can't eliminate fraud but the fiduciary standards are such as to guarantee honesty in the sense that, if there is going to be the disposal of these funds, it is going to be made as it probably should be made and somebody won't put it in his pocket and walk off with that.

Senator BENNETT. Doesn't the present law prevent that?

Senator JAVITS. It really doesn't as we proved to be the case in the Government Operations Committee.

Senator BENNETT. You mean a man commits a fraud and—

Senator JAVITS. There was no fraud there, Senator. The contract was such that the possessing party had the assets with no affirmative

*See Senate report No. 1348, 89th Congress, 2d Session, of the Subcommittee on Investigations, Government Operations Committee, entitled "Diversion of Union Welfare-Pension Funds of Allied Trades Council and Teamsters Local 815." This document was made a part of the official files of the subcommittee.

obligation for distribution. He could have gone and petitioned the court and said: Here is the $4 million. I don't know what to do about it. Nobody really owns it; what should I do about that?

But he didn't choose to do that.

Senator BENNETT. Does your bill provide specifically for the distribution of those funds under those circumstances?

Senator JAVITS. It provides for such fiduciary standards as to bring about a lawful and equitable distribution.

But I don't want to get off on that particular track, Senator Bennett.

Senator BENNETT. No, I understand that.

Senator JAVITS. I am delighted to answer the question, but the fundamental purpose of the bill and the point I am making now is our bill, anybody's bill, Senator Bentsen's bill, Senator Hartke's bill, the administration's bill, will at long last provide proper fiduciary standards as to these funds. That is the only point I am making.

Now, we have a horror story which really is a horror story which we would like to lay before the committee. We have had a lot of them but this is really a dilly. In August of 1971, in my own State, Mr. Robert E. Pratt of Hudson, N.Y., was laid off from a company called Gifford-Wood Co., due to poor business conditions. In the meantime, the company was sold to Greer Industries, Wilmington, Mass., in June 1972, by Stowe-Woodward Co., Inc., of Upper Newton Falls, Mass., former owners of Gifford-Wood Co. Gifford-Wood manufactured coal extraction, materials handling, and other machinery. It was a very old company that dates back to 1814.

So Mr. Pratt is laid off in August. Nine months later on June 30, 1972, the Gifford-Wood plant is terminated by the new controlling interests in the company. This was 3 months before Mr. Pratt's 65th birthday. Mr. Pratt had worked for Gifford-Wood Co. for 47 years. When he applied for retirement benefits on attaining age 65, he was told he would receive nothing for his 47 years of service since the plan had been terminated on June 30, 1972, and there were funds available to pay retirement benefits only to those who had retired before that date.

A copy of the correspondence between Mr. Pratt and the company, insurance, banking, and government officials concerning this matter is appended to my testimony. I ask unanimous consent that it may be included.

Senator NELSON. It would be included at this point.

[The correspondence described above follows:]

APPENDIX

CORRESPONDENCE INVOLVING LOSS OF PENSION BY ROBERT E. PRATT, HUDSON, N.Y. 12534

(Submitted as part of testimony of Senator Jacob K. Javits, ranking minority member, U.S. Senate Labor and Public Welfare Committee, to Subcommittee on Pensions, U.S. Senate Finance Committee)

Summary of Pertinent Points of Gifford-Wood, Inc., Employee Retirement Plans

Normal retirement date is after an employee has reached the age of 65.

The current monthly retirement allowance is $1.75 per month per year of Credited Service commencing with the first day of the month following the date of retirement.

Recent changes which clarify and improve the benefits are as follows:

(1) A member shall be retired on a Normal Retirement Allowance upon reaching his Normal Retirement Date, provided that on such date he has ten or more years of Credited Service.

(2) Any Member, upon ceasing to be an Employee for any cause other than death or retirement under the Plan, if he has completed 10 or more years of Credited Service, shall be entitled to a Retirement Allowance commencing at his Normal Retirement Date. The amount of such Retirement Allowance shall be the amount accrued to the Employee's date of termination of employment.

(3) The Normal Retirement Allowance shall be a monthly amount equal to $2.00 multiplied by the number of years of his Credited Service, effective April 15, 1971.

All other terms of the Retirement Plans remain unaltered. Any employee desiring further information regard the Retirement Plan may obtain it by contacting the Manager of Manufacturing or Supervisor of General Accounting, which whom a copy of the amended retirement plans is on file.

G. W. Dietrich,
Vice President and General Manager.

Gifford-Wood Inc.,
Hudson, N.Y., October 23, 1970.

Mr. Robert E. Pratt,
Hudson, N.Y.

Dear Bob: It is a pleasure for me to congratulate you on your forty-seventh year with Gifford-Wood. This is indeed a fine record, not often attained. May you enjoy many more pleasant years with our firm.

Sincerely,

C. F. Stephenson, *President.*

Gifford-Wood,
A Columbia Precision Company,
Wilmington, Mass., October 27, 1972.

Mr. Robert E. Pratt,
Hudson, N.Y.

Dear Bob: Received your letter last week, and it was certainly nice to hear from you.

Reaching retirement age is an accomplishment, and I hope you find the opportunity to enjoy your years of retirement. Bob, I am sorry to hear that you are not receiving a pension. The problem is a complicated one and involves the fact that Gifford-Wood is no longer a separate company, but is a predecessor to another corporation. Please be assured, though, that Mr. Loehr is investigating all the facts relative to retirement with our retirement principal. You should hear from him shortly—be patient a little longer.

We enjoyed many good years together at Gifford-Wood, but as is the case so often, we must look ahead not back.

If you are ever over this way, please drop in for a visit.

Very truly yours,

R. E. Adams,
Vice President, Research and Development.

Gifford-Wood,
A Columbia Precision Company,
Wilmington, Mass., November 20, 1972.

Mr. Robert E. Pratt,
Hudson, N.Y.

Dear Mr. Pratt: I am sorry to advise you that when the Gifford-Wood Salaried Employees' Retirement Plan terminated on June 30, 1972, the Plans assets were only sufficient to provide annuities for those employees who then had reached the normal retirement age of sixty-five years. As a result, you will not be able to receive an annuity under the Plan.

Sincerely yours,

Herbert F. Loehr,
Vice-President, Finance.

NOVEMBER 28, 1972.

Re: 40–034134—Gifford-Wood Co. Salaried Employees Retirement Plan.

NATIONAL COMMERCIAL BANK AND TRUST CO.,
Albany, N.Y.

GENTLEMEN: Att'n. Mr. Alfonso Meccariello, Assistant Manager, Trust Division.

As your Bank was a former distributor of checks to retired employees of Gifford-Wood Co. under the above plan, may I ask your opinion regarding refusal of Greer Industries, who took over Gifford-Wood Co. to put me on the list to receive a pension check, the same as other former retired employees of Gifford-Wood Co.

In August of 1971 I was under lay-off until negotiations were consummated regarding a sizable contract. However, I was never recalled to work in the Engineering Department.

On September 11, 1972, I reached my 65th birthday and, naturally, hoped to receive word of my eligibility for pension, after 48 years of service in the employ of Gifford-Wood Co.

I wrote to Greer Industries about a month ago and my letter was never answered until November 25, when I received notification that my pension check would not be forthcoming, as my name would not be placed on the list with the other employees.

You, of course, are not obligated to reply to this letter as you are no longer identified with the Pension Plan in question. However, I would greatly appreciate your review of the situation regarding the awarding of this pension to me. Or, if there is no redress on my part and I will have to abide by their decision to deny me this compensation in the form of a pension after my long years of service.

Please overlook by audacity in addressing this letter to you, but I was quite shaken up on being advised this income on which I have been planning for living expenses, etc. would be denied to me.

Very truly yours,

ROBERT E. PRATT.

NATIONAL COMMERCIAL BANK AND TRUST COMPANY,
Albany, N.Y., December 1, 1972.

Re: 40–034134 Gifford Wood Company Salaried Employees Retirement Plan.

MR. ROBERT E. PRATT,
Hudson, N.Y.

DEAR MR. PRATT: I received your letter of November 28, 1972 which are directed to Mr. Meccariello. As you know, this bank is no longer trustee for the above plan.

We do not feel that we can give an opinion concerning the decision made by Greer Industries. However, we suggest that you contact your attorney, who should deal directly with Greer Industries if you wish to continue to pursue this matter any further.

Very truly yours,

RICHARD E. RIGHTER,
Assistant Trust Officer, Trust Division.

JANUARY 11, 1973.

THE TRAVELERS,
Hartford, Conn.

Attention L. A. & Gr., Claim Department Group Annuity Unit—3 WS

GENTLEMEN: As your company (The Travelers) is now Trustee of the Gifford-Wood, Inc. Retirement Plan (salaried employees) and in turn is issuing the monthly pension checks to those retired people from Gifford-Wood who are entitled to the benefits, I wish to submit the following:

I was laid off (retired) from Gifford-Wood in August 1971 due to poor business conditions. In the meantime, the company was sold to Greer Industries in June 1972.

On September 11, 1972 I reached my 65th birthday, but was never notified as to the status of my pension.

I have a record of 47 years of actual service with Gifford-Wood from 1923 to 1971 and Gifford-Wood has all this information. I have written letters to personnel of the company who are in a position to give me some positive information regarding the reason why I am not receiving my benefits under the pension plan.

I am enclosing a copy of a letter dated November 20, 1972, in answer to my letter regarding my pension. This letter was signed by Mr. Herbert F. Loehr, Vice-President, Finance. I know that there must be a lot of information and a more concrete explanation than what is spelled out in this letter to me.

I have been a member of the Gifford-Wood Retirement Plan from its beginning. It seems that I must have accumulated quite a sum from my services and should receive my just benefits. I cannot understand how I can be completely cut off from my annuity under the Plan.

You, of course, are not obligated to reply to this letter. However, I would greatly appreciate your review of the situation regarding the awarding of this pension to me. Or, if I have no redress and will have to abide by Mr. Herbert Loehr's decision to deny me my just and due compensation in the form of a pension for my services.

Please overlook my audacity in addressing this letter to you, but I was quite shaken up being advised this income on which I have been planning for living expenses, etc. would be denied me.

Very truly yours,

ROBERT E. PRATT,

P.S.—Enclosed is copy of the original plan in part dated April 15, 1971 indicating a change in the normal retirement allowance which is self-explanatory and may be of some help in solving my dilemma.

R. E. P.

THE TRAVELERS INSURANCE COMPANY,
Hartford, Conn., January 18, 1973.

Re Group Annuity Contract GR-2056

Mr. ROBERT E. PRATT,
Hudson, N.Y.

DEAR MR. PRATT: I have reviewed your letter of January 11, 1973 and attachments. I have also reviewed the Retirement Plan for Salaried Employees of Gifford-Wood. As the Plan stands as a legal document, qualified by the Internal Revenue Service, the discontinuance falls within approved guidelines. Unfortunately you are one of the former employees who is not entitled to a benefit. Had you already attained age 65 on June 30, 1972, you would have been eligible for some annuity.

I think that a clarification of The Travelers involvement is in order. The Travelers is not the Trustee of this Plan as noted in the first line of your letter. We have merely contracted with Gifford-Wood to disburse the monthly annuity payments they advised us to make. We hold the money and guarantee that we will administer the payments.

As an employee of The Travelers I can only advise you that you are not one of the employees who we were contracted to make annuity payments to. Also, I can advise you that from the documents that were sent to me, the company acted within IRS guidelines in disbursing the funds of the Pension Plan when it discontinued.

I hope that this letter clarifies the involvement of The Travelers in this situation.

Very truly yours,

JOHN J. RZASA,
Underwriter, Group Pension Division.

MR. PRATT: On an official basis I might suggest that you contact your Senator who has been very active in this area recently, Mr. Javits.

The company has no legal obligation to you but there is definitely a question of the morality of choosing June 30, 1972 as the cutoff date or of not offering you something for your 47 years of service.

Hopefully the Senator would contact Gifford Wood regarding the situation.

J. RZASA.

STATE OF NEW YORK,
DEPARTMENT OF LAW,
New York, N.Y., February 26, 1973.

Mr. ROBERT E. PRATT,
Hudson, N.Y.

DEAR SIR: We are in receipt of your letter of February 22, 1973 dealing with your pension difficulties, and we have noted the correspondence which you have enclosed therewith.

Unfortunately, neither this office nor any State agency has any jurisdiction over unilateral pension plans in effect between employers and employee members thereof. Such plans are considered to be private contracts between the parties, and the rights of the respective beneficiaries depend entirely upon compliance with all of the terms and conditions of the plan.

The only Government agency that may have some information for you in the matter would be the U.S. Department of Labor, through its Welfare and Pension Plan Division, located at 26 Federal Plaza, New York, N.Y. Federal law, all retirement plans of any nature are required to be filed with this agency, and it has certain limited supervision over such plans.

As a last recommendation, we suggest that you consult a private lawyer concerning your rights in this matter, and it is quite possible that after a review of the pension plan and all of the facts that you furnish him, that he will be able to give you a sound opinion which can guide you in determining your right to retirement benefits at this time.

We are returning the file that you sent us with your communication.

Very truly yours,

LOUIS J. LEFKOWITZ, *Attorney General*
(By Daniel Polansky, Assistant Attorney General in Charge of Labor Bureau).

MARCH 1, 1973.

U.S. DEPARTMENT OF LABOR,
Welfare and Pension Plan Division,
New York, N.Y.

GENTLEMEN: In February, 1973, I wrote to Mr. Daniel Polansky, Assistant Attorney General in regards to the Retirement Pension Plan of Gifford-Wood Co., Hudson, New York, (Columbia County), as it was originally set up and written for all eligible retired employees of the company. Mr. Polansky has referred me to your department, as you will see in the copy of his letter that I have attached hereto.

Enclosed is a copy of the revised "Pension Plan" dated June 6, 1969 and paragraph (3) noting a change in the Normal Retirement Allowance effective April 15, 1971, which plan includes all employees upon reaching the age of 65, and accumulating ten years or more of credited service.

I was laid off (retired) from Gifford-Wood Co. in August, 1971 due to poor business conditions. In the meantime, the company was sold to Greer Industries, Wilmington Massachusetts in June, 1972 by Stowe-Woodward Co. Inc. of Upper Newton Falls, Massachusetts, former owners of Gifford-Wood Co.

I became 65 years of age on September 11, 1972, and according to the Pension Retirement Plan, I should have started receiving pension benefits in October, 1972. As time went on, I anxiously awaited for some word as to the status of my pension.

Rather than go into too many details at this time, I am particularly interested in whether your department handles such cases as this one.

I am enclosing copies of all correspondence that I have had in reference to this matter as well as the responses that I have received.

I would appreciate any help that you might be able to give me in this matter, and I look forward to hearing from you.

Very truly yours,

ROBERT E. PRATT.

U.S. DEPARTMENT OF LABOR,
LABOR-MANAGEMENT SERVICES ADMINISTRATION,
New York, N.Y., March 14, 1973.

Mr. ROBERT E. PRATT,
Hudson, N.Y.

DEAR MR. PRATT: We have received your letter of March 1, 1973 and its attachments concerning your attempts to obtain pension benefits.

Unfortunately, this agency is not in a position to aid you because there is no provision in the law—over which we have jurisdiction—which covers your case, i.e. withdrawal or cessation of a unilateral pension plan by an employer.

This agency's jurisdiction regarding pension plans is cited in "The Welfare and Pension Plan Disclosure Act." A guide booklet which defines and highlights provisions of this Act is enclosed with a copy of the Act.

It is with regret that we must advise you that under the present law, we cannot assist you in your claim.

Very truly yours,

HENRY W. BERRY,
Assistant Area Administrator.

Enc.

Senator JAVITS. Included is an unofficial note from the Insurance Agency who advised Mr. Pratt to contact me, his Senator, for help, since while "the company has no legal obligation to you, there is definitely a question of the morality of choosing June 30, 1972, as the cut-off date, or of not offering you something for your 47 years of service."

As I said, Senator Williams and I have had a lot of hard stories but I haven't found one that is any more eloquent than this one on the Funding Insurance concept.

Now, I do not wish to duplicate the fine statement of Senator Williams. I wish to address myself to a few major questions which have arisen in opposition to our bill. One of the primary questions is whether this bill shall be handled primarily as an Internal Revenue matter, as an aspect of qualification for tax deduction for deposits in the pension plan, or whether it should be handled as a labor matter.

Now, we believe that in the concept of handling it through dedications as an income tax matter, there are three fallacies, and the most basic one before I even name the three is this: That if the money was paid to the worker as salary, it would be deductible anyhow, so there is no big inducement for the employer, except the inducement of loyalty and relationship with his employee, to put it in a pension plan instead of paying it to the worker every week.

Now that is the basic proposition. So the first fallacy is that private pension plans are exclusively a creature of the tax incentives.

The second fallacy is that the Internal Revenue Service regulates private pension plan design and the third——

Senator BENNETT. May I interrupt at this point?

Before you leave the first one, your last statement was the fallacy was that this was exclusively a function of the Internal Revenue Service. Do you think that it is, on the other hand, exclusively none of IRS' business or do you think there is a joint responsibility here?

Senator JAVITS. I don't recall that I used the word "exclusive" Senator?

Senator BENNETT. No, I listened very carefully and you said "exclusively."

Senator JAVITS. Could we have it read back?

They deduct this from their taxes and the Internal Revenue Service examines all deductions. They have a right to examine this and——

Senator BENNETT. The reason I raised this question, Senator, is because if you insist on exclusivity, then we have no right to consider it.

Senator JAVITS. Well, let's read it back.

[The reporter subsequently read the following:]

Senator Javits. Now that is the basic proposition. So the first fallacy is that private pension plans are exclusively a creature of the tax incentives.

Senator JAVITS. That doesn't say they are exclusively the business of Labor either, Senator.

Senator BENNETT. Well, I agree with you that it is not exclusively the business of IRS, but I am asking you if you believe, when you say that somebody believes that private pension plans are exclusively a creature of the Internal Revenue Service, I am asking you if you believe the opposite is true; that is, that the Internal Revenue Service has no interest in it.

Senator JAVITS. Senator Bennett, if I said what you think I said then the answer to your question would be the Internal Revenue Service hasn't any interest, but I said no such thing.

All I said is that the tax incentive is not the exclusive reason people set up pension plans. That is all I said, nothing else.

Senator BENNETT. That isn't the way this sentence came out. We are arguing words, but my point is, if you believe that anybody believes that the purpose of pension plans is exclusively in order to get an Internal Revenue Service benefit, then nobody accepts that.

Senator JAVITS. Well, there is no question about that, Senator.

Senator BENNETT. OK.

Senator JAVITS. But at the same time I go farther than you—and I get the implications of what you said—I say that the fact that there is a tax deduction is less of an inducement than the fact that it is better employee relations.

Senator BENNETT. Well, I agree with that.

Senator JAVITS. That is my point.

Senator BENNETT. All right, but you do admit that we in this committee responsible for concerning ourselves with the legislation involving taxes do have a right to have an interest in the pension plans?

Senator JAVITS. Of course. I thoroughly agree with that. We show you the greatest respect, Senator Bennett, by both Senator Williams and myself coming here. We made a big point of it. We prepared very thoroughly for this. We could have waited until we got to the Senate floor and fought about it but we didn't choose to do that.

Senator BENNETT. Well, as you went by that word, it sounded to me that you believe since there was no exclusive right in IRS, we really had no power and it was a fallacy to assume that we in this committee had any consideration or interest in the bill.

Senator JAVITS. I am glad I got that clarified then. I said no such thing nor did I intend to say it.

The second fallacy is that the Internal Revenue Service regulates private pension plan design. The third fallacy is that the need for supporting IRS jurisdiction over this legislation is that it would result in more effective administration.

I will deal with these very briefly.

As to the first question, we would like to cite in that regard the testimony of a man named Pear E. Charlet, who is the research manager of Hewitt Associates, a well-known pension consulting firm. And back in 1966 he said: "Employer motivation for retirement plans in most cases is for reasons completely apart from tax considerations."

We state—and now I come to Senator Bennett's statement, and this is in my statement—that "while tax incentives, no doubt, help in getting private pension plans established, incentives are an element of facilitation not the element of decision. The other factors contributing to pension plan development must be considered for purposes of determining a suitable administration of pension reform legislation."

And then we point out that over 50 percent of all private pension plans are collectively bargained which means that tax considerations are not the prime considerations for private pension growth.

We cite all of that and various other authorities, including the report of the Douglas subcommittee back in the 1950's which also quotes a then Treasury official named Mr. Swarz, Director of the Tax Rules Division of the Internal Revenue Service, in which he says: "In seeing that the taxes levied by Congress are paid, the Internal Revenue Service does not seek to act as a regulatory agency." Then we cite various authorities in my statement.

Now as to the effective administrative and enforcement mechanism, we believe: first that the imposition of tax penalties may be either too drastic or too weak a remedy, depending on the circumstances in each particular case and we cite an example of over-kill where a single employee participating in a nationwide multiemployee pension plan with more than 1000 contributing employees might lose benefit rights because there has been some impropriety by the trustees of the plan and then the whole plan is disqualified with respect to the Internal Revenue Service. And this is the second example—ineffectiveness—where a company going out of business terminates its pen‹‹on plan and has no interest in the tax deduction, so there is really no sanction upon them.

The second point regarding effective administration is that we think that it would be more clear under regulatory law that the field is preempted in terms of States and State legislation rather than if it is an element of the Internal Revenue Service deduction.

The exclusive use of the tax code mechanism may permit additional State legislation in the field, which could lead to duplicating or even conflicting pension regulation at the Federal and State levels.

As to the the third reason, we state it is not the greater effectiveness of the Internal Revenue Service but rather anxiety over administration by the Labor Department of new pension laws which creates the impetus for putting Internal Revenue Service in charge of pension reform legislation.

Under the Internal Revenue Service, this is just one of maybe 70 or 80 particular items they have to examine in respect to checking individual returns or corporate returns.

So, we believe that in order to establish a uniform national set of standards for private pension plans and to avoid unnecessary regulation at both the Federal and State level, that by incorporating it in a regulatory statute, the best result would be accomplished.

Now, I am not going to argue the question of whether the greatest expertise resides in either the Internal Revenue Service or the Labor Department. What is more important in my judgment is whether a law for safeguarding the interest of workers in private pension plans should be given to an agency whose primary interest is tax collection, and whose primary means of enforcement is removal of tax privileges or the imposition of additional tax penalties, as is the case in Senator Bentsen's bill.

I might point out, and would ask unanimous consent, to place in the record in this connection an article by so conservative a trade and business publication as the Journal of Commerce——

Senator NELSON. It will be placed in the record.

[The article referred to follows:]

BEST COPY AVAILABLE

[From the Journal of Commerce and Commercial, June 6, 1973]

The Structure of Pension Reform

On the face of it, the Department of Labor seemed to come off better than the Internal Revenue Service in last week's argument over which should administer the private pension reform system Congress is now considering and is expected to pass in some form before very long.

A special six-man panel voted 4-2 for IRS, and apparently had the support of the Senate Finance Commitee, including that of its chairman, Russell Long and of Sen. Charles Curtis, of Nebraska. Their thought was that IRS, being considered well above the battle, could administer such a program expertly and also more fairly than a federal department strongly identified with the cause of the unions.

But the AFL-CIO thinks otherwise. It is willing to have IRS monitor compliance with federal revenue statutes under any new pension law, but it insists that administration of the law be charged to the Labor Department because to do otherwise would be to dilute the responsibility of IRS as a revenue-raising agency of the Treasury.

This view was presented with some force by Paul Berger, former legal adviser to IRS and the Treasury, but now special tax counsel to the AFL-CIO. And there is something to be said for it. Ideally, IRS should be kept strictly to its statutory function of tax-collecting, and in all other respects be allowed to keep as low a political profile as possible. The greater the extent to which it is detoured into other fields of action—such as the enforcement of Phase Two and Phase Three of price controls—the more prominent its profile becomes and the less effective it is likely to become in its own theater.

After all, when a taxpayer is called in to discuss problems that have come to the attention of IRS, he ought to be confident that the agency he is dealing with is interested solely in his tax liability, not in the maner in which he has (or has not) conformed to price controls or in the viability of his company pension plans, or anything else. This is—or should be—as important as the separation between church and state in the American constitution.

For this reason we had—and still have—our doubts about the President's decision to saddle IRS agents with the responsibility for monitoring compliance with price controls. Political involvement of IRS in non-tax matters raised one of them, but not the only one.

In a sense, this put IRS on a spot. For if the agency could spare hundreds of agents for non-tax work without impairing its efficiency as the nation's tax collector, was there not at least an implied admission here that it was carrying on its payroll a lot of agents it didn't need?

There certainly was such an implication and it is one that IRS has probably not overlooked. It could be argued, of course, that the price controls are temporary and that upon their removal, Internal Revenue will be well rid of what is only a temporary burden. That argument might hold for the duration of Phase Three, but the picture would change radically if IRS were given administrative charge of a new law on pension reform.

Oddly enough, in outlining the AFL-CIO position, Mr. Berger did not lay much stress on these points. Or on the fact that, in a limited sense, IRS has already had a good deal of experience in administering pension plans. Along with other opponents of IRS pension administration, he argued that the Labor Department could act more directly than IRS in enforcing pension standards on industry.

The reason is that Internal Revenue, when faced with a violation of a new pension law, would merely deny the pension tax exemptions claimed by the taxpayer. This is quite an effective treatment, as most who have been given it know, for the taxpayer's only recourse then is to take the case into the Tax Court, where the Treasury has run up a very good batting average indeed.

But it is apt to be slow. It is also likely to offer less drama than a situation in which a Department of Labor administering the pension law, would go into the courts demanding an injunction against the violator. This is a routine with which union circles are more familiar, and that is one reason why it may appeal to them.

This newspaper favors stronger laws on private pensions. We think it high time that workers who gravitate frequently from one job to another are given vested rights in their previous contributions to their own retirement plans. And we think the Administration's bill would provide a solid start in this direction.

But we do not see the Department of Labor either as the sole administrator of such a program, or as the chief administrator with IRS lurking in the back-

BEST COPY AVAILABLE

ground as a sort of strategic reserve. For all its undeniably good works, the department cannot expect to be considered wholly judicial and wholly impartial when union interests conflict with those of management.

There is even some doubt that it truly represents all the labor force. We recall, for example, the sense of incredulity that greeted the assertion of a previous secretary of labor that he spoke for non-union as well as union workers. It was as though a secretary of agriculture had claimed to represent the consumers as much as the farmers.

So despite the arguments against greater IRS involvement in pension programs—and they are weighty—we would prefer that to administration by the Labor Department, or to a sort of condominium in which both the department and Internal Revenue are treading constantly on each other's feet. Perhaps the best answer lies in something altogether different: something like the Social Security Board.

Senator JAVITS. Now, we have discovered something which may interest the committee in this matter of administration. We have obtained possession of a bill which was drafted by a task force of the experts in Labor and Treasury—a joint Labor-Treasury Task Force—which was submitted to the White House. The White House didn't choose to use this draft as a bill, which is perfectly legitimate, but it certainly represents in our opinion an important piece of expertise because in this bill enforcement and administration, et cetera, is turned over to the Labor Department.

Senator NELSON. And funding and vesting? Everything?

Senator JAVITS. The whole administration is turned over to the Labor Department, except for vesting, my staff tells me.

So this bill may be examined. We will make it available to the committee, but I would state, in fact, the administration has the right to choose what would be its plan and I submit this only as an item of evidence of the views of experts, technicians, et cetera, in drawing this bill and for no other reason. Again, I reiterate what Senator Bennett made so very clear and quite properly so, that this doesn't denigrate the interests of the tax authorities nor their interest in the deductions which are taken for payment to pension plans. They have a vital interest. We don't challenge that at all. But in terms of the predominant interest, we think the predominant interest is worker-management relations.

Senator NELSON. Fine.

Senator JAVITS. Gentlemen, as to the details of our bill, we believe—and I am sure you got a lot of testimony on this—that the concept of percentage vesting is very much superior to the Rule of 50, which will penalize older workers. We are having enough trouble with that now and we should not add to it and, indeed, we cite as one of our authorities the testimony of former Secretary of Labor James Hodgson, who served not in a Democratic but in a Republican administration, and who stated on April 18, 1973, in a speech to the First Annual Pension Profit-Sharing Conference under the auspices of Sutro & Co. in Los Angeles:

I worry that the Rule 50 might well cripple job opportunities for some older workers. It could work like this: An employer has two job candidates, one age 35 and one age 45. Note the latter would vest in only three years while he would have no such obligation to the former for eight years. In such circumstances, the temptation to hire the former seems considerable to me.

Also, we don't prefer the Rule of 50 because it deprives the worker of credit for his early years of hard work and this seems to us to be inequitable. So we oppose the Rule of 50 concept and prefer a percentage concept and, of course, a percentage concept is included in our bill as it is included in Senator Bentsen's bill.

On the issue of funding, again we disagree with the administration. Both our bill and Senator Bentsen's bill—and he has been very gracious in acknowledging a certain amount of authorship by us—calls for funding over a 30-year swing. The administration's bill calls for funding of the unfunded vested liabilities at the rate of 5 percent of the liabilities existing during the year. We think that there is a very serious difference in that approach.

Now there is a little difference between Senator Bentsen's bill and ours on the question of experience deficiencies caused by actuarial error. I won't trouble the committee about that detail. It can be studied by the subcommittee staff and I am sure it can be solved. But the basic difference between both our bill and Senator Bentsen's and the administration's, we think, is a very important one and I hope the committee will give that its considered attention.

The final point, since my formal statement deals with many of the other things, is that on questions of portability. Portability must be voluntary right now; you can't compel portability at this time, and ultimately we will get to it, I am sure but it can hardly figure as a major item of this bill because we are just not ready for it—but we need ~~some kind of~~ portability bank on a voluntary basis.

Senator NELSON. May I interrupt?

Senator JAVITS. Sure.

Senator NELSON. How important is portability in any event as long as his rights vest with an employer and he vests what he earns? Does it really matter that he may be paid by two, three, four, five employers?

Senator JAVITS. It matters. I would not give it paramount importance but it matters this way: Where a relationship of employer-employee exists, the employee has an interest on what is going to be earned with the money in the pension plan fund. This has gradually been building up as a serious matter. So many of these pension funds have earned as little as 2 percent or less. We feel where there is privity between the employer and employee and that particular employer is entrusted with the responsibility for the pension fund, the employee may have a greater interest in terms of what is earned on the investment and it is a matter of employee relations. When he switches jobs, he may wish to transfer his pension credits in order to get the benefit of more favorable investment experience. You know, it gives him a feeling of better relationship, but again I repeat that is definitely phase II in pension and welfare reform and the only reason we included it was the following:

(1) It may be possible to expand portability through Federal facilitation in some fields like multiemployer plans, perhaps in the building trades, etc., because of transfers in crafts; you know, the fellow who is a carpenter becomes a painter or whatever.

(2) The second aspect of it for consideration is the fact portability will be a growing consideration in years ahead as a matter of improving benefits. Thus, we begin to learn something about it by actual experience in the field on a voluntary basis. But as I said, it is not now a major item——

Senator BENTSEN. Mr. Chairman, I share Senator Javits' concern about the question of portability and in a small degree I have tried to provide portability through earlier vesting. Under my proposal, at the end of 5 years a person would have 25 percent vesting which provides a little bit earlier portability.

Now in S. 4 you provide for voluntary portability to a Federal clearinghouse and, in effect, that would require a supplemental amendment to the tax code, in order that it might be done on a tax-free basis; is that not correct?

Senator JAVITS. Well, not necessarily because the tax-free status has been established by the payment into the fund.

Senator BENTSEN. I know it is a tax-free status, but at the same time, I don't believe the tax courts have held they can transfer it out of that fund on a tax-free basis, or have they?

Senator JAVITS. The question which is raised here is whether the transfer would amount to "constructive receipt" and income to the employer.

Senator BENTSEN. You mean constructively construed as income to the employee?

Senator JAVITS. Yes—I meant the "employees." But if there was any question about it, Senator, I would hope, if voluntary portability were found desirable, that an appropriate provision would be made to quiet any doubt on the subject.

Senator BENTSEN. I would assume that that would be required because I have not seen an instance thus far where it has been construed as a tax-free transfer.

Senator JAVITS. I don't know that there are any cases on portability on pension funds. Anyhow, we can check into it.

As I said, I don't place the highest importance on the portability section. We include it for the reasons I stated.

Now, I just thought I would clear that away and get to the last two points, Mr. Chairman, because I don't want to intrude further on the committee's time. We feel very, very strongly about insurance, plan termination insurance. The administration does not have that at all in its bill. We feel very strongly about it because it is the big element of really giving assurance to the worker.

Now, of course, this is one of the hottest items of legislation in the whole labor-management field. In fact, I know of no other piece of legislation which has aroused the interest of workers as much as this one and one of the major things that the worker is deeply concerned about is the pension plan insurance. Now, insurance naturally goes with the regulations. In other words, it may be remembered that I found myself in an extremely embarrassing position about 2 years ago of opposing an amendment by Senator Hartke which would have installed insurance before we had any regulations.

The Senate sustained me in that, and I think quite properly, because if you are going to insure you have to have the basic conditions upon which you are willing to issue insurance. If you don't have the conditions, it is a bottomless pit. But we are establishing the conditions and the funding, et cetera, in this measure and, therefore, we believe that insurance is very much justified.

Our estimate is that about 20,000 jobs a year are involved in situations where plan termination insurance could be affected and the experience of the Federal Government with insurance has been very good in the financial sense and——

Senator NELSON. Excuse me, you said 20,000 a year, 20,000 people are being——

Senator JAVITS. May be terminated without a recourse.

Senator NELSON. Without anything?

Senator JAVITS. Without recourse, exactly. Without any pension beyond what the established fund would liquidate, Senator, although a Treasury-Labor Department study showed that for the first 7 months of 1972, 8,400 workers of some 20,000 who were terminated lost pensions. We think insurance is critically important and, really, gentlemen, if there was one thing that I would ask you, as you review the bill, to focus your attention on very importantly, it would be insurance because this is the very big difference between our bill and Senator Bentsen's bill——

Senator BENTSEN. No, no, Senator. I am in total concurrence with you.

Senator JAVITS. I didn't finish my sentence. It is the big difference between these two bills and the administration's bill. Senator Bentsen's bill also has insurance, which we greatly appreciate.

Mr. Chairman, I would just like to conclude as follows: The big thing here, the one thing above all else, is that whatever remedy we provide should be real and not an illusion because the field has been characterized much too much by frustration and disappointment. I believe that without materially increasing the load on employers, we can immeasurably improve that situation.

Now our bill gives vesting credit for service prior to enactment, and this is to me something that should be emphasized. This is a very, very valuable thing for the employer to have a good relationship with his employees. Now the big question is, what does it cost? Our estimate, of course, is depending on the pension plan, it costs from zero, because some pension plans have adequate vesting—to a maximum of 1.4 percent of payroll, and the medium cost might be around six-tenths of 1 percent of payroll. We respectfully submit that this is such a desirable and such a healthy reform, that it is worth that kind of expenditure in social terms, in terms of our Nation and its relations with its people, and, also, in labor-management terms.

Thank you, Mr. Chairman.

Senator NELSON. Thank you. Senator Bentsen?

Senator BENTSEN. Senator Javits, you stated the tax provisions are considered by some as an element of facilitation rather than an element of decision. This was in your statement.

I think that is a fair statement as long as the deductibility provision is there, but I think if it were removed and the contributions were not a deduction for tax purposes, then I think it becomes very much an element of decision and that is why I think you have, in effect, punitive powers here through removal of the provisions for deductibility, if they don't qualify. In turn, I feel that the Internal Revenue Service has begun to administer some of these vesting and funding provisions. Well, I can recall instances of forfeitures of employees' benefits would accrue to the benefit of the employer and his son-in-law, who were going to be with the company longer than anybody else and yet the Internal Revenue Service moved in to stop that in new plans that were being installed. And so, to a degree, they have been moving more and more towards administration and intervention in trying to see some reasonable vesting and funding provisions are in plans before they will approve them.

Senator JAVITS. Senator, we believe very strongly that the weight of administrative judgment is for administration in the Labor Department because, while you are absolutely right about the fact that IRS is doing more than they did, the fact is that it is still their primary jurisdiction to collect taxes and punish evasion and define people who evade. This represents such an enormous range in which they must operate, that pension plan supervision would only be one item. Also, the Internal Revenue Code has not been found suitable as a regulatory mechanism because essentially it is a negative mechanism. It takes time to catch up. It has no initiatory quality. If IRS happens to catch up with it, then they get you and do something about it. If they don't, then they don't.

If they get a complaint they might act on it, but there are lots and lots of complaints; thousands and thousands of them, for a whole diversity of reasons. So that the fundamental thrust that they have is to collect taxes and that isn't what benefits the worker. You know, the fact that they are going to punish some guy by denying him the tax deduction or making him pay taxes for what he didn't do with respect to the plan, doesn't really help the worker. What the worker wants is that he should enjoy his pension. As a matter of fact, it is interesting to me that when we came to enacting disclosure requirements for pension and welfare plans, there was never any discussion that it should be done any other place than the Department of Labor. They have all of this subject to review, audit, and so on.

Senator WILLIAMS. Can I——

Senator JAVITS. Oh, excuse me.

Senator WILLIAMS. No, no; go on. When you are through, I want to indicate—well, are you through?

Could I offer an observation on this, Mr. Chairman?

Senator NELSON. Yes.

Senator WILLIAMS. The most recent case of the adequacy of evaluating the workers' benefits, we have discovered, is with the airplane pilots. The question has arisen in the airline pilots pension fund—and we reviewed this with them last week—where the airline pilots under FAA Regulations must retire at the age of 60—and I will say about 8 years ago it was age 55, and the Committee on Aging here went to battle on that one and it was raised to age 60—at any rate, it is age 60 now, and the IRS is exploring whether their pension plan, because of that relatively early retirement or, at least, earlier than other employees in the airlines is a discriminatory aspect in favor of the pilots.

Now, certainly, they are in a more favored position in the sense that they are fully ready for their pension at age 60, but it is, of course, a matter of law that they have to retire at that age. I raise this as a question here of the adequacy of the administration by the Internal Revenue Service. These pilots have no standing to go in and argue their case at the Internal Revenue Service. They are not before the Internal Revenue Service, only the employer is because the whole force of administration is the grant or denial of tax deduction.

Now, it just seems to me that we have reached a point where pension legislation most clearly falls within the stated purpose in the law of the Department of Labor as a Department "to foster, promote, and develop

Best Available Copy

the welfare of the wage earners of the United States and to improve their working conditions and to advance their opportunities for profitable employment."

This is intimately part of the job of benefit protection and, historically, that part of the workers' arrangement with his employer has been watched over under law and regulation by the Department of Labor.

Senator BENTSEN. Mr. Chairman, I would certainly agree with Senator Williams that the individual should have some rights to promote his case and that would be true whether it was under the Labor Department or whether it was under the Internal Revenue Service but I think that it can be taken care of in the legislation itself. What concerns me is the fact we are saying, because the Internal Revenue Service does not regulate to the degree we would like, it should be in Labor. We haven't given them mandatory guidelines. I think they would do it if we did that. Now, at least they are regulating to a greater degree than the Labor Department. I have said this earlier, but I have not had an opportunity to say it to you two gentlemen, personally, and, that is, how appreciative I am of the great amount of work you have done in this field and your knowledge of the field and the contributions you have made.

Senator JAVITS. May I make one other observation, Senator Bentsen? If you were right, then the same thing should be true of Fair Labor Standards. The employer deducts his payments for wages and, if you are right, Senator, why not challenge him there, if he fails to pay a minimum wage or the proper amount of overtime? Just punish him by not allowing him a deduction. But we have never done that because we realize that, sure, it is an important thing in taxes, but the primary thrust is labor-management relations.

Now, there is a role for the Internal Revenue Service without any question—and this goes back to Senator Bennett's point—and it is an effective role. But what we are talking about here is in a situation like pension plans where workers' rights must be considered, where is the more effective administrator for the objectives sought to be served? And all we say is that the objective sought to be served is the employer-employee relationship. What has worried us, what has worried Senator Williams and myself, and I am sure Senator Bentsen, without having discussed it specifically—because you have certainly given a lot of thought to this field and are interested in the field—what concerns us is what we felt to be the erosion of morale in the American worker. We are trying to find ways to clear that up. This is not good; this is very unsatisfactory and very dangerous to our country.

And all of us simply have to push our heads through the clouds and forget what you might like and we might like in regulations, because the big thing here is doing a better job in the best and most efficient way and in a way which can be a major contribution to reaffirming the morale of the worker, his interest in the system and the fact that he is getting more of a "piece of the action." That is really what it comes down to.

And I hope we can get going on this because this is the larger problem to be solved and what has worried Senator Williams and myself.

Senator BENTSEN. Senator Javits, I couldn't agree with you more on that. I think that the position of workers would be vastly improved if either one of these bills were passed and I think there are good points in each that we could work together on.

Senator JAVITS. That is right.

Thank you very much.

Senator BENNETT. Mr. Chairman, Senator Curtis was not able to be here today. He had a question he intended to ask and it has been handed to me.

In 1969—and I am reading Senator Curtis' text, so when I say "I" it means Senator Curtis—in 1969, I sought to establish the idea that when someone violated his fiduciary standards with respect to a private foundation, the violator would suffer and not the charity. Those ideas about fiduciary standards grew into the provisions for private foundations. In those provisions, we took private foundations out of the prohibitive transactions provision you refer to in your statement.

This year, you and I joined in introducing rules to provide a similar set of rules for pension funds. that is, section 116. S. 1557, the bill you introduced for the administration, would set up a series of fiduciary standards. Section 6 of S. 1631—the bill Senator Curtis introduced—would impose excise taxes on people who violated those standards and would take pension plans out of the old prohibitive transactions rules that you criticized in your statement to us today. On the other hand, S. 4 would leave, in effect, the same old prohibited rules, which you criticized.

Now, would you advise us whether we should keep the old rules at this point, as S. 4 would do, or whether we should shift to a system that penalizes the faithless fiduciary and forces him to live up to his standards as S. 1631 would do?

Senator JAVITS. If I may answer. The statement was made, I gather, based upon my statement. Now, I would like to say that we believe if you are seeking practicality rather than symmetry, that insofar as the prohibited transactions provision of the Internal Revenue Code was duplicatory or inconsistent with the fiduciary standards in our bill, we recommend that it be repealed. In short, we would rather have the fiduciary standards enforced based upon the same concept as the Welfare and Pension Plans Disclosure Act, then to tie it also into the prohibited transactions provisions of the Internal Revenue Code. Our own judgment is that if the plan's tax qualification is withdrawn or tax penalties are imposed because of some abuse by a trustee, the employer may very well terminate the plan or pay less benefits, and that is detrimental to the participants.

Senator Bennett, you will be very thoughtful about this and I know Senator Curtis will, but we beg you to remember that there is nothing in our legislation, sir, there is nothing in Senator Bentsen's legislation or the administration's legislation, which compels anybody to install a plan. We always have to bear that in mind. We are anxious, on the contrary, to encourage plans and we think, therefore, that, from that point of view, what we recommend by way of action on the fiduciary standards is preferable.

Senator BENNETT. Senator Curtis apparently feels otherwise, though.

Senator JAVITS. Apparently.

Senator BENNETT. But I am very happy to get this colloquy into the record.

Senator JAVITS. Senator Bennett, you know, this is a subject which has received all of our attention; ours, perhaps a longer time than most Senators. But I beg you, sir, to remember that there are certain basic propositions. One of them is the fact that we want to encourage pension and welfare plans. They are very good and so we have to always have an eye to that. I say that, sir, for this reason: I always had a reputation around here for being a liberal but also for having a pretty hard head about American business and this is what is operating now, as far as my advocacy is concerned. I am anxious to be sure that whatever we do doesn't block our pension plans or discourage their establishment. That is one of the very fundamental points, and I think Senator Williams feels just as I do.

Senator BENNETT. I have no other questions, Mr. Chairman.

Senator BENTSEN. I have no other questions, Mr. Chairman.

Senator NELSON. We have witnesses who have testified that in their judgment the plan ought to be exclusively administered by Internal Revenue Service. We have had witnesses who said it ought to be exclusively administered by the Labor Department. We had witnesses who felt that the administration ought to be divided and some functions administered by the Internal Revenue Service and some by Labor. Are there some functions in the administration's plan that you think ought to be reserved to the Internal Revenue Service or are you saying they all ought to be in the Labor Department?

Senator WILLIAMS. Well, certainly, there is a role for the Internal Revenue Service in any pension plan legislation, it seems to me. We recognize that by not disturbing in any degree the present Internal Revenue Service responsibility. Certainly, any company that contributes money into a pension fund, well, this is part of its cost of doing business and, therefore, it has an Internal Revenue Service impact. We have carefully tailored our bill to present law in terms of permitted business deductions so we clearly recognize a continuing Internal Revenue Service responsibility here in making sure that the business deduction is justified.

Senator BENTSEN. Well, what would you and Senator Javits delineate as presently the role of the Internal Revenue Service in the administration of pension plans?

Senator WILLIAMS. Again, the Internal Revenue Service is doing just what it says; it is a tax collector and in order to be exempt from certain taxes or have deductions for tax purposes, these contributions to a pension fund can qualify. So, therefore, they have this ongoing responsibility.

I will say that there are areas—and this is not finally formed in my mind—but there are certain areas where it seems to me that if the Williams-Javits-Bentsen approach became law, there would be necessary new findings by our Internal Revenue Service, for example, the General Electric Co.'s recent contracts—and I don't know the details of the benefits under their pension plans—but under our insurance program, they will have to buy insurance. They would like to accelerate their own funding rather than paying insurance. Now, this would be an Internal Revenue Service question. I would believe. They, under present Internal Revenue laws, can only fund prior unfunded liabilities at a certain rate. I gather that the General Electric Co. would like to accelerate this funding of new liabilities they have out of their most recent labor contracts and they would rather do it that way than to pay insurance premiums. So that is, obviously, a legitimate IRS consideration.

Senator JAVITS. Another angle to it is, of course, the Internal Revenue Service almost always considers the reasonableness of the deductions. It does that with executives, too, you know, such as a fellow who is getting $25,000 a year and they are going to set up a pension reserve for him of $20,000 a year; that is obviously a tax deferral and not a pension payment. So the Internal Revenue Service has a fundamental role even if it were exclusively on the tax collection side.

Senator NELSON. As I understand it, S. 4 doesn't deal with the question of the discrimination in favor of shareholders, high-salaried employees or management.

Senator JAVITS. It does not. That stays with tax authorities, according to present law——

Senator NELSON. Doesn't the question of enforcing the eligibility and vesting standards as to plan qualification have to remain in the IRS? I am speaking as to plan qualification.

Senator JAVITS. Well, for tax purposes only, but as to regulatory features, it would go to the regulatory agency.

To give you a practical example of that, you take a utility company. The utility company charges *x* dollars for financing and charges *y* dollars for legal fees and *z* dollars for advertising. The tax authorities may strike some of that down but may sustain some of it, but they still have to run the hurdle of the Federal Power Commission or the State regulatory agency as to the same question, but for a different purpose, that is, the question what the consumer is paying for it. But the tax deduction aspects remain with Internal Revenue Service.

Now, the Internal Revenue Service may accept or it may not accept the basic findings of the regulatory commission as conclusive and that is exactly what will happen here. As a matter of fact, if anything, it seems to me, to be a very strong argument for nonadministration by the IRS because there are very different purposes which are being served. IRS is interested in tax collection. Our bill in terms of its regulations is interested in a fair and secure administration of a pension plan.

Senator NELSON. Is my memory correct about this: if a plan were being inadequately funded under Senator Bentsen's bill, the penalty is to deprive those employers of the tax deduction for contributions to the plan?

Senator JAVITS. Right.

Senator NELSON. Under S. 4, the Labor Department would move through the courts to enforce compliance?

Senator JAVITS. Exactly right.

Senator NELSON. What puzzles me about either one of those approaches is, supposing in a particular year the employer doesn't have the money to contribute?

Senator JAVITS. Well, supposing in a particular year he doesn't have the money to pay wages? Supposing in a particular year he misappropriates his withholding tax? Suppose he can't pay his bills? It is all the same. That is why we have all of the legal remedies.

Senator NELSON. I understand that, but I am talking about a case where he is in business, he is paying the wages, he has to pay his rent, he rents his facility, but he ends up without the money to contribute to the fund or without an adequate amount to contribute to the fund, in which case he loses his deductibility, which, of course, damages the whole pension plan. In your case, you go to court and do what?

Senator JAVITS. Sue him for the money.

Senator NELSON. But he doesn't have it.

Senator JAVITS. If he doesn't have it, it can't be collected but he still owes it. In addition, under our bill, he can seek a deferral of funding for good cause. We have certain escape hatches which will allow some kind of relief for a sudden financial squeeze, but laying that aside——

Senator NELSON. Is that an administrative decision to be made by the Labor Department?

Senator JAVITS. Exactly right. Based upon criteria which is specified in the bill.

But the important point Senator is if, in the ultimate, he really hasn't got the money, you face the same thing that you would with respect to any other financial responsibility of the employer. It is no different. It is a contractual responsibility. There are no criminal penalties in this as there are none for failure to pay your bills or pay wages or whatever it is.

Senator NELSON. But what is that remedy you are seeking in the court? Is it a judgment?

Senator JAVITS. You go after a money judgment just like the Fair Labor Standards Act, exactly.

Senator NELSON. Any further questions?

Senator BENNETT. One more.

Does the proposed early vesting rule under S. 4 mean that it would be public policy for an employer who wanted to offer greater retirement benefits for those workers who remained longer in service?

Senator JAVITS. Not at all.

Senator WILLIAMS. These are minimum standards, Senator.

Senator BENNETT. So if a man is vested, say, after 15 years and after having worked for more than 15 years and the employer desires to increase the level of his benefits, that can be done?

Senator WILLIAMS. Sure. These are minimum standards.

Senator JAVITS. Yes.

Senator BENNETT. I would be interested in your comment on this. I have just noticed this statement. Referring to the question of disclosure—and this is not in your statement—but in March 1967, the Comptroller General of the United States, based on an investigation, told the Senate that the Labor Department was not doing a good job of administering and enforcing the disclosure bill.

Do you think that justifies our putting faith in the Labor Department to administer this more complex bill? Have we had any indication that the Labor Department has increased its capabilities since 1967?

Senator WILLIAMS. This was in 1967?

Senator BENNETT. Right.

Senator WILLIAMS. And we are aware of that, Senator, and I will state not only in this area but in other areas also, we found that the Labor Department was less sensitive and responsive to their authority that has been given to them under congressional action. For example, occupational health and safety is another one, where we have had a lot of problems.

I will say we have equal evidence of less than precise and clear administration under the Internal Revenue Service as far as its present responsibilities with pension plans, and I mentioned the airline pilots situation.

So I will say there is work to do here but——

Senator BENNETT. Don't you think we had a case where there were two conflicting decisions made by separate courts? Isn't that the case to which you refer?

Senator JAVITS. We did.

But the important thing is the Labor Department got straightened out. They have put in an electronic data processing system, Senator. They strengthened management after extensive consultation with a prominent management consulting firm. As a matter of fact, my office complained about it very strongly because when we sent people up there, we found quite a mess in getting reports out of the files. This was 6 years ago but they have pretty well straightened it out by now and we are satisfied that their system is much improved.

Senator WILLIAMS. I am glad Senator Javits has updated that because now I have a statement from the General Accounting Office and it is a survey of the Internal Revenue Service. Can I quote this, Senator Bennett?

Senator BENNETT. Sure.

Senator WILLIAMS. This was in 1971:

> The Internal Revenue Service determines whether a sponsoring employer and the participating employees of the private pension or profit-sharing plan are entitled to tax benefits because their plan meets certain requirements of IRC of 1954. The Internal Revenue Service has conducted little investigative or audit activity to ensure that private pension plans are operated in compliance with tax laws or Internal Revenue Service Regulations.

This is evidence of just what I said earlier.

Senator BENNETT. Did your committee discover any cases where Internal Revenue Service did not enforce the standards of the present law on vesting and funding? If so, I would like the committee to have that information.

Senator WILLIAMS. We have some and I believe I can submit it.

[The committee subsequently received the following information:]

TESTIMONY OF WESTERN UNION REPRESENTATIVE BEFORE THE SENATE SUBCOMMITTEE ON LABOR (OCTOBER 12, 1971)

Turning to the matter of funding, the company's independent consulting actuaries have estimated the amount of unfunded prior service pension cost at $365.2 million as of June 30, 1970. From the plan's inception until 1955, pensions were paid on a pay-as-you-go basis. In 1955 we inaugurated a prefunding plan under which amounts equal to 50 percent of normal cost plus an amount representing interest on 50 percent of the present value of unfunded prior service costs were paid into the trust fund. Under the funding plan, the initial unfunded prior service cost amounted to $86.8 million. During the period from 1955 to 1968, additional unfunded prior service costs of $39.6 million were established as a result of plan improvements: $3.6 million because of bridging of breaks in continuous service, and $36 million from the gradual reduction of the social security offset provision. In addition, there was an increase of $16.3 million as a result of changes in actuarial assumptions.

In view of the mounting unfunded accruals under the funding plan, the company changed its policy and in July, 1959, the management changed and commenced payment into the trust fund of an amount equal to 100 percent of normal cost plus interest on 100 percent of the present value of unfunded prior service costs. As a consequence of this change, a further increase in unfunded prior service cost in an amount equal to $192.2 million resulted. Finally, in 1969, an increase of $30.3 million resulted from the elimination of the social security offset.

The $365 million amount as of June 30, 1970, therefore, is the sum of the initial prior service cost of $86.8 million plus additional amounts of $192.2 million for the change to 100-percent funding; $16.3 million because of a revision in actuarial assumptions; and $69.9 million because of benefit improvements. As a result of the change in policy, a ceiling has been placed on the unfunded prior service costs, assuming the absence of any further substantial benefit improvements.

Some interesting statistics were used by the subcommittee staff in pointing to the fact that our unfunded accrual was equivalent to 42 percent of the company's assets. Actually, as a result of a continuing expansion of the company, the frozen unfunded prior service cost of $365 million now bears a relationship of 33.9 percent to company assets.

Testimony Concerning Pension Plan of American Zinc Co., Before the Senate Subcommittee on Labor (May 1, 1972)

Mr. Cummings. As far as you know, this is a tax-qualified pension plan, is that correct?

Miss Hillmann. As far as we know, yes. We have been so informed by the company.

Mr. Cummings. I take it you are aware that, at least under the present interpretations of the Internal Revenue Code, a continuing plan has the obligation to fund no less than current service costs, plus an amount equal to interest on past unfunded credits, and I take it that what you are saying is that they have not even complied with the requirements of the IRS; is that right?

Miss Hillmann. The information we have now leads us to believe so, yes.

Mr. Cummings. Do you have any information which would suggest that the IRS ever took any notice of the fact that this plan was not complying with the code?

Miss Hillmann. We have no such information, no.

Mr. Cummings. And I take it, finally, just to let the record show, that if you had known that it wasn't complying with the code and sought to enforce the code, you would have only cut the throats of your own members by disqualifying the plan?

Miss Hillmann. Right. We are in a real bind here.

Mr. Cummings. So those requirements put you in a vicious circle, I take it, where the only remedy you get is to take money away from your own members?

Miss Hillmann. That's correct, but we are hoping that we might be able to do something in terms of the fact that, as far as we understand at this point, the company has not complied with even those minimum requirements on funding.

Testimony of Senator Adlai E. Stevenson III, Concerning the Elgin Co. Pension Plan, Before the Senate Subcommittee on Labor (February 15, 1973)

Senator Stevenson. Thank you. This company has been in continuous existence as a corporate entity for a long time, as Mr. Howard mentioned. In recent years, outside interests began to acquire the common stock of the company. New management came in. That management now proposes to terminate this pension fund. I am told that if it happens according to the plans which have been advanced that the present owners of the company will acquire more out of this pension fund than they ever invested in the company. They will acquire the pension fund surplus as well as the company. In accordance with suggestion that you made, Mr. Chairman, in your letter to me of February 1, I did conduct a 3-hour factfinding hearing in Elgin on Friday, February 9. The witnesses who testified at the hearing include pensioners, representatives of the company union, the company, pension experts, representatives of unions, and senior citizen organizations.

This subcommittee has documented numerous cases in which hundreds of thousands of innocent employees have suffered upon termination of underfunded pension plans. We know what happens when an underfunded plan terminates. The employee bears the risk of the loss.

The Elgin case is the other side of the coin. It demonstrates the when the termination involves an overfunded rather than an underfunded plan, the surplus may under existing law not go to the employes but to the company. What we have, then, is a no-win proposition for the employees and a no-lose proposition for the company. If for any reason the pension fund is too small, the employees are deprived of the benefits they were promised. If on the other hand, the fund proves to be larger than anticipated, the company may under existing law be able to terminate the plan and receive the entire surplus as a windfall.

As far as I can determine, the Elgin case constitutes the most extreme example of what can happen if the law permits companies to terminate overfunded plans at any time and for any reason. Elgin National Industries has not made any contributions to the pension fund since the overfunding was first discovered in 1957. Since then, much of the company's common stock has changed hands, and new management has taken over. Most of the contributions were made by the employees.

The company's contributions to the pension fund were deductible against corporate income for Federal tax purposes. For over 15 years, the income earned by investment of the money in the fund was exempt from taxes. Although the Internal Revenue Code provides that the surplus proceeds received by a company upon termination of a pension plan are taxable as ordinary income, it appears that in this case, Elgin National Industries may not have to pay any income tax on the surplus because the company has experienced large losses against which the surplus can be offset. Thus, if the efforts to terminate the plan are successful, it will be the company and not the employees who will be the prime beneficiary of the pension plan. It will be the company and not the employees which will reap the benefits of a 15 year tax-free investment program. But it will be the employees and not the company who will be left to live out their retirement years on small fixed pensions, which contain absolutely no protection against rising prices. And the taxpayers will have subsidized the company—not the employees

Mr. Chairman, I submit that if this company can crack this pension fund to the tune of $12 million, and if new legislation permits a company to take the entire surplus upon termination of an overfunded plan, every overfunded plan will be viewed as fair game by financial manipulators and fast-buck artists. We cannot allow that to happen.

Senator JAVITS. Senator Bennett, I will say this from our point of view. I think it would be most unfortunate to pit department against department. Somebody would come up with something that the Labor Department didn't do on pension and welfare funds, and somebody will come up with something that the Internal Revenue Service didn't do.

The legislative oversight function will continue to have to be diligently performed by both committees over their respective agencies. We expect that will happen——

Senator WILLIAMS. May I interrupt?

Senator JAVITS. Sure.

Senator WILLIAMS. I certainly agree with Senator Javits basically, because I think the question is, who will achieve the best results and, on a philosophical basis, what is the mission of the Internal Revenue Service and what is the mission of the Department of Labor?

Senator JAVITS. Exactly.

Senator BENTSEN. Let me say, along that line, Senator Bennett and gentlemen, my concern—and a point that Senator Javits has made—is that we don't want to make it too difficult to administer pension plans because this would tend to slow down the installation of new ones. I am concerned somewhat when we talk about the Internal Revenue Service continuing to have a role in determining deductibility of these contributions and the requirements for qualification of a pension plan. If we authorize the Labor Department to administer funding and vesting provisions also, we can certainly see the situation where the Internal Revenue Department might rule a plan in compliance while the Labor Department might give a conflicting opinion. Here you have the employer caught between the two agencies with conflicting judgments and rulings. I would like to avoid this sort of thing if possible.

BEST COPY AVAILABLE

Senator Javits. Mr. Gordon makes an interesting point on administration. Senator, which ought to be supplied for the record. In the Federal Unemployment Tax Act which taxes employers to provide unemployment benefits for their employees, provision is made for a credit to employers for any amounts contributed to State plans providing unemployment benefits. The Secretary of Labor is charged with the responsibility of ascertaining the nature of the various State plans to determine whether payments made to such plans can qualify for credit. In other words, there is no reason why, as between the agencies, there cannot be some agreement to avoid the kind of pitfalls that you have mentioned and this unemployment tax experience may be a case in point. In other words, the Secretary of Labor ascertains whether payments made to such plans can qualify for credit and then the Internal Revenue Service would determine whether the credit taken is the right one, but the basic qualification would come through the Secretary of Labor.

Senator Bentsen. By the same token, I recall during World War II and the Korean war, that wages paid in excess of the guidelines were disallowed as income tax deductions and that was handled by the Internal Revenue Service.

Senator Bennett. I would like to make the point there are 50 States to look at and thousands and thousands of pension plans for the Secretary of Labor to look at. I think the problem becomes much more complicated because of the number of units involved in this.

Senator Javits. Well, each of these points, as I said, can be seen by us to be buttressing our thesis and perhaps by you as buttressing yours, but in any case, those are the factual situations.

Senator Williams. Of course, the Department of Labor has already entered the field in many ways, that is, the pension field through legislation, the National Labor Relations Act and, of course, the Taft-Hartley Act, the Landrum-Griffin Act, the Welfare and Pension Plans Disclosure Act. And these are all Labor Department functions. In other words, many pension plans report to them and, of course, they do have all of the jurisdiction that arises out of the Welfare and Pension Plans Disclosure Act--I believe—and they also have the responsibility of regulating jointly administered funds in section 302 of the Taft-Hartley Act. So it is not a new area for them. Most of the legislation dealing with pension plans is now legislation directed to Department of Labor administration.

Senator Bennett. No further questions.

Senator Bentsen. I have one further question and perhaps this was covered earlier, but there is another difference between our bills in that the Williams-Javits bill excludes those plans with 25 or fewer participants and I would like to hear the reasoning on that.

Senator Williams. That is a worthy question. As a matter of fact, we, as recently as this morning, compared the Bentsen bill and our bill in this regard and I think Senator Javits will add also it was the thought that we fixed the age of 25——

Senator Bentsen. No; I am talking about the 25 participants.

Senator Williams. Oh.

Senator Bentsen. Being excluded.

Senator Williams. Yes.

Best Available Copy

Senator BENTSEN. In my experience, the worst abuses have been in the very small pension plans where a principal employer could tailor it for his own benefit rather than the employees.

Senator WILLIAMS. Oh, I misunderstood. There is a difference on the other and, that is, because we felt on the transitory employment we should not go into the administrative expense.

Now, on the other question—and Senator Javits would agree with this, I think, because I think this fits right into some of the things he said on the encouragement of the growth of pension plans and——

Senator JAVITS. Could I interrupt?

Senator WILLIAMS. Yes.

Senator JAVITS. We were concerned about discouraging smaller pension plans through the regulatory aspects of the bill. That is our only reason. As a matter of fact, I am very interested, and my statement said so, in the administration's plan with respect to tax deductibility on a Keough plan basis for individual blue collar workers or white collar workers. I think that may be a very sound thing to initiate. That could also involve a pool of pension plans by smaller employers in which the banks could get very interested and that, I think, would be a very good thing. It is a mighty fine idea.

Senator BENTSEN. You are seeing a lot of that done now?

Senator JAVITS. Yes. So, for all of those reasons, we left them out in the hope of encouraging this and that is the only reason. On the same theory, we exempt small businesses from various types of wage and hour regulations and many other things to encourage them.

There is no magic in the cutoff figure of 25, except it is kind of a historical figure which was used in the WPPDA.

Senator BENTSEN. My concern is that in these situations in the very small companies, you don't have the public reporting necessary; you don't have the broad stockownership that is checking on how these plans are funded or how they allocate the benefits and that they don't come under as much general public scrutiny. You don't have the SEC filings, the S-1's. Here is a situation where you often find the most serious abuses and that is why, on balance, I felt they should be included.

Senator JAVITS. Well, it is certainly an arguable case. You know, you have the SEC exemptions for $300,000 issues. It is something on which we have to make the best kind of judgment that we can.

Senator NELSON. Well, thank you very much, gentlemen. We appreciate your taking the time.

[The prepared statement of Senator Javits follows:]

PREPARED TESTIMONY OF JACOB K. JAVITS, A U.S. SENATOR FROM THE STATE OF NEW YORK

REFORMING OF PRIVATE PENSIONS—WHAT IS REALLY NEEDED

In 1963, Studebaker shut-down its automobile facilities in South Bend, Indiana and cancelled its pension plan. Approximately 4,500 employees lost eighty-five percent of their earned pension benefits. Some of them committed suicide. This economic and social tragedy caused the late Walter Reuther to observe—

> "Studebaker made covered wagons. They celebrated their 100th anniversary a few years back, and now they are part of history. But the workers, what happened to the workers?"

Mr. Chairman, for the last 3 years, the Senate Committee on Labor and Public Welfare has made inquiries into what happened to the workers—and not just the workers at Studebaker but thousands of workers in private pension plans all over the country. Personally, my concern over the injustices in private pension plans dates back to 1967, when I introduced the first comprehensive private pension reform bill—the predecessor to S. 4, the current Williams-Javits bill.

What I discovered in 1967, and what the Senate Labor Subcommittee discovered within the last 8 years—after a massive and thorough study—authorized and funded by the Senate—is that the private pension promise all too frequently is a broken promise—leading to economic deprivation and bitter resentment by older workers looking forward to retirement years of dignity and security.

By now the "horror stories" concerning unjustified loss of pension benefits are commonplace. The files of the Senate Labor Subcommittee are bulging with case histories of private pension plan victims and any newspaper reporter with a minimum degree of enterprise can discover similar examples in virtually any community throughout the United States. The Administration has itself estimated that somewhere between one-third and one-half of the 35 million workers covered by private pension plans will never collect a dime from their plan, and studies by the Senate Labor Subcommittee indicate that historically the rate of benefit loss has been much, much greater by about half of that estimate.

Yet the progress toward achieving enactment of meaningful private pension reform—while substantial—has been slow and painful, and there still is no law on the U.S. statute books which safeguards adequately the pension rights of workers. While careful legislative deliberation is always appropriate in consideration of such a complex field as private pensions, we should be aware that while we debate, discuss, differentiate and study, untold numbers of workers are being needlessly and irreparably injured by the lack of sufficient pension protection.

To illustrate this point, I feel compelled to advance yet another recent "horror story"—perhaps one of the most shocking I have encountered.

In August of 1971, Mr. Robert E. Pratt of Hudson, New York was laid off from Gifford-Wood Co. due to poor business conditions. In the meantime, the company was sold to Greer Industries, Wilmington, Massachusetts, in June 1972 by Stowe-Woodward Co., Inc. of Upper Newton Falls, Massachusetts, former owners of Gifford-Wood Co. Gifford-Wood manufactured coal extraction, materials handling and other machinery. It was a very old company that dates back to 1814.

On June 30, 1972, the Gifford-Wood plan was terminated, three months before Mr. Pratt's 65 birthday. Mr. Pratt had worked for Gifford-Wood Co. for 47 years. When he applied for retirement benefits on attaining age 65 he was told he would receive nothing for his 47 years of service since the plan had been terminated on June 30, 1972 and there were funds available to pay retirement benefits only to those who had retired before that date.

A copy of the correspondence between Mr. Pratt and company, insurance, banking and government officials concerning this matter is appended to my testimony. Included is an "unofficial" note from the insurance agent who advised Mr. Pratt to contact me for help since while "the company has no legal obligation to you—there is definitely a question of the morality of choosing June 30, 1972 as the cut-off date or of not offering you something for your 47 years of service".

I doubt there can be any more eloquent testimony than such case histories—and they are legion—as to the imperative need for enactment of the Williams-Javits bill without any futher delay.

The bill has been 8 years in the making, it is co-sponsoder by 53 Senators, it is on the calendar and ready for consideration by the Senate.

We await now the disposition of concerns expressed by the Finance Committee regarding this legislation, and it is to these concerns that I now turn.

I—THE ADMINISTRATION AND ENFORCEMENT OF PRIVATE PENSION LEGISLATION

There are three major fallacies that have arisen in connection with the argument that the Williams-Javits bill or its analogues should be handled as part of the tax qualification procedures of the Internal Revenue Code. *The first fallacy is that private pension plans are exclusively a creature of the tax incentives; the second fallacy is that the Internal Revenue Service regulates private pension plan design; and the third fallacy is that the need for supporting IRS jurisdiction over this legislation is that it would result in more effective administration.*

As to the first, there has been expert testimony before numerous Congressional committees that the growth and development of private pension plans has not resulted exclusively from the provisions for favorable tax treatment. For example, the Research Manager of Hewitt Associates (a well-known pension-consulting firm), Pearl E. Charlet, testified before the Joint Economic Committee in 1966 that:

"A company does not initiate and maintain a retirement plan because it receives a tax deduction for its contributions, since the same tax deduction would be permitted for the same amount of money paid in wages. *Employer motivation for retirement plans in most cases is for reasons completely apart from tax considerations.* The reasons may include need for an orderly method of removing the too-old workers from the payroll, creation of a sense of employee security and morale, competitive advantage in the labor market, and a form of extra-compensation for long service." (Emphasis added)

While tax incentives, no doubt, help in getting private pension plans established, incentives are an element of facilitation not the element of decision. The other factors contributing to pension plan development must be considered for purposes of determining a suitable administration of pension reform legislation. Indeed, the testimony cited above indicates quite clearly the great significance of pension plans in labor relations and their almost universal use as a major work incentive. Moreover, over 50 percent of all private pension plans are collectively-bargained—which means that tax considerations are not the prime condition for private pension growth.

It has also been acknowledged that IRS regulations of pension plans is only incidental to its basic task of revenue collection.

Mr. Harold Swartz, then the Director of the Tax Rulings Division of the Internal Revenue Service, on July 20, 1955 told the Senate Subcommittee on Welfare and Pension Funds that:

"I would like to emphasize that the principal function of the Internal Revenue Service is the collection of Federal taxes. There are more than 70 different internal revenue taxes so imposed. The collection of these taxes involves the processing of nearly 95 million tax returns. Obviously, we can neither examine nor audit all of these returns. We must channel our limited examining manpower to the items which are believed to be the most productive. Accordingly, only a small portion of our time can be devoted to examining into the annual information returns filed by exempt organizations."[1]

The Douglas Subcommittee in its Final Report referred to Mr. Swartz' testimony in concluding that the I.R.S. does not perform a regulatory function in the pension area:

"A plan may lose its tax-exempt qualifications if it engages in any of a list of prohibited transactions, most of which involve dealings between the trustee and the entity which set up the trust that would benefit the concern to the detriment of the employees. However, as pointed out by Mr. Swartz during his testimony, 'It should be understood that the transactions are not actually forbidden by the revenue laws but are *prohibited* only in the sense of being inconsistent with continued tax privileges.' It is apparent then that 'regulation' by the Internal Revenue Service does not regulate as such, but merely allows certain tax exemptions in return for compliance. Mr. Swartz made this position clear when he told the subcommittee, 'In seeing that the taxes levied by Congress are paid, the Revenue Service does not seek to act as a regulatory agency'."[2]

Many others have reached similar conclusions about the adequacy of tax "regulation" to protect employee benefit plan participants.[3]

Incidentally, the same Mr. Harold Swartz who testified before the Labor Subcommittee in 1955 as to the limitations of the Internal Revenue Service in regulating pension plans, testified before *this* subcommittee on May 31, 1973, that "it would seem logical and preferable, therefore, that any additional vesting, funding and other similar provisions that may be required of these plans be enforced and administered through the Treasury Department."

[1] *Welfare and Pension Plans Investigation*, Hearings before the Subcommittee on Welfare and Pension Funds of the Committee on Labor and Public Welfare, U.S. Senate, Part 8, 84th Congress, 1st Sess., July 20, 1955, p. 847.

[2] *Welfare and Pension Plans Investigation, Final Report*, submitted to the Committee on Labor and Public Welfare by its Subcommittee on Welfare and Pension Funds, U.S. Senate, 84th Cong., 2d Sess. (April 1956).

[3] Isaacson, *Employee Welfare and Pension Plans: Regulation and Protection of Employee Rights*, 59 Col. Law Rev. 96 (Jan. 1959) at 105. Regulations under the Internal Revenue Code and Taft-Hartley Act have "some impact on the plans, but have failed to be effective sources of regulation, in large part because their concern with the benefit plans has been incidental to other purposes." See also 45 Minn. Law Rev. 575 at 607.

I believe it is also incorrect to assume that incorporation of the Williams-Javits pension reform standards into the tax code presents the most effective administrative and enforcement mechanism available. Senator Williams and I have prepared a detailed memorandum on this subject which is being submitted jointly in connection with our testimony today. I will, therefore, sum this up in three points as follows:

First, imposition of tax penalties may be either too drastic or too weak a remedy, depending on the circumstances.

Second, the exclusive use of the tax code mechanism may permit additional state legislation in the field—which could lead to duplicating—or even conflicting—pension regulation at the federal and state levels.

Third, it is not the greater effectiveness of the IRS but rather anxiety over administration by the Labor Department of new pension laws which creates the impetus for putting IRS in charge of pension reform legislation.

There are literally hundreds of examples that could be given that would demonstrate the comparative inflexibility of the Internal Revenue Code as an enforcement mechanism, but here are two, the first illustrating *overkill* and the second indicating *ineffectiveness.*

Example No. 1 (overkill): An employee participating in a nationwide multiemployer pension plan with more than 1000 contributing employers, complains that the trustees of the plan have improperly applied the vesting-eligibility standards and disqualified him for vested pension rights. IRS investigates the complaint and confirms its validity under law. The trustees of the plan disagree and refuse to qualify the participant for a vested pension. IRS then disqualifies the plan with the following consequences: contributions of over 1000 employers to the pension fund are no longer tax deductible, the income from the trust is no longer tax free, and any employer contributions that are made are taxable to the employees—in short, the operations of a nationwide pension plan are brought to a standstill over a complaint involving a single employee.

Example No. 2 (ineffectiveness): A company going out of business terminates the pension plan. The participants complain to IRS that the assets of the trust were distributed inequitably and in violation of the priorities established by statute. IRS cannot disqualify a terminated plan nor can it retroactively disallow deductions for prior years of plan qualification since the company is no longer in existence. The beneficiaries may have a cause of action under state law but may also lack the resources to bring such an action. *Result*—the violation is not remedied.

Both of the deficiencies described above with respect to an IRS approach are more suitably handled under the Williams-Javits bill. In the first example, the tax status of a multiemployer plan would not be adversely affected by the misapplication of law to a single worker. The Secretary of Labor would enforce the participant's rights in court. In the second example, the Secretary could, through court action, compel the plan trustee to redistribute the plan assets in accordance with the governing statutory priorities.

I also have serious doubts as to whether incorporating pension reform standards in the Internal Revenue Code would prevent the States from legislating further in the field through additions to their banking, insurance or securities laws or by some independent enactment. There are bills concerning pension reform standards already pending in several state legislatures, and at least one state New Jersey—has passed a pension law regulating pension funds of companies that remove themselves from the local jurisdiction.

There ought to be a uniform national set of standards for private pension plans so as to avoid unnecessary regulation at both exceptions, preempts the States from regulating the subjects covered by the bill. The question is whether a similar objective can be reached by exclusive reliance on the Internal Revenue Code. My staff is currently engaged in legal research on this subject and I would be pleased to share the results of that research with this Subcommittee.

The IRS has developed substantial expertise concerning pension plans under the tax qualification provisions of the Internal Revenue Code. The Labor Department has developed substantial expertise on pension plans under the reporting and disclosure provisions of the Welfare and Pension Plans Disclosure Act as well as under seven other labor laws it administers which regulate some incidents of pension plans.

I do not profess to know whether the expertise of the IRS outweighs the expertise of the Labor Department. What is more important, in my judgment, is whether a law for safeguarding the interests of workers in private pension plans should be given to an agency whose primary interest is tax collection and whose primary means of enforcement is removal of tax privileges (or, if we were to adopt Senator Bentsen's bill, the imposition of additional tax penalties).

Even if more adequate enforcement powers were given to IRS for purposes of protecting workers' pension rights, there is still a serious question as to whether the primary interest of IRS in tax collection would not displace effective protection for beneficiaries or result in undue disruption of IRS's traditional role. In this regard, a recent editorial in the Journal of Commerce notes:

"Ideally, IRS should be kept strictly to its statutory function of tax-collecting, and in all other respects be allowed to keep as low a political profile as possible. The greater the extent to which it is detoured into other fields of action—such as the enforcement of Phase Two and Phase Three of price controls—the more prominent its profile becomes and the less effective it is likely to become in its own theater.

After all, when a taxpayer is called in to discuss problems that have come to the attention of IRS, he ought to be confident that the agency he is dealing with is interested soley in his tax liability, not in the manner in which he has (or has not) conformed to price controls or in the viability of his company pension plans, or anything else. This is—or should be—as important as the separation between church and state in the American constitution."

Indeed, I believe that the professionals in IRS and Treasury also have serious reservations about this matter. I have with me today a copy of the draft bill which a joint Treasury-Labor Department Task Force drafted and which was submitted for clearance to the White House in April. This draft bill would have established mandatory funding and fiduciary standards and a program of Federal reinsurance, and is similar in a number of important respects to the approach taken in the Williams-Javits bill.

As we know, the White House did not accept the bill—and certainly that is its right and prerogative. *However, what I find particularly interesting about the Task Force bill—and I emphasize this—is that administration and enforcement of the funding and reinsurance provisions were turned over to the Labor Department. Apparenly, the experts in both the Treasury and Labor Departments concluded that this approach would be the most effective.*

Accordingly, while I have no doubt that many arguments can be advanced for entrusting new pension reform standards to the IRS, the heart of the problem is that there is anxiety that the Labor Department, if entrusted with this responsibility, would not act objectively but would favor the interests of organized labor.

I don't believe this would be the case, and I have seen no serious evidence that supports this proposition. *In any event, the argument that the Labor Department is the wrong place does not make the Treasury Department the right place.* There are other viable alternatives, such as the independent commission approach, which I originally espoused.

The important thing is that the agency selected be unencumbered with other potentially conflicting missions, and that it be given the tools to do an effective job. If we are to make pension reform legislation work in the interests of 35 million workers, we cannot afford to do less.

II—THE SUBSTANTIVE STANDARDS OF EFFECTIVE PRIVATE PENSION REFORM

A. *Vesting.* The Williams-Javits bill provides a vesting formula which gives a worker a 30% vested right after 8 years of service, increasing by 10% each year thereafter, until 100% vesting is reached with the completion of 15 years of service. Further, the Williams-Javits bill gives workers vested benefit credit for all service performed prior to the effective date of the law.

Senator Bentsen's bill (S. 1179) provides a vesting formula which gives a worker a 25% vested right after 5 years of service, increasing by 5% each year thereafter, until 100% vesting is reached with the completion of 20 years of service. Senator Bentsen's bill gives workers who are 45 years old, vested benefit credit for service prior to the law.

Senator Griffin's bill (S. 75) provides vesting of 100% after 10 years of service with credit for service prior to the bill.

Finally, Senator Curtis' bill (S. 1631), the Administration's proposal, provides for 50% vesting when a plan participant's age and service add up to 50 and 100% vesting within 5 years thereafter. The so-called "Rule of 50" is prospective only in application; no credit is given for service performed for the employer prior to the law.

Of these four proposals, all but the Administration's incorporates the two principles which I regard as indispensable to an effective and meaningful vesting standard. These two principles are: first, a federal vesting standard should be based on length of service only i.e. the standard should be age-neutral; the second, some form of credit should be given for service rendered prior to the law in order to protect adequately the interests of this generation of older workers.

The Administration's "Rule of 50" is the least acceptable. I believe that it will exacerbate age discrimination in hiring. In a recent speech, former Secretary of Labor James D. Hodgson stated:

"I worry that the Rule of 50 might well cripple job opportunities for some older workers. It could work like this. An employer has two job candidates, one age 35 and one age 45. He knows the latter would vest in only three years while he would have no obligation to the former for eight years. In such circumstances the temptation to hire the former seems considerable to me." [4]

The Rule of 50 also deprives a worker of credit for his early years of hard work, and this also seems inequitable.

In general, I prefer the graded approach to vesting used in the Williams-Javits bill and the Bentsen bill since it tends to avoid the "all or nothing" result for the worker who is severed from employment just prior to the year when vesting is applicable. However, we permit 100% vesting at the end of 10 years under the Williams-Javits bill where it can be shown to be as equitable; while the Bentsen bill does not provide such an alternative.

I am opposed strongly to the idea that has been advanced in these hearings that the law ought to permit employers to choose between the four vesting alternatives that have been advanced. Aside from the fact that many might choose the Rule of 50—which I regard as inadequate—there ought to be as nearly as possible a single basic standard. The law ought to tell the worker what he is going to get, and when he is going to get it, and there should not be any wide variation in achieving vested pension rights if workers are to be convinced that they are being treated fairly.

B. *Funding.*—Both the Williams-Javits bill and the Bentsen bill provide for the funding of all unfunded pension liabilities over a thirty year period. By way of contrast the Administration's bill calls for the funding of the unfunded vested liabilities at the rate of 5% of the liabilities existing during the year. Thus, under the Administration's bill, there is no target period during which all unfunded vested liabilities must be fully funded.

The major difference between the Williams-Javits bill and the Bentsen bill in connection with funding is a difference in treatment for "experience deficiencies" caused by actuarial error. Under the Williams-Javits bill, experience deficiencies must be funded over a five year period unless the employer is not financially able to make the payment, in which event he may obtain an additional five year period to fund the deficiency. Under the Bentsen bill, on the other hand, experience deficiencies can be funded for the remaining working period of the workers—which could be as long as another thirty years.

The Williams-Javits approach on experience deficiencies is to be preferred because it protects more adequately the federal reinsurance program against the possibility of pension plan liabilities being shifted unnecessarily to the insurance program due to actuarial mistake. Actuarial practice is not an exact science, and it is all too possible that underestimated liabilities would be cranked into the cost of reinsurance despite the fact that the employer has the means to fund these deficiencies more quickly.

The Administration's formula for funding is the least preferable because it has no fixed target date when full funding of vested liabilities must be completed and also because it is unenforceable. It is least preferable because this is the slowest method of funding that has been proposed and is even inconsistent with Accounting Opinion No. 8, as the American Institute of Certified Public Accountants confirmed in testimony before this Subcommittee on May 22nd.

The Administration's funding standard—weak as it is—is unenforceable because in the event of the failure to make the 5% contribution the only sanction is that all employees would vest in contributions made to the plan up to that point. If no contributions have been made, the employees vest in nothing. Also, the Administration's bill does not resolve the status of the plan if the year after a failure to make the required contribution the employer gets back on the track and begins to fund in compliance with the bill. Do all the employees who previously

[4] *Private Pensions and Public Policy*, Remarks by James D. Hodgson, First Annual Pension and Profit Sharing Conference, Sutro & Co., Inc., Los Angeles, California, April 18, 1973.

became vested then become unvested? Do they continue to be vested in the new contributions made by the employer? The bill is quite deficient in these areas.

C. *Plan Termination Insurance.*—There is no more vital need in pension reform than a program of federal plan termination insurance.

When Congress enacts a law which contains requirements for vesting it will generate new expectations and bring into being new rights. It will be the law that fixes the worker's pension rights and not just the pension plan. How are we going to answer those who will continue to lose their pensions as a result of plan termination, after we in the Congress have enacted a law which gave them those rights? Only a program of plan termination insurance, as proposed in the Williams-Javits bill or in the Bentsen bill, will assure that the statutory rights that Congress has enacted will be adequately protected.

I recognize that we are breaking new ground here and that as one witness has put it: "we are changing the rules of the game". So because this is an innovative program, concern is being expressed from a number of quarters as to the feasibility of reinsurance. They are the same kind of concerns that were expressed when the federal insurance for bank deposits was first proposed, and it should be recalled that, originally, that type of insurance was opposed—and opposed vigorously—by the banking community.

These government insurance programs have been highly successful. They restored and promoted confidence in private institutions and contributed greatly to the growth and expansion of these institutions. The same is true of federal pension reinsurance. We should not, and must not wait for another catastrophe—such as the Studebaker closing in 1963—in order to protect pension rights of a generation of beneficiaries.

D. *Portability.*—The Williams-Javits bill establishes a federal clearinghouse fund in the Department of Labor to promote on a voluntary basis the transfer of vested pension credits from one plan to another as a worker changes jobs. The Bentsen bill would permit the tax-free transfer of vested pension credits from plan to plan without establishing a federal clearinghouse. The Administration also claims that the liberalized tax treatment it proposes for lump-sum distributions from pension plans could also encourage portability.

There is much to be said in favor of either the Williams-Javits approach or the Bentsen approach. Senator Bentsen's bill is based upon the experience in Canada where both tax-free transfers of vested credits were authorized as well as the establishment of a clearinghouse mechanism. Apparently the clearinghouse mechanism has never been utilized in Canada. The advantage to the Williams-Javits proposal is that it would centralize record keeping and relieve employers of these burdens and also would provide a mechanism which could ultimately serve as a type of pension bank for universal portability. There may be merit to trying both the Williams-Javits approach as well as the Bentsen approach since there is no inherent conflict between the two.

E. *Fiduciary Standards.*—There is a consensus that additional federal fiduciary standards for pension fund administrators are required. Both the Williams-Javits bill and a separate Administration proposal (S. 1557) would establish protection against fund abuse and conflicts of interest. Both bills amend the Welfare and Pension Plans Disclosure Act and would charge the Secretary of Labor with responsibility for administering and enforcing the fiduciary standards.

S. 1631, however, would also incorporate the new fiduciary standards into the "prohibited transactions" provisions of the Internal Revenue Code and would impose tax penalties for a breach of trust.

The inherent disadvantage of this approach—or any approach that seeks to curb fiduciary abuse by removal of tax privileges or imposition of tax penalties—is that it is the participants who bear the brunt of tax sanctions. If the plan's tax qualification is withdrawn because of some abuse by a trustee, the employer may very well terminate the plan to the detriment of the participants. If tax penalties are imposed for breach of trust there may be less money available to pay pension benefits. Tax sanctions are not effective in this area because they are only imposed after the breach of trust has occurred. Under the Williams-Javits bill, steps can be taken *to prevent* as well as redress breaches of trust.

Although consistency between the "prohibited transactions" provisions of the Internal Revenue Code and the new fiduciary standards bill might seem desirable, this consistency is designed more in the interests of symmetry than practicality. Insofar as the "prohibited transactions" provision of the Internal Revenue Code is duplicatory or inconsistent with the fiduciary standards of the Williams-Javits bill, I recommend that it be repealed.

III—FURTHER TAX INCENTIVES TO ENCOURAGE THE EXPANSION OF PRIVATE PENSION COVERAGE

In order to encourage the further expansion of private pension coverage, I support, in general, the Administration proposal for permitting individual employees to deduct from taxable income an amount equal to 20 percent of earned income or $1500, whichever is less, for annual contributions to individual retirement funds or company funds. I am in favor of increasing tax deductions for contributions to plans covering the self-employed and their employees also.[1] I believe that Senator Bentsen's proposal for a tax credit in addition to a tax deduction for the employees contribution to an individual retirement plan or a company plan is a good one and should be supported because it would more adequately extend the benefits of the Administration's proposal to lower paid employees.

Nevertheless, it seems to me that the major obstacle to widespread employee utilization of these advantages is the fact that they rely on specific tax deductions and credits. The majority of employees the Administration and Senator Bentsen are attempting to reach with these tax incentive proposals do not itemize tax deductions but rather use the standard deduction. Accordingly, it is unlikely that many employees will take advantage of these proposed benefits unless some method is found to simplify the tax reporting responsibilities to the Internal Revenue Service.

In addition, I believe that special consideration should be given to establishing a tax credit for small businessmen which would encourage them to establish or participate in pooled pension fund plans. The overwhelming majority of employers without private pension plans are in the small business sector.

Finally, should the Finance Committee wish to report separately the tax incentive proposals—which clearly belong in the Internal Revenue Code—from the pension reform proposals of the Williams-Javits bill I could see no objection.

CONCLUSION

I have no doubt that the Congress can develop a fair, feasible and efficient system of private pension plan regulation. And under that kind of regulation, private plans will develop even more rapidly than in the past because we will have assured to the beneficiaries that pension promises are kept and reasonable expectations built upon those promises are not disappointed.

The legislation will be better—fairer, more feasible, more efficient—if we work it out in the bipartisan manner which has characterized its progress to date—and if we keep the interests of 35 million workers uppermost in our minds.

This is historic legislation. It breaks new ground and recognizes that not since the enactment of Social Security has there been such a welling-up of public interest in assuring more adequate retirement security through reform of the private pension plans. In response to inquiries I made in New York just two weeks ago, I have received over 20,000 letters of support for prompt enactment of the Williams-Javits bill—and that is just in a two week period!

The one thing above all else that we must assure is that the legislative remedies we enact are *real* and not illusory. There has been *enough* disappointment in this field. Let us put that disappointment and frustration to an end, and *let us do it this year.*

[Whereupon, at 11:35 a.m., the subcommittee recessed subject to the call of the Chair.]

[1] Although I feel the deduction for the employed and the self-employed should be the same.

Appendix A

Communications Received by the Subcommittee Expressing an Interest in the Subject of Private Pension Plan Reform

STATE OF WISCONSIN,
OFFICE OF THE GOVERNOR,
Madison, Wis., May 31, 1973.

Senator GAYLORD NELSON,
*Chairman, Subcommittee on Private Pension Plans, Senate Finance Committee,
Washington, D.C.*

DEAR SENATOR NELSON: Insurance Commissioner S. C. DuRose has provided me with a copy of his letter to you of May 31, 1973.

From the standpoint of Wisconsin employes, it would appear desirable to modify the pre-emption language in proposed federal employe pension and welfare plan fiduciary standard legislation. Commissioner DuRose has provided you with a suggested amendment to accommodate State interest in this matter.

Chapter 211, Wisconsin Statutes, enacted in 1957, provides for Wisconsin fiduciary standard regulation of any fund covering one or more Wisconsin employes. I believe that vesting, funding, portability, and reinsurance standards should be enacted at the federal level. I also can appreciate the need for alert and aggressive fiduciary standard regulation at the federal level for large multistate funds such as the International Barbers Pension Plan, the Mine Workers Plan and the Elgin Watch Company Plan. But I am concerned that the proposed federal pre-emption would eliminate the present consumer protection to participants in smaller funds, particularly profit-sharing retirement funds, where trustee conflict of interest questions are more likely to arise and where employes are reluctant to question their employer about their benefit treatment.

About 900,000 Wisconsin employes are covered by the consumer protection afforded to funds reporting to the Wisconsin Commissioner of Insurance under Chapter 211, Wisconsin Statutes. Of this total about 118,000 employes participate in 5,000 relatively small funds (trusts) located in Wisconsin and covering between one and 200 employes.

These retirement programs need active surveillance by a governmental unit and none of the proposed bills provide the authority or the funding for a federal agency to provide this needed attention. The fund participants need the ombudsman type service now provided them under our Wisconsin law.

The State interest in this legislation merits careful consideration.

Sincerely,

PATRICK J. LUCEY,
Governor.

WISCONSIN STATE AFL–CIO,
Milwaukee, Wis., June 6, 1973.

Mr. SHERMAN STOCK,
*Home Secretary to Senator Nelson,
Federal Building, Milwaukee, Wis.*

DEAR SHERMAN: The following is a list of some of the things regarding pension plans that I would like to call to your attention, as well as to the attention of Senator Nelson.

First of all I would like to point out to you that there are two different types of private pensions. One is the single-employer retirement program that is not administered under a joint employer union Taft-Tartley trust fund. As a result, this private, single-employer retirement program is subject to an employer closing his doors, selling his business to another company or terminating the pension plan, which leaves the employees in the position of having to receive partial or no pension because funding has come to an end. Generally there is no arrangement for completion of funding for pension benefits that were promised. It is this type of pension plan that has given all private pension programs a bad name, and it is this type of pension program that legislation ought to address itself to.

This problem could be solved by requiring single employers who have a retirement plan that is not a part of a multi-retirement program to take steps to guarantee that promised pensions will be paid despite plant termination or sale of the business. This could be done by creating a lien on the assets of the company in an amount equal to the accrued liability of the promised benefits. This could also be guaranteed by requiring such an employer plan to be insured against termination of the plan because of sale or termination of the business.

It seems to me that apparently Legislators are by-passing this real danger and instead are focusing on funding investing. As wonderful as these words sound, the proposals considered would not accomplish the protections hoped for. If Congress passes the 40 year funding proposal, for instance, present plans and any new plans adopted will have 40 years to get funded. When the employer promises new benefits he will have 40 years to fund them from the date promised. In the meantime, the employees will be in exactly the same position as now with their plan only partially funded. If the employer terminates or sells his business the plan will not meet the promises.

Similarly, the proposals for vesting will not help employees where the employer terminates or sells, because there is no guarantee there will be money in the plan to pay even fully-earned benefits.

I don't see the subjects of funding and vesting as items requiring legislation. The place where people are being hurt is plant terminations or sales, and there is where the need for legislation is.

There are examples of employers who will not recognize any vesting until the employee reaches normal retirement. I do not think this is typical or of such numbers that it should warrant legislation. Legislation would not be harmful here, but would be of minimal value unless the employer must guarantee the benefits will be paid out of the assets of the corporation or provide such a guarantee through insurance against termination. Neither would promises of long-term funding be of great help.

The other phase of private retirement plans is the multi-employer joint Union-employer trust fund. These funds carry the employees of businesses that terminate or are sold and in effect have their own insurance, using part of their contribution dollar to pay the benefits for employees whose employers dissolve. This is typical of our construction contracts that have pension plans. It will be a real hardship if Congress requires multi-employer joint funds to buy insurance, because this will result in paying for double insurance and there will be no value from the second insurance. I am of the opinion that joint employer funds repeatedly mature in a short number of years after their creation, improving their funding and vesting as they grow up.

Legislation here would be burdensome because the vesting and funding formulas wou'd be a deterrent in paying ample pensions to the first retirees of the fund and, therefore, would deter their creation. Our experience is such funds do improve their vesting and funding as quickly as they can actuarily do so it the end of each collective bargaining term, and as a result the proposed legislative formulas would deter rather than grow.

In conclusion, would hope you keep in mind these two different types of private employer retirement plans, the first one needing some legislative requirements for guaranteeing benefits on termination and sale of the business, and the second already having adequate safeguards. They should not be handled as one.

If you have any questions, please feel free to contact me.

Sincerely,

JOHN W. SCHMITT,
President.

MONSANTO COMPANY,
St. Louis, Mo., June 18, 1973.

HON. GAYLORD NELSON,
U.S. Senate Office,
Washington, D.C.

DEAR SENATOR NELSON: The purpose of this letter is to submit a written statement of Monsanto Company's position with respect to proposed pension legislation. I respectfully request that it be submitted to the Subcommittee on Private Pension Plans of the Senate Finance Committee for inclusion in the printed record of the hearings held on May 21, 22, & 23, 1973.

PENSION ADMINISTRATION

Monsanto believes that it is essential that any new legislation be administered by the Treasury Department. Our many reasons for this include:

The Internal Revenue Service has already developed considerable expertise and capacity for analyzing and reviewing complicated actuarial and other provisions of pension plans.

The tax law is self-enforcing because if the tax rules are not met, plans would not be "qualified" under the Internal Revenue Code.

If another department were designated to administer new, proposed provisions, this would result in a dual system of administration. This, in turn, has substantive disadvantages such as dual staffs and dual reports; and the distinct probability of differences in application, and conflicting requirements.

PLAN TERMINATION INSURANCE

Monsanto believes that protection of pension benefits will be served more effectively through reasonable, minimum vesting and funding requirements. Moreover, the technical problems of establishing an insurance program as well as an agency to insure the payment of benefits upon the termination of an inadequately funded plan appear exceedingly difficult—if not insurmountable.

Going into greater detail, Monsanto believes there are a number of serious reasons that mitigate against any legislation in this area such as:

A definite need has not been established to substantiate and support the risks and requirements of such a program. Indeed, previous studies have shown an extremely high percentage of funding in pension plans, and an extremely low percentage of plan terminations that deprive the employee of vested benefits.

Any program of Federal insurance has a definite possibility of extensive regulation and the need for a new bureaucracy to administer it.

Such a program might encourage speculative investment of plan assets, inasmuch as losses would be covered by insurance.

Some proposals provide for employer reimbursement of fund deficits. This requirement would compound a financially troubled employer's problems and further reduce access to credit. Other proposals would impose an employers reimbursement liability as a lien on a successor company. This would have an adverse effect upon the saleability of a company with financial difficulty. Such proposals would therefore have a detrimental effect not only upon existing and successor employers, but possibly upon employes as well as because it might affect their actual employment.

VESTING

In general, Monsanto presently has 100% vesting after 10 years of employment. Therefore, we would support any reasonable vesting legislation, including the Administration's "Rule of 50". However, we believe that any new legislation should be flexible enough to permit a plan to be exempted from a provision that, on the average, is not as liberal as the vesting provisions of an existing plan. Monsanto would be opposed to any proposal that would materially increase the cost of existing plans because this could result in reducing future improvements that might be made for other provisions that could be of greater benefit to more people. Relatedly, unreasonable and costly vesting provisions would impede adoption of plans by companies who do not currently have retirement programs. Incidentally, we believe this latter point should be an objective for over-all pension improvement and should receive much higher legislative priority than unnecessary restrictions to, or overly-liberal provisions for existing plans.

FUNDING

Monsanto believes that funding legislation goes hand in hand with vesting, i.e., vesting has limited value unless there are assets to support the vested benefit. Monsanto would support legislation requiring reasonable funding standards but would oppose legislation that dictates how to fund, or would interfere with the types of investments that a pension fund could hold other than the exercise of prudence.

PORTABILITY

Monsanto does not understand how a portability provision will benefit a participant who has a vested benefit. If the plan meets the funding requirements and is administered in compliance with the fiduciary standards, there is no need to transfer funds to a federal trust. The premature distribution of funds with respect to such transfers would make private plans more costly because the employer contributions will be compounding for shorter periods of time and trust investments will need to be more liquid, hence less productive. This result is discriminatory against the participants who remain in the plan. We also believe that the administrative effort required to create and operate an agency to administer the funds is not justified.

FIDUCIARY STANDARDS

Monsanto would support legislation covering fiduciary standards, but subject to the following suggestions: Neither an employer company, its directors, officers, nor its employes associated with the administration of its pension plans should be encompassed under a broad definition of "fiduciary" so as to place them on the same level of legal responsibility as a Trustee of the Pension Trust Funds under the proposed legislation. Plan *administrators* of an employer company perform functions substantially different from trustees of pension funds. Their functions include management, judgment, and discretion and implementation of pension plans, and as such they should not be held liable for fines and penalties of the type which might be imposed upon pension plan *trustees* by Federal legislation. Fiduciaries, as defined in any legislation, should be held liable only for the breach of their own duties and responsibilities—not for those of other fiduciaries. Recourse to corporate and insurance indemnification should not be prohibited by any legislation. The definition of "standard of care" for a "fiduciary" under proposed legislation could be similar to that required of a director under Delaware corporate law, viz.

> "Directors (fiduciaries) must use the ~~amount of~~ care which ordinarily careful and prudent men would use in similar circumstances."

DISCLOSURE

Monsanto supports the disclosure of meaningful information regarding the provisions, operations, and financial condition of pension plans. However, we believe that submission of all pension fund investment data would not serve to inform the participants and may, in fact, by its sheer volume inhibit the monitoring of more meaningful information. Furthermore, the bulk of such required data would greatly increase the cost of administration, both from the standpoint of the company submitting such reports and the office responsible for reviewing and filing them.

We also believe that disclosure will be more meaningful if each plan is required to report only those investments that are associated with parties-in-interest, securities that are not registered with the Securities and Exchange Commission, transactions that are not made through an arms-length trade at fair market value, investments in the securities of one company that equal or exceed 5% of the market value of the pension fund, and investments in securities that equal or exceed 5% of the capitalization of the issuing corporation.

INDIVIDUAL TAX DEDUCTIONS

Monsanto would support legislation that would provide individual tax deductions for contributions to private pension plans, including the Administration's proposal.

ENFORCEMENT

Although Monsanto would support reasonable enforcement procedures, we believe that any legislation should limit the right of plan participants to institute legal procedures only for damages suffered directly by them as a result of a violation of the legislation. All other enforcement powers should reside in the responsible governmental agency, which—as previously stated—we believe should be the Treasury Department.

PREEMPTION OF STATE LAW

Monsanto feels that any legislation enacted by Congress should provide for preemption of state law on these subjects. Failure to do so may result in different and/or conflicting action (and perhaps separate pension plans in some cases) for a company conducting multistate operations.

Sincerely,

W. B. DAUME,
Director, Corporate Personnel Department.

BEST COPY AVAILABLE

Statement on Behalf of Eli Lilly and Co., Submitted by Walter C. Taylor, Jr.

On behalf of Eli Lilly and Company, I offer the following comments with respect to various pension bills pending in Congress and respectfully request that these comments be made a part of the record of the hearings of the Subcommittee on Private Plans. I am Assistant General Counsel of Eli Lilly and Company and Secretary of the Company's committee which administers its plans.

The Company maintains a non-contributory Retirement Plan under which each employee obtains a vested right to a pension benefit after ten years of service. In addition, Lilly maintains a Savings Plan under which each employee may contribute on a voluntary basis and his contributions are matched by the Company in an amount equal to at least 40% of the employee's contributions. Additional amounts may be contributed in the discretion of the Company. Our plans have worked well and have provided our employees with what we consider to be very comfortable benefits for their retirement years. The Savings Plan also provides funds which participants may use for the education of children or other needs requiring substantial funds.

There are several bills pending in the Senate dealing with the subjects of disclosure, Federal fiduciary standards, vesting, funding, insurance and portability. We believe that the private retirement system has done a remarkable job in providing employees with retirement security. Through the past decade the number of plans has continued to grow, and there has been substantial improvement of benefits afforded by many plans. To the best of our knowledge, the cases of failure of plans have been relatively few. Nevertheless, we support certain aspects of the legislation which has been proposed. We feel that Federal laws setting forth certain minimum standards to be met by all plans will strengthen the private pension system for the benefit of all concerned. Lilly's plans may be affected by certain provisions of the legislation, although the extent is not at the present foreseeable.

Moreover, the proliferation of State proposals regulating private retirement plans makes action by Congress desirable in order to avoid a multiplicity of rules at the local level.

In brief, we favor legislation which will provide for disclosure of information to employees which will help them understand their plans. We also favor the establishment of Federal fiduciary standards and favor a Federal law imposing minimum vesting and funding standards.

We vigorously oppose, however, legislation creating a system of Federal insurance of pension benefits or a system of so-called portability of pension credits. In fact, we would oppose any legislation containing such features notwithstanding our belief in the necessity of legislation dealing with disclosure, fiduciary standards, vesting and funding. We submit that most of the circumstances which have resulted in a loss of pension benefits after long years of service can be avoided through imposition of adequate funding and vesting requirements.

We are also opposed to the delegation of authority to the Department of Labor with respect to funding and vesting. Accordingly, we urge the deletion of these objectionable provisions from whatever pension legislation is enacted.

Comments on Vesting

There are two points on vesting we would like to make:

(1) A primary question is what benefit is to vest under the proposed law. For example, the Lilly Retirement Plan provides a life annuity to a retired employee, plus certain annuities to the surviving spouse or dependent children of deceased retired employees and certain deceased active employees.

Some of the pending legislation does not clearly define the benefit to be vested. We suggest that the legislation should require vesting only of that portion of the benefit equal to the life annuity payable to the employee at normal retirement age as defined in the plan or at age 65. In other words, survivor's benefits such as those provided under the Lilly Retirement Plan should not be included in the statutory benefit to be vested.

(2) We strongly recommend that whatever vesting provision is adopted be sufficiently flexible to permit alternative vesting provisions. Each of the pending bills has a different vesting provision, namely, the rule of 50 in the Administra-

BEST COPY AVAILABLE

tion proposal; 30% at 8 years with graduated vesting each year thereafter with 100% vesting at 15 years service (S. 4); 25% at 5 years service with graduated vesting thereafter until there is 100% vesting at 20 years of service (S. 1179); and 100% vesting at 10 years service has also been proposed. We do not argue for any one vesting schedule as opposed to another. Under a given set of circumstances, any one could be appropriate. We do urge, however, that whatever legislation is enacted contain language permitting alternate vesting schedules which are as equitable to employees as the primary schedule set forth in the legislation. This will avoid the necessity for all plans to conform to a single rigid standard.

FIDUCIARY STANDARDS

Under our Savings Plan an employee may designate whether his own contributions are to be invested in U.S. government obligations, including Savings Bonds, or in a fund consisting of a diversified portfolio of common stocks other than Company stock. The Company's matching contributions, however, are invested in Company stock. Indeed, it is this feature which we feel has interest in the Company.

The provisions of S. 4 and S. 1557 which prescribe fiduciary standards limit to 10% the amount of assets of a pension plan which may be invested in company stock. However, the bills permit a greater investment in company stock by certain plans which would include our Savings Plan. Some legislation (notably H.R. 2 by Congressman Dent) casts doubt on the ability of a plan to invest in company stock even where the very purpose of the plan is to provide for such investment under savings arrangements similar to our Savings Plan.

Accordingly, we strongly urge the retention of provisions such as those in S. 4 and S. 1557 with respect to the ability of profit sharing plans to purchase company stock in excess of the 10% limit.

FUNDING

As stated above, we are not opposed to a mandatory funding requirement. We would endorse the proposal set forth in S. 1631. A requirement for amortization of vested liabilities over a 30 year period would also seem to be reasonable.

Whatever legislation is finally enacted should, however, have certain features:

(1) The liabilities subject to mandatory funding should be the vested liabilities rather than total liabilities under the plan. Such a requirement will simplify actuarial assumptions, we are advised.

(2) Legislation should not contain a requirement such as that found in S. 4 that "deficiencies" in funding must be liquidated within a period of 5 years. Funding the liabilities under a pension plan is a matter of long range planning. During the funding period, whether it be 20 or 30 years, there are apt to be temporary variations from the assumptions used by the actuaries to provide that funding. The fluctuation in the market value of the underlying assets is an excellent example. Those fluctuations are not in a true sense "deficiencies" but are either actuarial gains or losses which will iron themselves out in the long run. The employer should not be required to liquidate these temporary variations within a short period of time. It is suggested that such gains or losses be allowed to be taken into account over the remaining period of employment of the covered employees.

ADMINISTRATIVE PROVISIONS

S. 4 would delegate to the Secretary of Labor authority to administer the vesting, funding and insurance requirements. As previously stated, we are strongly opposed to the concept of insurance. However, we sincerely urge that regulatory authority with respect to funding and vesting be left with the Internal Revenue Service. The Internal Revenue Service has been active in these areas and has developed expertise in dealing with them. Both funding and vesting involve significant tax considerations and the Treasury Department is where regulatory authority with respect to them belongs. Further, we are concerned about possible inconsistencies in regulations that may result from the delegation of regulatory authority to separate departments. It would be unfortunate to create a situation where the Department of Labor could set forth a position inconsistent with that of the Internal Revenue Service.

INSURANCE

We are opposed to all of the insurance proposals contained in pending legislation. We can think of no circumstances under which a workable insurance proposal can be made acceptable. Further, it is our position that by the imposition of mandatory funding and vesting requirements, most of the cases of pension loss will be avoided and, therefore, insurance is unnecessary. It should also be borne in mind that the proposed Federal fiduciary standards will help avoid pension failures.

It would seem that efforts to protect an insurance fund must, of necessity, ultimately involve the government in the regulation of investment policy, actuarial assumptions, valuation of assets and perhaps other vital areas of plan administration.

Each pension plan for the most part is adopted to accommodate the interests and concerns peculiar to one employer and its employees. If there is anything that is needed in the private pension field it is the flexibility to accommodate these interests without the pull of unnecessary outside influences.

Insurance would be such influence and we fear that it may serve as an inducement to make pension plans more liberal than the economics of a situation would justify. This in turn will cause more restrictive regulations or legislation.

One of our strongest objections to insurance is that prudent employers will have to bear the cost of imprudent employers.

Another objectionable aspect of the proposed pension benefit insurance is the feature which would subject employer assets to an obligation to reimburse the insurance fund for payments of unfunded liabilities when a plan is terminated. Such a provision in the law would operate to the detriment of an employer in financial difficulty and may actually hasten the termination of a plan, if not the business itself. If an employer faces a period of financial difficulty, it would be considerably more difficult to obtain funds if the lender knows that as a matter of law the employer's property may be taken to first satisfy the employer's pension deficiency. Thus, the result could be exactly the opposite of the intention of the legislation, namely, to make pension benefit more secure.

Moreover, new plans would be discouraged by this provision. It is almost universal practice to provide past service benefits when a plan is adopted in order to adequately provide for the older workers. This often entails the instant assumption of a large liability which must be funded over a reasonable period of time. An employer would be reluctant to set up a plan knowing that its property might be subject to a lien in favor of the Federal Insurance Fund. At the very least, the employer would have a tendency to keep past service benefits—and hence unfunded liabilities—to a minimum in order to avoid a possible attachment of its property.

AMENDMENT TO PROCUREMENT REGULATIONS: PROTECTION FOR WORKERS ON GOVERNMENT CONTRACTS

Part D of Title II of S. 4 authorizes amendments to Federal procurement regulations for the purpose of protecting professional, scientific and technical personnel from loss of pension rights associated with changes in federal procurement objectives and policies.

At Lilly, no employee has gained or lost employment solely because Lilly's receipt of a government contract or because of termination of a government contract to which the Company was a party. However, Part D of Title II seems broad enough to permit regulations which would be applicable to some, if not all, of Lilly's professional, scientific and technical personnel.

Lilly objects to Part D of Title II because any regulations promulgated thereunder would be extremely difficult, if not impossible, to apply to its activity with respect to government contracts. No Lilly employees are assigned exclusively, or even for most of their time, to work related to government contracts.

If regulations promulgated pursuant to Part D of Title II were applied to Lilly, the alternatives which would be presented would be (i) to include all employees who occupied job positions within the protected groups or (ii) to devise some means of arbitrarily determining which employees are working on government contracts and which employees are not. Either alternative is unsatisfactory.

If the first alternative is adopted, the added cost could be prohibitive. If the second alternative is adopted, possible resentment on the part of those employees not included within the protected class could present grave personnel problems for the Company. In either event it would seem necessary to adopt a separate plan for the protected class of employees and another plan for those not protected by Part D of Title II.

Part D of Title II is also objectionable because its implementation could involve the application of specialized and more limiting rules of funding, vesting and portability which would substantially affect the cost of affected retirement programs.

The problems of professional, scientific and technical personnel are not materially different from those of other employees who are faced with a loss of employment, whether from changes in Federal procurement programs or from other causes. Therefore, there is no justification of enacting special legislation for their protection. However, if it is felt that special legislation is required, a specialized program similar to the Administration's recommendation for tax deductions for contributions to personal savings or retirement plans is preferable to the provisions of S. 4.

Subject to the above comments, we offer our support of legislation imposing Federal fiduciary standards, minimum standards for vesting and funding and legislation requiring disclosure of information to plan participants.

SEARS, ROEBUCK CO.,
Chicago, Ill., May 31, 1973.

Hon. GAYLORD NELSON,
Chairman, Subcommittee on Private Pension Plans,
Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR NELSON: This statement is being file by Sears, Roebuck and Co. on behalf of the more than 224,000 employee members of the Sears Profit Sharing Fund. It is respectfully requested that this statement be included in the record of the hearings before the Subcommittee on Private Pension Plans.

We will confine our comments to the tax treatment of lump sum profit sharing distributions and the fiduciary responsibility of profit sharing trustees investing in stock of the employer corporation. In brief we believe that:

(1) It would be desirable that the Internal Revenue Code be amended so that the entire taxable amount of a lump sum distribution be treated as a long term capital gain. This was the treatment for lump sum distributions prior to 1970.

(2) If a return to full long term capital gain treatment is not considered feasible, then we recommend retention of existing law, which taxes post-1969 employer contributions included in a lump sum distribution as ordinary income under a special averaging device, and treats the balance of the distribution as long term capital gain.

(3) Unrealized appreciation in employer stock distributed in kind should not be taxed until the employee realizes it through a sale. This is the long standing rule under present law.

(4) Trustees of a profit sharing plan (as distinguished from a pension plan) should not be subject to restrictions on investments in stock of the employer corporation.

We will discuss these points in greater detail below, but first we would like to briefly describe the Sears Profit Sharing Fund and explain how it works.

SEARS PROFIT SHARING FUND

The Sears Fund was created on July 1, 1916, almost 57 years ago. One of the fundamental principles of the Fund when it was first established was the policy of investing in Sears stock. This policy has remained virtually unchanged from 1916 to the present day.

Over the years, the Fund has consistently purchased Sears stock. At the end of 1972, the Fund held almost 31 million shares of Sears stock or slightly less than 20% of the Company's total outstanding shares. At December 31, 1972 the value of the Fund's assets was in excess of $4 billion, of which the Sears stock was approximately $3½ billion.

An employee may join the Fund after one year of service. Each participating employee deposits 5% of his pay, but not more than $750 per year. This means that an employe participates in the Fund only on his first $15,000 in annual earnings. The purpose of this limitation is to provide a more equitable participation by *all* employes in the profits which the Company contributes to the Fund.

The formula for the Company's contribution is based on an increasing percentage of its pre-tax profits. The contribution for 1972 was at the maximum level of 11% and amounted to over $128 million.

Each employee member has his own account in the Fund. The Company's contributions from profits are allocated to the employe's account under a formula which is based on his own deposits, his years of service and age.

The amounts contributed by Sears and by the employes are invested largely in Sears stock. To a lesser extent they are invested in a balanced portfolio of other securities. Each year the employe receives a statement showing the total number of shares of Sears stock allocated to his account and the total value of the other Fund investments which have been made for him.

After five years of service the account of the employee is vested and thereafter he can vote his Sears stock. Also, he is then entitled to take the full credit to his account if he leaves the Company for any reason. And, perhaps most important of all, a vested member may ask that his shares of Sears stock be distributed to him in kind when his employment ends. The record shows that most retiring Sears employes ask for distribution of their stock rather than take the cash equivalent of the shares. In 1972, for example, the Fund distributed almost 3 million shares of Sears stock to withdrawing members.

BENEFIT TO EMPLOYES

The actual dollar value of any particular employe's retirement benefit from profit sharing cannot be predicted with certainty. It will depend on many factors including his years of service, future profits of the Company, and the market performance of Sears stock. However, the benefits Sears retirees have currently received is worth noting. For example, in 1972, the employes who retired with 25 to 30 years of service received, on the average, cash and Sears stock with a combined value of $114,828 each. These employees had deposited from their pay an average of $7,246 over their entire working years.

Under the Rules of the Fund, a retiring employe can request the Trustees to use a portion or all of his Fund account to purchase an annuity contract from an insurance company. The average account value for the retiring employe with 25–30 years service—$114,828—would purchase an annuity contract that would pay almost $11,000 per year. However, relatively few retiring employes purchase annuity contracts. Most Sears employes ask for their Sears stock and continue as Sears shareholders during their retirement years. They receive dividends on their stock and may sell stock as needed to supplement social security. Since Sears has prospered and its stock values and dividend rates have increased over the years, retirees in general have been able to maintain a comfortable standard of living during retirement.

Through the ownership of his Sears stock, the retired employe retains the flexibility to meet his needs and responsibilities as new conditions and circumstances arise or as they change. It also allows the employe to protect his retirement savings from dissipation through inflation.

SEARS EMPLOYES ARE PART OWNERS OF THE BUSINESS

From this description, it is evident that Sears Fund members become part owners of the Company with a stake in the success of the business. As stockholders they stand to benefit from any growth in value and assume the risk of a decline in value. As employes working for growth, they have an added incentive to help their Company prosper. Sears employes are real partners in the success of the business. They are entrepreneurs just as much as anyone who owns his own business. We believe this is American free enterprise at its best.

The Company distributes an important share of its profits to its employes. These funds, along with the employe's own deposits, are invested in Company stock. Thus, you have a double barreled participation by Sears employes. They not only share in the current profits but they have the opportunity to share in the future Company growth. Through the loyalty and devotion which their ownership in the Company has inspired, the Company has grown and prospered, and the employes have greatly benefited from this growth. Sears retirees in all of the 50 states have a deep interest in the Company in which they are still part owners.

TAX TREATMENT OF LUMP SUM DISTRIBUTIONS

Sears employes take their benefits from the Fund in lump sum distributions and they, therefore, have a vital interest in how these benefits are taxed.

Prior to the 1969 Tax Reform Act a lump sum distribution from a qualified profit sharing plan was taxed as a long term capital gain. Moreover, the appreciation in any employer stock included in the distribution was taxed when the stock was sold by the retired employe and not at the time of the distribution.

In 1969, there was a change in the tax treatment of lump sum distributions. Congress apparently concluded that the employer contribution was compensatory in nature. It, therefore, provided that employer contributions made after 1969 should be taxed as ordinary income when distributed. The 1969 Act provided relief from bunching that ordinary income in one taxable year through a special 7 year averaging method. This method is intended to tax the ordinary income as though it was received in the 7 years following the year of retirement.

The capital gain treatment was continued for the balance of the distribution. Also, the treatment of unrealized appreciation in employer stock remained unchanged.

In 1969, when the Tax Reform Act was being considered by the Senate Finance Committee, Sears testified and stated that the capital gains treatment on lump sum distributions arrived at a fair result, was the proper way to tax a profit sharing accumulation, was easily understood, and should be retained in full. During the course of this legislation, we also indicated that if Congress felt it was necessary to treat employer contributions as ordinary income, then the averaging device for taxing these contributions which was developed by the Committee on Finance and which was finally, included in the 1969 Tax Reform Act reached a reasonable result.

Our position today is much the same s it was in 1969. We still believe that capital gains treatment is the most desirable method for taxing lump sum distributions. An employe's profit sharing account, including his share of the employer's contribution, is an investment at risk and, therefore, is entitled to capital gains treatment the same as any other risk investment. Capital gains treatment provides a fair and equitable method for taxing this risk investment with a minimum of complexity.

The method of taxing lump sum distributions since 1969 arrives at a reasonable result in most cases for individuals who are over age 59½. However, it can be somewhat harsh on those employes who retire or leave prior to reaching age 59½. They are required to include their salary received in the year of termination in the tax base in making the averaging calculation.

The 1969 method can be more complicated than capital gains treatment in many cases. However, we believe the recently proposed Treasury regulations prescribing the manner of computing the tax under this new method have done much to simplify the computation and minimize many of the criticisms initially directed against it.

On balance, it is our view that a return to full capital gains treatment would be desirable. In this connection, it should be noted that the 1969 Tax Reform Act increased the maximum capital gains tax rate. Also, ½ of the gain may be subject to the 10% minimum tax on tax preference items. Thus, any possible argument that capital gains treatment produced too low a tax was answered by the 1969 Tax Reform Act when it substantially increased the tax on the larger capital gains, especially for those higher income individuals who receive large lump sum distributions.

If it is concluded that capital gains treatment cannot be restored, then we recommend the retention of existing law. If there were to be a change to another new method of taxing lump sum distributions, this would create further uncertainty in the minds of the millions of employes in qualified profit sharing plans. Retiring employes should not be subjected to untried and experimental methods for computing the tax on their retirement savings. It is certain that there will be additional complexity if there is another new change in the law.

TREATMENT OF UNREALIZED APPRECIATION IN EMPLOYER STOCK

The tax on unrealized appreciation in employer stock which is distributed to a retiring employe is deferred until the appreciation is realized. This provision has been in effect for many years and should be retained.

It is a fundamental concept in our tax laws that appreciation in securities is not taxed until it is realized through a sale. An employe is the beneficial owner of his Sears stock allocated to his account while he is a member of the Profit Sharing Fund. The distribution of his stock to him should not be an event which would cause the unrealized appreciation in this stock to become taxable to him. No other owner of stock is required to pay a tax before he realizes appreciation through a sale of his stock.

A tax on unrealized appreciation would discriminate against retiring employes. Generally, they would not have the cash to pay the tax and would, therefore, have to sell some of their stock. This, in turn, would decrease the amounts available to provide for the employe's retirement security and would be most unfortunate. Sears employes consider themselves owners, and would feel keenly the injustice if they had to pay a tax on the unrealized appreciation in their own stock merely because their trustee transferred it from their Profit Sharing Fund accounts to their own names.

The present tax treatment for distributed employer stock is fair and proper and should be retained.

FIDUCIARY RESPONSIBILITY AND INVESTMENT IN STOCK OF THE EMPLOYER

There is a very fundamental difference between a profit sharing plan such as the Sears Fund and a pension plan. While there may be justification for restricting a pension plan from investing heavily in stock of the employer corporation, there are very valid reasons why a profit sharing plan should not be restricted in making such investments.

The main purpose of a pension plan is to provide retirement income for employes as a supplement to social security, the basic pension for all emloyes. The pension plan is a contract between the employer and the employe under which the employer makes contributions to a trust, which in turn will pay a fixed retirement annuity to the employe when he retires. The employer's annual contributions are based on actuarial standards and are intended to provide the funds to pay for this annuity. The employe has no allocable interest in the specific assets of the trust.

It is to the employer's advantage if the securities purchased by the contributions to the plan appreciate in value. In this case, the employer's future contributions will be reduced. Yet, if the trust fund depreciates in value, and this depreciation is not made up by the employer, the employe will suffer as there will not be sufficient money in the trust to pay him his promised retirement annuity.

In a Profit Sharing Plan, the employer does not commit to pay any definite amount to the employe when he retires or withdraws from the plan. After vesting, the employe may withdraw the full market value of the assets credited to his account in the plan. These assets are generally in the form of securities purchased by the plan trustee out of the cash flow represented by annual contributions from company profits, the employe deposits (if any), and the income from dividends or interest on the investments made.

Thus, in a profit sharing plan the employe is not assured of any definite amount, either in annual contributions by the company (since these depend on company profits) or in the accumulated value of his account at retirement. He assumes the same risks and has the same opportunity for gain as any business proprietor or stockholder. He is not relying on the employer's promise to pay him a pension. He is an investor in the growth of the Fund with no limit on the amount of his benefit. When the fund is invested primarily in the stock of the company for which he works, he has an added incentive and motivation in the efficiency of his work and that of his fellow employes, for he truly benefits from the Company's growth.

Every year the trustees of Sears Profit Sharing Fund invest a substantial portion of the available cash flow in Sears stock. The Sears Fund has followed this program of stock ownership for over 50 years. It is our sincere belief that the employe stake in Sears is responsible for the success of the Company. This success has also greatly benefitted the employes who share in the Company's growth.

Many of the pension reform bills presently before Congress contain provisions imposing Federal fiduciary standards and a "prudent man" rule on the administrators and trustees of pension and profit sharing plans. Most of these bills, however, recognize the unique objectives of those profit sharing plans investing in stock of the employer and the special incentives offered to employees participating in such plans. Therefore, these bills have exempted such profit sharing plans from any diversification rules, under a prudent man rule or otherwise, with respect to investments in stock of the employer.

If Congress concludes that Federal fiduciary standards are desirable and should be enacted, then care should be exercised to prevent any limitations on investments in employer stock by profit shring plans. S. 4, as reported to the Senate, contains specific provisions allowing profit sharing plans to continue to invest in employer stock without violating a prudent man rule or other fiduciary standard. It is urged that these concepts be retained in any legislation which would impose Federal fiduciary standards on profit sharing plan trustees.

CONCLUSION

The Sears Profit Sharing Fund offers a dramatic example of the employee motivation inspired through part ownership of the business. We believe this employee stake in Sears is directly responsible for the success of the Company and the resulting benefits to the employees. The motivation of the employees has been stimulated over the years by the fairness of the capital gains treatment, and by the fact that appreciation in their Sears stock will not be taxed until it is realized through a sale.

We urge the Committee to restore the full capital gains treatment to lump sum profit sharing distributions. If, however, such treatment is not to be restored, then we recommend the retention of existing laws and further urge the retention of the present tax treatment for distributed employer stock. We earnestly believe that no change in the law should be made which would impair the value of profit sharing to participating employees and their companies, and erode the incentives and productivity gains resulting from such plans.

There are essential differences between pension plans and profit sharing plans, especially those profit sharing plans investing in stock of the employer company. They have different objectives and therefore require different standards in applying a prudent man rule to their investments. Accordingly, we urge that any legislation enacting Federal fiduciary standards recognize their inherent differences and allow profit sharing plans to continue their programs of increased motivation through investments in employer stock.

Respectively submitted,

R. P. Bilger,
General Manager, Texas.

Statement by John H. Martin, Vice President of Litton Industries, Inc.

United States industry and workers have, in a relatively short time, developed a remarkably effective private pension system. A large proportion of those still uncovered are the young who are still moving from job to job in search of their place in the economy. There is little reason to be concerned about an 18 year old high school graduate not having started his retirement program. Our concern should be to assure that *there is a place for him* in a retirement program when he is ready for it.

I recognize that there are weak spots in this huge rapidly growing program and much of S. 1179 and other bills before the Congress point squarely at several of them. It is not my intention, however, to comment on the specific proposals for strengthening the existing system.

I wish to concentrate my attention and I hope your interest, in that section of S. 1179 which has the potential of adding a whole new dimension to the U.S. private pension system. I refer to Section 42, Retirement Savings.

Section 42, with its provision for a tax credit for individual contributions to pension plans, takes direct aim at the most significant way in which private pension coverage can be extended.

Even a cursory look of the present system reveals that its success is based on its tax status. The rapid growth of Corporate private pensions got underway at the time of the high tax rates during World War II when employers used the tax deductibility to make a benefit available to workers whose wages were frozen.

Subsequently, the full tax deductibility, within limits, of the Keogh plan for the self-employed provided stimulus for expanding pensions in this area. It seems completely logical that a similar provision for employees would have a similar affect.

A close look at the uncovered employees who should be covered will reveal two principal categories—employees of small, often new firms, and those employees whose work is for short periods with many employers. Section 42 makes provisions for these employees *as individuals* to establish a program for themselves and some will do so. However, standing by itself this approach has two weaknesses. (1) Most people, at least until late in life, just don't make the effort and are not interested in saving for retirement. (2) It means all of the cost of the retirement is born by the individual employee.

These difficulties would be at least partially overcome were the Section to be modified so as to encourage cooperation between employees and employers rather than to penalize such cooperation. Specifically, the limitation provision 42(b)(2) *Reduction on Account of Employer or Owner-Employer Contribution* to a great extent dissipates the tax advantage offered those employees whose employer attempts to help them with retirement plan costs.

There seems to be a prevalent oversimplified belief that either employees are completely and adequately taken care of by an employer or there is no possibility of them participating in a pension plan. In point of fact, there is a wide group of companies and employees who would like to work out something jointly. However, the employer does not feel he can make the full long-term commitment to a pension plan and the employee realizes that in contributing after tax money to any form of retirement he is at a disadvantage. In brief, the present situation tends to create a competitive situation between the employer and the employee rather than a cooperative one based on each side being equal within limits with regard to the value of their after tax dollar contributed to a pension plan.

The reason this limitation provision has this effect is perhaps not apparent on the surface since it appears simply to offset the employer contribution (which in itself is not equitable). In point of fact, in any employee-employer plan other than a straight money purchase plan, the only realistic means of offsetting the employer contribution is the 7% of earned income provision in the Section. This has the affect of saying that regardless of how much or how little the employer is contributing, the employees hoped for tax advantage would be reduced or eliminated to the extent of 7% of his *total* income.

Furthermore, and perhaps equally important, the provision in its administration would be so complicated by changing levels of income and benefits that very few employees or small employers without an expert in house would even attempt to use it. (I believe I am correct that an early proposal for the self-employed was a partial tax relief on a formula basis. It never took hold until Keogh established a flat dollar amount of tax deduction.)

It is my belief that the individual should have the *right* to a tax postponement when he invests in his retirement up to a reasonable level which is similar to the *right* of a company to invest for him or the *right* of the self-employed to invest for himself.

This is no different than any other provision granted to an individual for offsetting taxes in that it is not contingent on some outside factor. For example, the deduction for dependents is the same regardless of income or who a man works for and the charitable deductions are the same for anybody as long as they are qualified deductions, etc. In fact, Canada uses a flat $2500 deduction limit for pension contributions similar to what we do for the self-employed.

The 7% offset was inserted as a revenue saving proposal, but would have the affect of changing the basic policy of the bill. I suggest the primary objective of this bill should be to enact sound *pension* legislation. If revenue is all important, lower the ceiling, but keep the principle.

Specifically, I suggest that Section 42(b)(2) *Reduction on Account of Employer or Owner-Employer Contribution* be eliminated.

I would also favor changing Section 42(b)(1) to an amount of deduction based on the Social Security wage base, say 15% of that base rather than a credit which is frozen in the legislation. I agree, however, this is not a matter of policy, but purely a different way of arriving at the same basic objective with which I am concerned.

In summary, my position and strong belief is that the most important objective we can accomplish by pension legislation is to promote the growth of the private pension system. While this will be done by many of the strengthening provisions proposed for the existing system by the legislation, the most important new dimension which can be given this system is by making available as a matter of right to the individual the possibility of acting either independently or in conjunction with his employer to develop a retirement plan to meet his needs on a comparable tax basis with that of the employer and the self-employed.

MARSH & MCLENNAN,
New York, N.Y., May 31, 1973.

Mr. TOM VAIL,
Chief Counsel, Finance Committee,
2227 New Senate Office Building, Washington, D.C.

DEAR MR. VAIL: We wish to make the following observations with respect to certain aspects of the pension legislation now under consideration.

(1) Vesting—We agree that the time has come for some form of mandatory vesting. Practical considerations are important in determining what form vesting requirements should take and there are two important principles which need emphasis.

First, a mandatory vesting provision should not result in the preservation of miniscule or trivial benefits. The administrative costs of maintaining the necessary records for many years would be far out of proportion to the value of the benefits. As an example, a provision for 25% vesting after 5 years of participation, if applied to a plan providing a 1% pension benefit for each year of service and an employee whose earnings are $8,000 per year, would give a monthly pension of $8.33 if the employee terminates when first vested. We believe that preservation of benefits of this order over many years of probable inflation is an inefficient use of pension fund moneys, which could be used to better effect in other ways.

The second point is that, in our opinion, vesting requirements should be framed in a way as to favor older employees when a determination of priorities must be made. It is relatively unimportant for an employee age 30 to have accrued a vested pension benefit as he will have an opportunity to accrue benefits later in his working career; it is far more important for an employee age 60 whose working lifetime is close to its end.

Because of these considerations, we favor the "rule of 50" type of provision over alternatives such as the provisions in S. 4 or S. 1179.

(2) Eligibility Requirements—Pension plans have traditionally imposed service and age requirements for eligibility. These requirements have served the important purpose of reducing the administrative burdens involved in processing large numbers of employees many of whom will terminate without benefits.

Since vesting requirements may be related to service from employment rather than service covered under the plan and benefit credit can be given retroactively to employment date when an employee becomes eligible for plan membership, restrictive eligibility requirements for plan membership need not have any effect on the benefits provided. There is little or no recognition of this notion in the various bills now under consideration. However, we believe it is a valid point and that the administrative problems which overly liberal participation requirements would cause are, in fact, unnecessary.

We favor plan participation requirement of three years continuous service or age 30, if later, as in S. 1631, rather than the lesser requirements proposed in other bills. However, we believe more stringent requirements should be allowable if a sufficient degree of retroactive credit is given for benefit accrual and vesting eligibility.

(3) Funding—We favor some reasonable requirements such as funding of normal costs plus unfunded past service liabilities over 30 years, as an example. However, we do not believe that local governmental plans should be excluded. Such plans are not generally backed by the tax resources available to state and federal plans and their financial status is frequently deplorable.

We also object to any requirements for the funding of experience deficiencies over five years. Where actuarial assumptions are reasonable (and the implication of proposed legislative limitations on assumptions is that they must be) such deficiencies will be primarily the result of temporary deviations from expected experience. A break in the stock market could temporarily depress asset values, for example. We do not think it is desirable to impose a short and arbitrary period for correction of such fluctuations. Furthermore, an arbitrary five year period is inconsistent with many actuarial funding methods under which actuarial gains and losses are systematically spread over the future service of the employees. Where such methods are used, it would require considerable expense and inconvenience to accommodate the five-year funding of experience deficiencies without any significant gain to plan participants.

(4) Plan Termination Insurance—While we recognize the problems such insurance is designed to meet, we do not believe that any of the proposed legislation has dealt successfully with the problems involved in developing a fair and satisfactory plan of insurance.

To cite an example of the problems, both S. 4 and H.R. 462 provide that a solvent employer with a terminating plan is liable for insurance benefits paid out under the plan termination insurance. In the case of S. 4, this liability is limited to 50% of the employer's net worth. No precise definition of net worth is included in the bill. In the case of H.R. 462, there is no specified limitation on the liability of the employer for such benefits.

The ex-post-facto imposition of such potential liabilities on existing plans is unfair and could adversely affect the financial position of employers who may have to terminate pension plans for various legitimate reasons. A major factor encouraging an employer to adopt a funded pension plan may well have been the fact that his liability for benefits in the event of distress was limited to the assets of the pension fund.

How such a provision could apply to multi-employer plan terminations needs to be considered and, if possible, detailed in the legislation.

There are other technical problems which could also be mentioned. We believe that the unresolved problems are sufficiently serious to make any of the current proposals unsatisfactory. We strongly urge therefore that any legislation dealing with plan termination insurance be deferred until more research and consideration have been put into an effort to solve these technical problems. We believe it would be appropriate for the Senate Finance Committee, as well as other interested Congressional committees, to stimulate and sponsor research aimed at the resolution of these problems.

We appreciate the opportunity to make these comments.

Very truly yours,

HENRY J. L. FORTUIN, Jr., F.S.A.,
Senior Vice President and Actuary.
JOHN N. ALLMAN, F.S.A.,
Vice President and Actuary.

FORD MOTOR CO.,
June 1, 1973.

HON. GAYLORD NELSON,
Chairman, Finance Subcommittee on Pensions, U.S. Senate, Washington, D.C.
Re Pension funding and reinsurance under S. 1179 and S. 1631.

DEAR MR. CHAIRMAN: Ford Motor Company wishes to express its opposition to the "reinsurance" provisions of S. 1179 and its endorsement of the minimum funding requirements for corporate plans in S. 1631.

Although we take pride in the accomplishments of private plans, including the success of the Company's Retirement Plans, we do not close our eyes to the shortcomings of the private pension system. The Subcommittee's hearings have produced further evidence that parties to the private system are reaching agreement upon the need for measures on fiduciary standards, disclosures to employees, vesting and funding. Newly legislated requirements should be administered under the existing regulatory framework with vesting, funding, and other financial requirements under the Treasury Department.

There is, however, one issue on which neither need nor feasibility has been established; that is "reinsurance" of vested benefits against plan termination. Reinsurance would tax sound and continuing plans to pay for mismanaged or terminated plans. Reinsurance is controversial. Only a few unions support it, while the Administration and most employers, including Ford Motor Company, are opposed. Our detailed statement on reinsurance and funding is enclosed.

Reinsurance is not needed according to the Government's own studies. Only one in 5,000 workers lost any vested benefits because of plan termination in 1972. In other words 99.98% were unaffected. Reinsurance will not work without changes that will result in massive standardization and regulation of private plans and their investments. Reinsurance also will remove a prime incentive for pension funding and distort the collective bargaining process between management and labor.

We do not suggest that the loss of vested benefits be ignored because the problem is small. We ask, however, for consideration of an alternative solution, improved minimum funding standards to assure that assets are available to meet pension obligations. Improved funding will meet the problem directly without seriously damaging the voluntary system. If plans with lagging funding improve their funding of vested liabilities, the losses from plan termination will decline or be eliminated. Legislative reform should help each employer keep its own pension promises, not pass the problem on to others.

Very truly yours,

MARC M. TWINNEY, Jr.
Fellow, American Academy of Actuaries,
Pension Manager.

Enclosures.

STATEMENT OF MARC M. TWINNEY, JR., PENSION MANAGER, FORD MOTOR CO.

This statement is submitted in my capacity as Manager of the Pension Department in the Treasure's Office of Ford Motor Company. My professional qualifications include membership in the Society of Actuaries, the American Academy of Actuaries, and the Institute of Actuaries in Great Britain. My experience in employee benefits extends over a period of 16 years, the first 11 years in private practice as a consulting actuary. At Ford Motor Company I am responsible for funding and cost aspects of retirement plans, including the preparation of financial information used in reports to employees, to stockholders, and to governmental authorities. My office is the primary contact with the independent actuary retained to perform the actuarial determinations required to administer financial aspects of the pension plans.

The opportunity to submit comments on proposals for pension legislation, specifically S. 1179 and S. 1631, is appreciated. The Company also would like to commend the Senate Finance Committee for its thoughtful action last year in insisting upon deliberate and objective discussions of pension issues.

OPPOSITION TO PENSION REINSURANCE

S. 1179, as S. 4, would establish a Federal program to which all private plans would be required to contribute for the purpose of "insuring" the benefits of employees in the event of plan termination. "Reinsurance" is, of course, a misnomer. It is really a system to exact from sound and continuing plans money to pay for the losses of mismanaged or terminated plans. Legislative reform if soundly based would assure that an employer keeps its own pension promises, and would not encourage it to pass its burdens on to other employers.

A reinsurance program is not essential. An Interim Report on Plan Terminations in 1972 prepared jointly by the Treasury and Labor Departments demonstrates that plan terminations cause the loss of relatively few *vested* benefits. In 1972 one in 5,000 employes covered by private plans lost any vested benefit (2/100 of 1%). In other words 99.98% were unaffected. This is not perfect but what price are private plans to pay for perfect results?

Ford Motor Company has participated in a study group that has tried to work out a system to "reinsure" vested benefits but has been unsuccessful. The casualty and the life insurance industries have been no more successful in developing a workable approach without standardization of benefits and over-regulation. A plan cannot buy true reinsurance in today's insurance market.

A reinsurance system would require burdensome government control and regulation over private plans, particularly as to investments and actuarial determinations if adverse selection and outright manipulation is to be voided. Reinsurance would also tempt some employers to adopt benefits they could not afford and would distort the collective bargaining process by making unfunded or underfunded obligations popular in negotiated settlements.

Program curtailments and toughened requirements stemming from abuses of FHA mortgage insurance and private investor's security insurance are instructive in considering pension reinsurance. Reinsurance would tempt fund managers into unwise speculation in investment of pension funds. Investment controls as to proportion and types of investment could, of course, be used to stop the speculative investment, but such controls would substantially reduce a fund's rate of return. A very small variation in the long term rate of return can greatly affect benefits. For example, a decrease of 1% in long term rate of return would decrease benefits per dollar of contribution by 25% because of reinsurance, employes will have paid a dear price for reinsurance.

Advocates of reinsurance admit that other constraints would be necessary to prevent an underfunded plan for "dumping" vested liabilities onto the program. Although this practice could be partly deterred by requiring a pledge of the employer's assets; the cure itself would be objectionable because it would hurt the employer's credit rating for borrowing, at a time when it may need financial help to stay in business. In some industries, construction for example, where an employer has corporate life only for the duration of its project, the pledge might be unenforceable. On the other hand, a good risk, like Ford Motor Company, pays its own costs in connection with plants closed to stay efficient, and its pledge would pay the vested rights even if the plan terminated in its entirety.

Reinsurance would neutralize a primary incentive for adequately funding pension obligation. We find this alarming because the fundamental solution to the problem of benefit losses from plan termination is *more* funding, *not* less. The reason so few employes in the 1972 study were hurt by plan terminations was not that so few plans terminated but that the funding was adequate for so many of the plans that terminated. If Congress imposes with one hand an obligation to vest, we respectfully submit that it should not with the other hand impose a reinsurance scheme that would encourage employers not to fund the vested benefits.

ENDORSEMENT OF MINIMUM FUNDING STANDARDS

Ford Motor Company has made studies of the legislative proposals for pension reform. We favor many of the features of S. 1631, including its specific requirement for funding, while recognizing that some amendments may be needed to improve the Bill.

Governmental regulation of private pension plans should be at the Federal level. New provisions on vesting and funding can be added as requirements to tax qualifications of plans under the Internal Revenue Code and administered by the experienced personnel in the Internal Revenue Service of the Treasury Department. An entirely new agency obviously need not be created to regulate plans under new legislation. Any additional disclosure requirements can be made to the Department of Labor and be effected by way of amendment of the present Welfare and Pension Plans Disclosure Act.

The Treasury's Internal Revenue Service has administered the key provisions of the laws relating to private pension plans with efficiency and fairness for more than 30 years. Under this system, Congress determines what provisions a private retirement plan should contain in the public interest, the Internal Revenue Code requires that those provisions be incorporated in plans to assure tax deductibility for corporate contributions and tax exemption for the investment income of the trusts, and the Internal Revenue Service provides advance clearances for plans and plan amendments that meet the statutory requirements.

We urge that this system be used for the proposed reform provisions relating to funding, vesting, and any other financial requirements that may be provided by law for private pension plans. Retention of the present system would place reliance on the existing expertise of personnel in the IRS's district offices and in Washington. This would preserve the outstanding virtue of the present system, the complete impartiality of the Internal Revenue Service as between competing private interests.

As Secretary Shultz pointed out in his testimony before Subcommittee last Tuesday, it would be a serious mistake, and a costly one, to attempt to transfer jurisdiction at this stage to another department of government lacking the expertise, personnel, and experience of the Treasury in this area.

The vast majority of cases of participants losing an expected benefit can be cured by improved vesting in private pension plans. Despite steady improvement in voluntarily adopted vesting provisions, there is now a recognized need for Congress to enact mandatory minimum vesting standards. It is extremely important, however, that Congress be mindful of the cost burden of any new standards it may impose. The standard for pension vesting should specify performance requirements, not dictate the design of a plan or the details of its administration. The relative merits of one or another set of standards or rules for vesting are still debatable, whereas there is no longer any doubt that benefits should be required to vest reasonably early.

Ford Motor Company for many years has been providing such vesting, 100% after ten years of service (see Attachment I). This is prompt vesting under any reasonable standard, although it would not explicitly qualify under any of the principal Senate bills now under consideration with the exception of S. 75. Although we do not suggest all private plans be required to vest pensions after ten years of service, we do believe that any minimum standards enacted should allow the Company plans' vesting to continue unchanged.

General comments on minimum funding standards

Reasonable and orderly funding is also essential to the pension undertaking. If an employer sets up a pension plan, he should organize its funding so that the legitimate pension expectations of his employes are fulfilled under ordinary circumstances. If Congress requires early vesting, it should also consider how the employer is to fund the vested rights Congress has mandated.

Contrary to the general impression, employes normally do not have individual pension accounts in a corporate plan and pension contributions are not allocated among individual employes or pensioners. (Only profit-sharing and thrift plans, which have other objectives than retirement security, and a relatively few pension plans of the "money purchase" type allocate to individual accounts.) Normally, all pension contributions are made on behalf of all employes as a group. All assets stand behind all benefit claims. (See Attachment II, Funding Information on Ford Motor Company's Plans.)

Another unwarranted impression seemingly held by some critics is that a small unfunded pension liability is good and, by the same token, a large unfunded liability is bad. Indeed, the mere existence of a large unfunded liability is often taken as proof that funding practices are somehow unsound or else that investments have been poorly managed. But in actuality, the largest source of unfunded liabilities are new or improved benefits that extend to past service to provide more adequate benefits for those already or nearly retired. Thus, an unfunded obligation may simply be an indication that the plan sponsors are improving benefits or facing up to the challenge of maintaining benefit levels in times of inflation.

A sound funding requirement should not be the product of concern over ratios of vested to funded benefits; it should be related to providing protection for vested rights at a reasonable rate in view of the employer's resources. This should aim for the greatest employe security while recognizing the complexity of the technical problems involved. Above all, the system should avoid rigidities that could cause costs to fall inequitably upon different businesses. For these reasons, we favor the funding requirement in Section 2(a) of S. 1631 over other proposals. S. 1631 requires annual funding of normal cost plus interest on past service costs for all benefits, plus 5% of the unfunded liability for vested benefits. These requirements are clear and determinable. If adopted, they would substantially improve the present limited funding requirement which has existed as an administrative matter since 1939.

A plan, of course, should be able to base its compliance with any funding requirement on reasonable actuarial methods and assumptions approved by its qualified actuary. This practice has been followed in the past and has worked well. There is also a need in administering funding requirements to establish standards for qualification of the actuaries to assure employes and the public of the reliability and source of actuarial determinations.

It is surprising to us that S. 4 and S. 1179 would require that actuarial "deficiencies" be identified and funded, since an actuarial "deficiency" is no more than a variance at any given date between the plan's actual experience and the actuary's earlier projections. In particular, we regard S. 4's proposal that an employer be required to liquidate such "deficiencies" in five years as punitive and unproductive.

Also use of the term "deficiencies" may unduly alarm employes because it falsely suggests a real shortage when there is simply a variance from forecast. The largest source of these variances are fluctuations in security prices that are almost invariably of a temporary nature. The terms "actuarial gains and losses" are more accurate. Such variances are expectable and may continue until the last pensioner is deceased.

Specific recommendations on funding standard

1. Minimum funding standards should be properly related to the obligation for vested benefits. Section 2(a) of S. 1631 contains a proposed minimum funding provision for vested benefits which appears sound and should in our view be included in any new pension legislation.

2. The vesting standard should provide that any vested right required by law would first become payable at age 65 without reduction for age. We regard the retirement age definition in paragraph (15) of S. 1179 as preferable to the definition in paragraph (11) of Sec. 2(a)(2) of S. 1631. (Congress may wish, however, to consider authorizing the Secretary of Treasury to fix an age higher than 65 as a transition arrangement for the relief of some industry-wide plans where cost effects may be unusual.)

3. Plans which define the benefits by a unit per year of service should be allowed to have the plan provisions govern in determining vested rights. Thus, paragraph 12(d) in Sec. 2(a)(2) of S. 1631 should be revised so that it would clearly apply only to plans which do not provide defined benefit units per year of service.

4. Consideration should be given to increasing allowable tax deductions for pension contributions so that more rapid deduction of contributions will be permitted when the vested benefits are not fully funded.

5. The proposal that would require separate identification and rapid liquidation of so-called actuarial "deficiencies" presently appearing in S. 4 and S. 1179 should *not* be included in any new legislation.

BEST COPY AVAILABLE

6. A plan should remain free to base compliance with funding requirements on reasonable actuarial assumptions and methods. The law should affirmatively provide this right to employers.

7. The Treasury Department should be granted authority to determine who may certify actuarial statements. Any legislation establishing funding requirements should include a provision along the lines of section 323 of S. 1179 (page 12, lines 7–12) which would grant this authority to the Secretary of Treasury.

[ATTACHMENT I]

Outline of Vesting Provisions in Benefit Coverage of Ford Motor Co.'s Employes

NONCONTRIBUTORY PENSIONS (ALL PERSONNEL)

The life income benefit payable at age 65 is vested after ten years of credited service. Because service credit is granted for up to 0.9 of one year of lay-off or sick leave, as few as 9.1 years of work would be required to vest. Reduced benefits are payable as early as age 60.

CONTRIBUTORY PENSIONS (SALARIED PERSONNEL)

The contributory retirement benefit payable at age 65 vests after seven years of employment, during five of which the employe must have contributed. Reduced benefits are payable as early as age 60.

CONTRIBUTORY SAVINGS & STOCK INVESTMENT (SALARIED PERSONNEL)

The Company's contributions for each year vest progressively during the third year following the year of contribution and are 100% vested at the end of that year. At that time employes may elect distribution immediately, defer distribution (limited to their contributions) to a later date, or defer distribution to retirement, disability or death.

SOCIAL SECURITY OLD AGE BENEFITS (ALL PERSONNEL)

Social Security benefits require that a male employe age 62 in 1973 must have 22 quarters (5½ years) of coverage. Younger employes (born 1929 or later) must have 40 quarters of coverage (ten years) without regard to age to maintain eligibility.

[ATTACHMENT II]

Funding Information on Ford Motor Co.'s Retirement Plans

CONTRIBUTIONS AND ASSETS

There are two principal retirement plans for employes of Ford U.S. with separate trust funds. The Ford-UAW Retirement Plan covers hourly employes represented by the UAW, and the General Retirement Plan covers substantially all other employes of the Company and certain consolidated and unconsolidated domestic subsidiaries. In addition to these two principal plans, certain other subsidiaries of the Company have separate plans covering their employes.

The financial operations of the Ford U.S. trusts for the year 1972 were as follows (in millions):

Funds at January 1, 1972—with securities valued at cost	$1,845.6
Additions:	
Payments into trusts	(263.2)
Interest and dividends received	(67.7)
Net gain realized on sales of securities	(21.8)
Net additions	352.7
Less: Retirement payments and expenses	(140.3)
Funds at December 31, 1972—with securities valued at cost	2,058.0

Payments into the trusts included contributed by the Company and by salaried personnel. Company contributions included current service costs and $101 million attributable to prior service costs. Prior service costs are being funded by the Company over periods of not more than 30 years.

BEST COPY AVAILABLE

No portion of the Company contributions to the trust fund, or of the assets thereof, is paid or set aside for the account or benefit of any individual employe.

World-wide consolidated pension costs in 1972 were $312.1 million, up $72.9 million or 30.5% from $239.2 million in 1971. The substantial increase in pension costs in 1972 resulted from certain amendments to the two principal plans that took effect late in 1971, as well as adjustments based upon actual experience. The actuarially computed value of vested benefits under the various plans exceeded the market value of fund assets by approximately $190 million at December 31, 1972.

FORD-UAW AND GENERAL RETIREMENT PLAN ACTUARIAL METHODS AND ASSUMPTIONS

Actuarial cost method.—Entry Age Normal Cost (projected benefit method) with frozen supplemental liability for past service costs.

Actuarial interest rate.—6 percent per annum, compounded annually.

Write-up method.—Assets valued at adjusted cost and at a minimum are equal to cost. Book value is adjusted in an amount equal to the difference between the 6% actuarial rate and actual cash income and realized net gains, but after write-up cannot exceed 90% of market value. If required asset write-up/(down) exceeds limits imposed, past service costs are adjusted.

Normal retirement age.—Age 65.

Average benefit unit.—$7.50 life income per month per year of service.

Survivorship option.—Elected by 70% of those retiring, 80% of employes married with male employes having wives three years younger and female employes having husbands three years older than themselves.

ILLUSTRATIVE FORD-UAW ACTUARIAL RATES

Age	Non-retired lives mortality [1]	Termination of employment				Disability retirement	Early retirement		
		1st year	2d year	3d year	Ultimate		Less than 30 years	30 or more years	Mutually satisfactory
20	0.0006	0.2340	0.1580	0.1300	0.1097	0.0007			
25	.0007	.1180	.1220	.0990	.0831	.0008			
30	.0011	.1500	.0940	.0730	.0622	.0010			
35	.0016	.1220	.0720	.0545	.0466	.0013			
40	.0025	.0990	.0560	.0405	.0362	.0017			
45	.0037	.0800	.0440	.0300	.0281	.0025			
50	.0057	0	0	0	.0211	.0042		0.0500	
55	.0089	0	0	0	.0168	.0076	0.0325	.1500	0.0026
56	.0098	0	0	0	.0164	.0088	.0390	[2] .1700	.0030
58	.0117	0	0	0	.0166	.0112	.0520	[2] .2100	.0040
60	.0141	0	0	0	.0174	.0150	.1700	[2] .2700	.0120
62	.0174	0	0	0	.0189	.0205	.3750	[2] .3000	.0500
64	.0213	0	0	0	.0216	.0280	.2250	[2] .2000	.0120

[1] Mortality table after service retirement: 1963 George B. Buck mortality table rated back 1 year. A special mortality table is used for disability retirements.

[2] Rate applicable to the age at which the employee first becomes eligible for an unreduced supplemental allowance is increased by 100 percent.

—— —— ——

NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS,
Washington, D.C., June 1, 1973.

Hon. GAYLORD NELSON,
Chairman, Subcommittee on Pensions, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR NELSON: Representing over 14,000 independent accountants in public practice and thousands of their clients who make up much of the small and medium-sized business community, the National Society of Public Accountants applauds your interest in the subject of Private Pension Plans, especially as they apply to the self-employed individual.

NSPA is the only national accounting organization which encompasses all categories of recognized professionals in the public accounting field. Our members include certified public accountants, licensed and registered public accountants, accounting practitioners and, where no state licensing exists, the individual accountant who chooses to practice within the strict discipline of our Code of Professional Ethics operating upon our membership.

On the whole, the National Society of Public Accountants favors the provisions of the Administration bill, S. 1613, relating to retirement plans for the self-employed person.

NSPA offered its views on this important subject last year when H.R. 12272 was under consideration in the House Ways and Means Committee.

We endorse provisions which more nearly bring comparability between the corporate employee and his counterpart who is self-employed. Too long the sole practitioner, his staff and their families have suffered from a policy which favors the corporation employee.

Proposed increases in the permissible level of annual tax-deductible contributions from 10% or $2,500 to a 15% or $7,500 maximum level is logical and reasonable.

Without such treatment, the individual in the accounting profession is unduly enc~~ouraged to~~ seek professional incorporation with some of its attendant drawbacks if he wishes to provide more adequately for his retirement.

A similar dilemma faces the small and medium-sized businessman whom our members serve in their practice of accounting and management advisory duties.

Speaking to the general legislation in the field and requirements calling for statements by qualified independent accountants, we believe this is to be an excellent and prudent requirement. Of course, it may be necessary for certain equivalency standards to be established for measuring the competence of accountants where licensing, except as a CPA, is not presently available.

We would be happy to work with the Committee and its staff in formulating such recommendations.

The memorandum of the Comptroller General in September, 1970, was an excellent approach to this matter, but that document should be brought up-to-date by (1) the removal of any restrictions for persons becoming licensed by a state since the cut-off dates prescribed and (2) the inclusion of reasonable but comprehensive equivalency standards which could be applied where no state licensing other than as a CPA is presently possible.

We are greatly encouraged by the interest evidenced by your Subcommittee's holding hearings and we look forward to prompt action on the legislation.

Sincerely,

IRVING ROSEN, *President.*

BLUE BELL, INC.,
Greensboro, N.C., May 15, 1973.

Hon. HERMAN E. TALMADGE and Hon. HARRY F. BYRD, Jr.,
Senate Finance Committee,
Washington, D.C.

DEAR SENATORS TALMADGE AND BYRD: We are quite concerned about the proposed pension legislation and understand the Senate Finance Committee will be holding hearings next week concerning the Administrative Bill, the Pension~~ Bill S. 1179~~, and Senate Bill S. 4.

Last June when similar proposed legislation was being discussed, we stated our company's position with the Honorable Wilbur D. Mills as well as Senators Harrison A. Williams, Jr., and Jacob K. Javits. Our position remains the same as stated at that time, and I am therefore sending you herewith a copy of this statement.

We understand Senator Bentsen's bill proposes to provide insurance for unfunded plans. We have not read this proposed legislation, but understand it is designed to require firms whose plans are already completely funded to participate; therefore, we are very much concerned about this suggested insurance plan as our plan is fully funded. Why should firms whose plans are fully funded be required to pay insurance for unfunded firms which we understand we may be compelled to do as a result of this legislation?

Not only do we hold you in very high regard and believe you want to see that the fair thing is done about this legislation, but we are very active as a company in your respective states and feel that we can turn to you for every reasonable assistance and support in a matter of this kind.

Kindly see that our views are taken into consideration in these hearings, and please keep us advised of any proposed legislation on the subject and let us know what further assistance we can be thereon.

Sincerely,

G. E. DIXON.

Enclosure.

BLUE BELL, INC.,
Greensboro, N.C., May 17, 1972.

Re: Proposed legislation affecting private pension plans.

Hon. WILBUR D. MILLS,
Chairman, House Ways and Means Committee,
House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: This letter is a brief statement of our company's position with respect to some of the proposed Federal legislation relating to private pension plans and in particular President Nixon's address to the Congress on December 14, 1971, and House bill HR 12272 as introduced to the House by you and the Honorable John W. Byrnes.

We will not attempt to go into detail nor get into a lot of the technicialities involved on this subject, but we wish to make several observations which we feel are pertinent and hopefully impress your Committee and others concerned that any such legislation should be extremely carefully thought out and not hastily adopted because of the tremendous impact this could have upon private pension plans even to the point of destroying them completely:

1. With respect to the President's first point, it would be difficult to object to the principle that employees who wish to save independently for their retirement or to supplement employer financed pensions should be allowed to do so possibly by deducting on their income tax returns amounts set aside for these purposes. In so saying, we should not overlook the fact that all employees and employers are already setting aside vast sums of money every year in the form of social security taxes which among other things are designed to provide retirement income for all employees. The extent to which individual employees or employers might be able to afford additional deductions of this kind is certainly not known, but in our own case, we seriously doubt if our employees as a whole could afford a great deal more, although some doubtless would take advantage of such an opportunity. Based on what we hear about what has become of the social security funds paid in, doubtless monies put aside by employees and employers for private pension funds would be far safer and more dependable as a means for retirement income than will be social security funds. Should inflation continue at the high rate it has been over the past several years, none of these funds will be of much value.

2. We also agree with the President's second point in that self-employed persons who invest in pension plans for themselves and their employees should be given a more generous tax deduction than they now receive, although we feel that in some respects this relates back to the points made in #1.

8. With respect to the President's item #8, we likewise agree that employees should not be denied reasonable pension vesting rights so as to preserve these even though they leave their jobs before retirement. We strongly feel that too liberal a formula for vesting and in particular the "rule of 50" would render a disservice both to employers and employees by encouraging voluntary terminations and creating more labor turnover rather than stabilizing the work force.

Our own experience prior to 1964 (we have had a retirement program since the earliest days of qualified plans under the tax laws) when we had a very liberal vesting formula taught us that employees who become too fully vested, especially in their younger years, will quit their jobs in spite of an otherwise satifactory employment relationship in an attempt to get this money to use for any and all kinds of purposes when it is designed for their retirement—the very antithesis of what it was designed to do! In our own experience, the tighter vesting formula which we adopted since that time has helped us stabilize our employment, and we are confident these funds are and will be used more in keeping with the objectives.

With respect to the effect the "rule of 50" would have upon the employment of older persons, (and we agree the older persons should have a break), if this vesting formula is too generous, it might well tend to bar older employees from receiving fair consideration for employment in spite of equal employment opportunity legislation.

Furthermore, whether uniformity in vesting is desirable is open to serious question in view of the disparity in working conditions, profiability, and other fringe benefits from one industry to another, one geographical area to another or even among companies in the same industry and geographical area. However that may be, given the lack of uniformity in retirement benefits in general, it is unwise to attempt to single out a single aspect of the field and legislate rigid rules for one.

We would recommend that your Committee avoid all mandatory vesting rules and allow the Internal Revenue Service to continue to police this area on a flexible basis, as in the past, so that the facts of each situation can be fully considered before a rule is imposed. There is nothing presently to prevent the adoption of a "rule of 50" by the IRS as a general standard, but employers and employees would, under such a rule, have an opportunity to show that under the facts of the particular case a different rule was desirable.

To further protect both the employee and the employer regardless of what vesting schedule applies, the spotlight on vesting and employee rights should include statements concerning forfeitures in case of embezzlement, dishonesty, and the like. Also, some mention should be made that these vested funds can be reserved for the individual's retirement and need not be paid out as a lump sum at termination.

4. We are in complete agreement with the President's item #4 with respect to the Employers Benefits Protection Act insofar as its basic principles are concerned.

5. We agree completely with the President's point #5 that this whole subject needs considerably more research and study in an effort to determine what really needs to be done to preserve employee benefits under pension plans which are terminated. In addition, we strongly recommend taking a good look at what the present House and Senate sub-committees' studies on this general subject will reveal and that your Committee take plenty of time investigating the variety of plans in existence and the effects the proposed legislation would have thereon.

6. Without attempting to comment on the details of H.R. 12272 or any of the other several pieces of proposed legislation which we have heard about, we would strongly caution your Committee and all of our Congressmen and Senators to go very slowly in what might appear to be a complete Federal takeover of private pension plans lest we run the horrible risk of killing the incentive of employers to provide such plans or destroying them entirely.

As further developments take place with respect to this legislation, we would be pleased to work with your Committee, the House and the Senate in any manner we can on any aspect of this very important subject and will greatly appreciate your consideration of the thoughts expressed herein.

Yours very truly,

E. A. MORRIS,
Chairman,
R. S. LEMATTY,
President,
L. K. MANN,
Executive Vice President,
G. E. DIXON,
Vice President, Finance.

STANDARD OIL COMPANY OF CALIFORNIA,
San Francisco, Calif., June 20, 1973.

TOM VAIL, Esq.,
Chief Counsel, Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR MR. VAIL: I am writing to express our views in connection with the hearings being conducted by the Committee on Finance, Subcommittee on Private Pension Plans. This letter is submitted for inclusion in the printed record of the hearings.

By way of introduction, our Company, Standard Oil Company of California, maintains two qualified plans: the Annuity Plan for Employees of Standard Oil Company of California and Participating Companies ("Annuity Plan") and the Stock Plan for Employees of Standard Oil Company of California and Participating Companies ("Stock Plan"). Both plans are qualified under section 401(a) of the Internal Revenue Code.

During 1972, the Annuity Plan covered 39,649 active and retired employees and benefits of $23,230,155 were distributed to more than 7,500 retired or former employees. All regular employees of the Company are eligible to participate in the Annuity Plan on the first day of their employment. Benefits are 50 per cent vested after 15 years of service and 100 per cent vested after 25 years of service. Benefits also are 100 per cent vested at age 65, upon becoming totally disabled, or upon early retirement at the direction of the Company after attaining age 55 with 15 years of service.

The Stock Plan, which covers all employees with five or more years of service, covered 21,165 employees during 1972. Company stock, having a value of $22,275,-000, was distributed to members during the year on account of retirement, death and termination of employment. Benefits are 100 per cent vested under the Stock Plan at age 60, upon becoming totally distabled, in the event of death or upon termination of employment with 20 years of participation in the Plan.

For the most part, the proposals presently before Congress will not have any substantial adverse impact upon the operation of the Annuity Plan or the Stock Plan. However, we believe that certain of the more extreme suggestions for reform would tend to discourage the establishment of new plans or the liberalization of existing plans. This would be a most regrettable result indeed.

Before outlining the areas which give us particular concern, we shall comment on those provisions of the pending bills which we favor.

1. We support minimum mandatory vesting and prefer the provisions of Senator Bentsen's bill (S. 1179). The Administration bill (S. 1631) would be acceptable only if the minimum service requirement prior to imposition of the "Rule of 50" were to be increased from 3 years to 5 years.

2. We support minimum funding requirements. We believe that it is reasonable to require past service benefits to be funded over a period of 30 years, and for experience deficiencies to be paid for over a period of from 10 to 15 years. In this connection, we submit that the provision of the Williams-Javits bill (S. 4) provides too short a period for the funding of experience deficiencies. Senator Bentsen's bill (S. 1179) offers a more practical and sound approach to the problem.

3. We support, withone major exception, the concept of Federal fiduciary standards. The exception relates to the definition of "fiduciary" set forth in all of the various bills which deal with the subject. Specifically, the definition provides that "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."

We submit that the foregoing definition is too broad. The consequence of being a fiduciary under the proposed fiduciary standards rules is severe and could result in personal liability. We agree that all persons who have discretion with respect to the investment of plan funds be subject to a strict code of conduct. However, we are concerned that the definition will be interpreted to apply to persons who exercise ministerial duties in connection with the day-to-day administration of plans, yet have no discretionary power with respect to the investment or disbursement of funds.

In the case of our Annuity Plan, for example, all funds are invested by a corporate trustee. No employee of the Company exercises any power over the trustee in the performance of its fiduciary duties. On the other hand, employees of our Benefits Division calculate the amount of benefits payable to participants upon retirement, death, disability or other-termination of employment. In the course of performing these functions, such employees exercise no discretion but merely apply the provisions of the Annuity Plan to the facts of a given case. Having calculated the amount of benefits due to a participant, the Benefits Division gives direction to the corporate trustee to disburse the funds.

Another example involves the work of our Comptroller's Department, employed actuaries and consulting actuarial firm. Each year these financial and actuarial experts consider various data, actuarial assumptions nd methods, valuation of plan funds and other factors as a prelude to making a recommendation to the Company's management and board of directors as to the amount of the Company's contribution to the plan. We do not believe that such persons should be considered "fiduciaries." Because such persons do engage in some degree of "management," they could be deemed to be fiduciaries under the proposed bills.

We do not believe that the proposed fiduciary standards should apply to our personnel who engage in the above and other related activities. We urge that consideration be given to a definition of "fiduciary" which is limited to persons who exercise "*discretionary powers*" with respect to the "control, management, or disposition" of plan funds. Persons performing ministerial, administrative and consulting duties clearly should be exempt.

4. We strongly support the provisions of the Administration bill (S. 1631) which would amend section 401(a)(3)(A) of the Internal Revenue Code to provide that in determining whether the coverage requirements for qualification are met, "employees who are included in a unit of employees covered by * * * a

collective bargaining agreement" are excluded. We do suggest, however, that this exclusion be broadened to apply as well to determinations of nondiscriminatory classifications made under section 401(a)(3)(B). This technical amendment will alleviate a conflict which has existed for many years due to the Internal Revenue Service's insistence that employes represented by labor unions be included in testing the existence of discrimination even though such employees do not choose to bargain coverage under the Company's plan.

5. We support the retention of administrative jurisdiction over qualification by the Internal Revenue Service (S. 1179 and S. 1631). There is no question but what the Service has developed the necessary expertise. While we do not always agree with the positions taken by the Service, we do respect their integrity and competence. To shift this function now to the Department of Labor would cause confusion and conflict for the many years required to make the necessary transition.

We are strongly opposed to the concepts of portability and reinsurance. In our opinion, the adoption of minimum standards for vesting and funding will obviate the need for such measures.

1. Although it might be possible to devise a scheme of portability with respect to profit sharing plans, we know of no program which could deal with the myriad of differences which exist between pension plans in terms of funding, actuarial assumptions, benefit formulas and optional payment forms. Moreover, we know of no way of preserving the purpose of a stock bonus plan and providing portability of the benefits thereunder.

2. Reinsurance is an extremely complicated subject and none of the proposals submitted to date is sufficiently well-conceived to merit serious consideration. We are most apprehensive about the costs of such a program and the long range implications which it may have with respect to the investment of plan funds. The concept of reinsurance is fallacious in a private system where the most likely causes of benefit payment deficiencies are poor investment results and inadequate funding of liabilities by employers. Both causes would better be remedied by new fiduciary standards and minimum funding requirements.

We shall make one final point. As a result of the Tax Reform Act of 1969, the determination of the tax consequences of lump sum distributions from qualified plans has reached the height of absurdity. To date, even the Internal Revenue Service has been unable to publish final regulations with respect to such calculations. The obvious and simple solution to the problem is to repeal the 1969 action and treat the entire taxable portion of such distributions as a long term capital gain. A return to long term capital gain treatment will not necessarily be more favorable than the present burdensome system because the former is now subject to a maximum tax of 35 per cent rather than 25 per cent and may even give rise to a preference tax. The great merit of long term capital gain treatment is that it is simple and understandable for all concerned. It is counter productive to adopt a tax reform proposal in the name of equity which only the most sophisticated tax practitioners remotely comprehend. The tax consequences of lump sum distributions should be easily understood and determinable by all employees. Only a return to long term capital gain treatment will achieve this result.

Your serious consideration of this letter shall be appreciated.

Yours very truly,

H. L. SEVERANCE,
Secretary.

THE PROCTER & GAMBLE CO.,
Cincinnati, Ohio, May 30, 1973.

Re: *Taxation of lump sum distributions—IRC section 402(a).*

Hon. GAYLORD NELSON,
Chairman, Subcommittee on Private Pension Plans, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is a statement submitted for inclusion in the record of the current hearings of your Subcommittee on qualified pension and profit sharing plans.

Procter & Gamble welcomes this opportunity to make known its views on the subject of taxation of lump sum distributions from qualified pension and profit sharing plans: a subject of extreme importance to thousands of employees in our Company. This statement is presented on behalf of Procter & Gamble and the some 21,000 employees who participate in the Company's profit sharing plans. These 21,000 employees live and work in all 50 States of the Union.

A BRIEF SUMMARY OF PROCTER & GAMBLE'S PROFIT SHARING PLANS

The major elements of Procter & Gamble's profit sharing plans are:

a. Employees from the hourly worker level on up participate in our profit sharing plans;

b. Employees join the plan after 12 months consecutive service;

c. Company profits determine the amount of the Company's contribution, which is placed in a trusteed deferred profit-sharing fund (there are no employee contributions to the fund);

d. The profit sharing fund is then allocated to specific participants' accounts, each participant's share is invested by the Trustees in Procter & Gamble common stock, and participants are regularly informed of their account balances;

e. The participant's account vests after 10 years of participation (11 years of service) and is available upon retirement, death, total disability or termination. A non-vested participant's account is available upon death or disability.

f. A vested participant may ask the Trustees to purchase a deferred annuity contract from an insurance company with all or part of his account.

Procter & Gamble employees depend solely on these profit sharing plans for their Company retirement benefits.

PROCTER & GAMBLE AND ITS EMPLOYEES—INTERESTS AND WELL BEING INSEPARABLE

The policy of Procter & Gamble has always been "to recognize that its interests and those of its employees are inseparable." For nearly 70 years the Company has demonstrated its firm belief in that policy by investing profit sharing contributions in Procter & Gamble stock.

We have found over the years that the greatest possible spirit of harmony and common purpose exists within such a framework. To a great extent, we attribute our sound and rapid growth, which has more than doubled our earnings every 10 years, to the fact that Procter & Gamble employees are part owners of the business.

Our plan allows employees a choice of payouts: an annuity, cash lump sum, installments, Procter & Gamble stock, or a combination of these. Well over 90% have chosen to receive the payout in the form of a lump sum distribution including the Procter & Gamble Stock in their profit sharing plan accounts at retirement.

The result of common goals being shared by Procter & Gamble and its employees is high productivity, top quality products and low prices for consumers.

We know of no better way to reward and motivate people than by giving them an opportunity to own part of the business in which they work, and to share in the benefits of the growth of the Company.

TAX TREATMENT OF LUMP SUM DISTRIBUTIONS

Since the Revenue Act of 1942, Congress has recognized that a person receiving a lump sum distribution of his entire interest in a qualified pension or profit sharing plan made in one taxable year on account of separation from employment or death has a severe "bunched-income" problem, where, as normally is the case, that distribution has been earned over a long period of years, which in many cases represents the person's entire working career.

Prior to the adoption of the Tax Reform Act of 1969, the "bunched-income" problem with respect to an employee's total accrued benefits distributed or paid in a lump sum from a qualified plan within one taxable year was solved by taxing the distribution as a long-term capital gain.

With the Tax Reform Act of 1969, Congress decided to tax as ordinary income the portion of a lump sum distribution attributable to employer contributions for plan years beginning after December 31, 1969, but to retain capital gain treatment for earnings and appreciation on those contributions, and for all benefits accrued during plan years beginning before January 1, 1970.

For that portion of the distribution which is to be taxed as ordinary income, the 1969 Act continued to recognize the "bunched-income" problem and provided relief by means of a seven-year forward averaging formula, available to persons who have participated in a plan for five years or more. The averaging concept is simply that, since income received over a period of years generally falls into lower brackets than income "bunched" into one year, the tax bracket attributable to the "bunched-income" is to be computed as if it had been received in equal installments over a period of seven years. The tax at that lower bracket is then multiplied by seven.

CONCLUSIONS AND RECOMMENDATION

Employees from the hourly worker level on up participate in our profit sharing plans. These Procter & Gamble employees depend solely on our Profit Sharing Plan for their Company retirement benefits. Lump sum distributions are the major consideration in the retirement plans of almost every one of these hourly workers, clerical employees, middle management executives and others. This is true in spite of the various alternative methods of distribution which are available. Retiring employees request lump sum distributions for a number of reasons, such as the desire for a free rein in handling their own resources, the desire to use a capital sum in purchasing a small farm, a duplex, or some other form of small business which would combine a residence with an active retirement interest, or the desire to relocate upon retirement.

Any proposed changes in the tax treatment of lump sum distributions which would impose a tax burden greater than that imposed by current law would reduce retirement income and threaten the retirement arrangements and plans of these thousands of Procter & Gamble employees. Similar problems would be faced by employees of hundreds of other companies—large and small—which stimulate and protect their employees with profit sharing plans.

Another most important consideration is that any suggestion that Federal tax law may be changed to subject lump sum distributions to a greater tax burden inevitably results in uncertainty among older employees. Such uncertainty will, in many cases, lead the employee to request early retirement. This was our experience in 1968, in 1969, and again in 1972, when uncertainty among our employees as to the tax treatment of lump sum distributions led to a rash of early retirements. With the continuing shortage of skilled labor and management, this is a loss our Company would like to avoid. Of even greater importance, we believe, is the fact that the overall economy cannot again afford such a loss.

Corporate pension and profit sharing plans are today, more than ever before, clearly in the public interest, providing economic security for the employee's retirement years. For many years Congress consistently has pursued a policy of encouraging the establishment and growth of such plans through incentive taxation methods. It is vital that incentive taxation methods continue in order to encourage the adoption and growth of pension and profit sharing plans.

Procter & Gamble firmly believes that the capital gains tax treatment of lump sum distributions which existed prior to the Tax Reform Act of 1969 is a fair and reasonable method of taxing such distributions. In addition, it is a method easily understood by each employee. We respectfully request that Congress restore full capital gain treatment to all lump sum distributions. If, however, the full capital gains treatment cannot be restored, then we recommend retention of the existing law as enacted by the Tax Reform Act of 1969. Tax law reforms every few years produce confusion and misunderstanding in the minds of employees.

Our earnest hope is that you will consider our position not as a plea for special treatment for Procter & Gamble, but as a plea for the employees of hundreds of companies—large and small—which stimulate and protect their employees with profit sharing plans.

J. W. NETHERCOTT,
Vice President-Comptroller.

STATEMENT OF THE NORTHWESTERN MUTUAL LIFE INSURANCE CO., MILWAUKEE, WIS.

GENERAL STATEMENT OF POSITION

Private pension plans funded by life insurance companies now cover more than 10 million active workers. During 1971 over 1.8 million retired workers received over $1.5 billion in pension benefits from such plans. Self-insured plans operated unilaterally by employers or jointly by employers and labor organizations have in the main also performed well. We believe that the private pension system should be maintained and, to the extent necessary, improved to do a better job in future years.

To that end The Northwestern Mutual Life Insurance Company (NML) supports reasonable measures, including appropriate Federal legislation, which will increase the effectiveness of such plans and encourage their growth and expansion.

In developing legislation, however, it should be remembered that the private pension system is not and should not be the sole provider of retirement income to the working force of America. To coin a phrase, retirement income is a three-sided coin. Together, Social Security, individual savings and private retirement plans combine to do the job of providing retirement security. In our view a balance between these three systems is desirable and economically sound. To make the total system work, the Government should offer more encouragement for the use of various private savings media, including insurance company products.

It is important to improve pension plans now in existence. It is equally important to expand such coverage to more workers under the private system. About 30 million workers are covered by private plans. But about the same number are working for employers without private pension plans. The 30 million non-covered workers in the main work for smaller firms and for self-employed persons. If the uncovered are to be covered, Federal legislation must encourage the small employer by maximizing tax advantages and minimizing complexities.

Specifically, here are measures NML supports to encourage the growth and expansion of private retirement plans, in order of priority:

1. Adoption of reasonable mandatory minimum vesting requirements for qualified pension and profit sharing plans. NML favors a graded system of vesting and supports the "rule of 50" contained in S. 1631.

Many thousands of plans are funded with individual insurance and annuity policies under a level deposit method of funding his defined pension benefit. Therefore, any vesting legislation should contain an option defining vested accrued benefits in terms of dollar amounts accumulated in the plan for an employee as of his service termination date.

2. Funding minimums should be legislated. The standard adopted should apply to all types of plans, including multi-employer plans. For NML, the funding standard in S. 1631 is acceptable. If an employer has made a pension promise, he should be willing to make annual contributions sufficient to cover the pension plan's normal service cost: interest on the unfunded past service liability; and at least 5% of the plan's unfunded vested liability.

Subject to certification by a qualified actuary, funding assumptions and methods utilized in a particular plan should be left to the discretion of the sponsor of the plan. They should not be prescribed by a regulatory agency. No single set or range of funding methods and assumptions is suitable for all situations.

3. Liberation of the Internal Revenue Code relating to pension plans for the self-employed. Increase allowable contributions and tax deductions; remove some of the restrictions; and permit a more flexible schedule of vesting.

4. Employee contributions to qualified plans should be deductible for tax purposes.

5. Allow deductions or credits by individuals for amounts set aside in appropriate savings and pension vehicles for their own retirement accounts.

6. High standards of fiduciary responsibility and increased disclosure of meaningful information are non-controversial. But to avoid duplication in reporting requirements and a proliferation of forms, Federal departments and bureaus should coordinate their reporting requirements.

7. The Federal Government should pre-empt the regulation of plans in the areas of disclosure, plan design, vesting, funding, investment restrictions and fiduciary responsibility. State laws should not encroach on these areas.

8. Simplification of taxation of lump sum distributions from qualified pension and profit sharing plans is desirable as long as such distributions are permitted. The law should recognize that such distributions represent amount accumulated over a period of years.

9. Consolidation of Federal regulation of pension plans in a minimum number of departments. One way of accomplishing a minimum of duplication regarding reports, approvals, etc., would be to create a new Federal agency charged with control of all aspects of private pension plan regulation.

PORTABILITY

NML believes that satisfactory vesting, adequate funding, accurate record keeping and better communication will attain the objective of preserving and fulfilling the pension rights of employees who change employment. A more costly and complicated system is unnecessary.

When discussing portability, one must first determine what is intended—a transfer of funds or a transfer of credits. The former would be reasonable (subject to the complications of conversion and the selection of the transferee). A transfer of credit is unreasonable and unworkable. The new employer should have no obligation to credit service with a prior, unrelated employer in determining the transferring employee's pension benefit under its plans.

If, in its judgment, the Congress does decide to mandate some sort of portability, consideration should be given to using the proven annuity paying capacity of the life insurance industry. For example, when an employee leaves a qualified plan due to employment termination, his vested benefit would be converted equitably to a dollar amount. Those dollars would then be used by the administrator of the plan to purchase a deferred annuity from an approved insurer. That annuity contract would then go to the annuitant with effective restrictions on his right to use the values in the contract prior to normal retirement age.

PENSION PLAN TERMINATION INSURANCE

In our opinion, an insurance program to protect accrued vested pension benefits in event of plan termination is an idea whose time has not yet come. More detailed consideration of the problems and complexities of such a system is required. It cannot be done both quickly and properly. The private sector of the economy will pursue such study. We believe that attempt to legislate such a program currently would be a mistake.

Existing government sponsored money insurance programs—such as the FDIC, FSLIC and even flood insurance cover known items. The bank deposit is a specific number of dollars as is the deposit in the savings and loan organization. Property which might be damaged or lost because of floods has a determinable dollar value in advance. The item insured under a pension plan termination program will not be known until the insurer is called upon to pay benefits. At that time the insured amount to be covered will depend on many things—the age of the plan; the ages of the participants; the extent of their vested benefits; and, of utmost importance and bearing on the amount of the risk, the status of the investments in the fund at termination.

Furthermore, if such a plan is to work it will be necessary that employer (and, possibly, union) liability be a part thereof. That fact alone—changing what now are intentions of employers to firm commitments backed by the total assets of the employer—would make employers reluctant to create or maintain plans.

DEFINE ACCRUED BENEFITS

Any legislation covering vesting and funding must in an understandable and equitable manner define "accrued benefit". Failure to do so will produce misunderstanding, inequity. Development of a suitable definition must take into consideration the many types of plans, benefit formulae, etc.

ACT ON VESTING AND FUNDING NOW

After several years of national discussion about pension reform legislation there is majority opinion that something should be done soon about (1) fiduciary responsibility, (2) meaningful disclosure, (3) mandated minimum vesting, and (4) adequate funding.

Still very controversial are the subjects of: (1) portability, (2) plan termination insurance, (3) liberalization of H.R. 10, and (4) provision for individual retirement savings programs with tax advantages.

NML strongly favors immediate action on the non-controversial items in this pension legislation package. Then, during the next several years, experience will prove whether or not there is a need for further complicating provisions to cover the controversial areas. If the need then exists, further legislation can be developed.

Statement of the Southern States Industrial Council, Submitted by Harmon L. Elder, Washington Representative

The Southern States Industrial Council is a general business organization with approximately 3,000 member companies which employ about 3,000 people. Virtually all of these companies and their employees would be directly affected by legislation before this committee which would place additional controls on private pension plans.

American business and industry takes justifiable pride in the rapid strides that have been made in providing retirement income for employees through private pension plans. More than 35,000,000 employees in this country already are covered by private pension plans, and the number is growing rapidly. Billions of dollars have been contributed by employers to pension funds irrevocably set aside for employees at the time of their retirement.

Business firms compete against each other in obtaining desirable employees, and this competition makes it necessary that salaries and other employment benefits be made as attractive as possible. The result is a continual effort to improve company pension plans, which are an important consideration for most people in making their job choices. Sound, healthy, fast-growing private pension plans are part of the evidence of how well the American free enterprise system serves the needs of the people when it is permitted to function properly.

Many of the proponents of pension control legislation try to give the impression that private pension plans are presently unregulated—that helpless emloyees have no assurance that the pensions promised them by employers will ever be paid. The fact is, of course, that the Internal Revenue Code contains many provisions to insure that pension plans are soundly based and nondiscriminatory. In addition, the Congress in 1958 passed the Federal Disclosure Act covering private pension plans. In 1962, the Act was amended and the Secretary of Labor was given the power to enforce its disclosure requirements.

Since perfection is unattainable in an imperfect world, there have been a few instances in which a particular set of circumstances resulted in employees not receiving the pensions they had believed would be theirs. These were rare and isolated instances, but they have been seized upon and publicized to provide a rationale for governmental control of almost all aspects of private pension plans.

There are those inside and outside the Congress who believe that the federal government, and only the federal government, can cure any and all ills. They continually work for more federal intervention into all the fuctions performed by private enterprise. It is not surprising that they want to bring private pension plans under complete bureaucratic control.

The Southern States Industrial Council believes the encroachment of the federal government into more and more areas must be halted. We assert that no case has been made for the need for more government control over private pension plans. We further declare that federal intervention would, as it has in most instances, create more problems than it would solve. It would tend to stifle the healthy growth of private pension plans by increasing their cost, making them more complex and inflexible, and would discourage innovation and improvements in pension plans. Proposed pension control legislation would, therefore, be against the best interests of employees and employers.

The SSIC does support, however, the Administration's proposal that self-employed persons be encouraged to set aside money for retirement by increasing their tax credit on money thus set aside from 10% to 15% of their income, up to $7,500 per year. We also favor giving employees a tax deduction for their contribution to either an employer-sponsored plan or their own savings-retirement plan up to 10% of their earnings, or $1,500 per year. These tax deductions would encourage individual enterprise and initiative in generating or augmenting savings for a time when they are needed. They are keeping with the American spirit of self-relaince and independence.

Although we believe any further regulation of private pension plans is unnecessary and could hamper growth of the plans, we object less strongly to strengthening the disclosure regulations than to some of the other regulatory proposals. Disclosure regulations should be reasonable and should not place any more power in the hands of the Secretary of Labor to interfere in pension plans.

If regulations on mandatory vesting should be adopted, they likewise should be reasonable. The period for vesting should not be so short as to drive up costs, forcing some employers to drop their pension plans or stopping employers from setting up plans for the first time. Of the various vesting proposals being considered, we would choose as most reasonable the "rule of 50," i.e. 50% vesting when a combination of age and length of service total 50, with additional 10% vesting each year thereafter. Of the total of 50 points, at least five should be for service. Alternative plans also should be authorized to fit the particular circumstances and limitations of some employers. Since in some instances mandatory vesting requirements would substantially increase pension plan costs, the employer should be given ample time in which to comply.

The SSIC is opposed to providing for portability of pensions. The portability schemes proposed are expensive and complicated. Furthermore, if vesting be made mandatory, the reason for portability advanced by its proponents is eliminated.

We see no need for additional funding or fiduciary standards. Adequate standards already are enforced by the Internal Revenue Service for private pension plans. Many pension experts are convinced that proposed new funding standards would do more harm than good.

The SSIC also is opposed to provisions for a termination insurance plan. Such plans are extremely complex. They would require administrative control and regulation of every aspect of private pension plans in order to work at all.

We are strongly opposed to the creation of any new agency and new bureaucracy for the regulation of private pension plans. If mandatory vesting should be enacted, it should be handled by the Internal Revenue Service along with funding and fiduciary requirements. The regulation of pension plan disclosure should remain in the Department of Labor.

Statement by Jerry Wurf, President, American Federation of State, County and Municipal Employees, AFL–CIO

I appreciate this opportunity to come before your subcommittee in these important hearings. I'm here on behalf of the American Federation of State, County and Municipal Employees, AFL–CIO, which is the nation's largest union of public employees. We have some 615,000 dues-paying members today. We represent about 1¼ million state and local government workers in collective bargaining and day-to-day affairs on the job in virtually every state, plus Puerto Rico and the Canal Zone. As you perhaps are aware, membership in our union is voluntary; we generally do not control jobs or enjoy "union shop" security. Thus, there is a disparity between the number of workers who belong to the union and those who benefit from the union's work.

Our union is in general agreement with the aims and purposes of the pension reform legislation offered by Senators Williams, Javits and others. We believe however, that S. 4 should be amended to extend its guarantees and protections to the 11 million men and women who work for state and local government. As we've watched this legislation evolve, we've come to recognize a great many similarities in the problems affecting private pensions as in the public sector.

The legislation offered in the House by Congressman Dent, H.R. 2 and H.R. 462, parallels the Williams-Javits proposal except that H.R. 2 does include public workers. We would hope this subcommittee would make the necessary changes in S. 4 to bring public employees under the Williams-Javits Bill.

To exclude government employees is to exclude a formidable percentage of the American work force. Bureau of Labor Statistics figures for 1972 estimate that some 14½ million of our 84 million American workers now are in public employment, or about 17 per cent of the work force. Without wishing to reduce the emphasis this legislation places upon the need for reform in private pension plans, I think these statistics are compelling evidence of the need to extend protection to public sector workers, as well.

It is important to explode a the outset a myth that we run into around the country these days: the myth that public employee pensions are outrageously fat and that cities and states are going bankrupt in their good faith efforts to maintain their contributions.

Like most myths, this one is rooted in a truth from the past which has warped with time. In the early part of the century and down through the Depression, many Americans accepted government jobs knowing that salaries were low, but knowing, too, that job security and retirement possibilities helped even things out. In the depression years, especially, when companies were failing and millions were out of work, the most unrewarding government jobs seemed alluring because governments were not going out of business. In that period of great economic insecurity, government employment offered a relatively stable and predictable future. Job tenure and the promise of a pension of some sort became substitutes for competitive salaries and reasonable working conditions.

But today government employment is not the security blanket it used to be. Cities and states have resorted to layoffs and cutbacks in the face of serious budget shortages. Working conditions have become more onerous in a great many localities where staff cuts through attrition have collided with an ever-growing public demand for services. Moreover, the growth of unionism in private industry and an increased concern among workers and management for retirement programs has narrowed the gap between public and private employment.

Finally, the very nature of public services and public institutions is changing. The dichotomy between public and private service delivery has been blurred by the growing practice by government of "contracting out" some services to private corporations and relying upon non-profit agencies for other services.

As workers shift from government to quasi-government employment and back again, as public officials experiment with first this and then that method of delivery, surely the need for protecting employee pension rights is evident. Surely a single, federal standard should apply.

While we're thankful that the depression psychology no longer hangs so heavily in public employment, it's clear that American workers—public and private sectors alike—do not enjoy the retirement security that is available to workers in the developed nations of Europe. A quick examination of public and private pension benefits available to workers in Sweden, Switzerland, Belgium, West Germany and the Netherlands indicates that these Western European countries provide for their workers' retirement at two-thirds to three-fourths of their final income—while American workers look to Social Security and their private pension benefits to bring them less than 50% of their final earnings.

I can think of no valid reason why we in the world's richest nation should have a risky and inferior retirement system for our workers.

Our union bargains with more than 2,000 government units throughout the nations and most of them have at least one pension program of their own. Many have two or three. Your average city government will have a pension program for police and fire fighters and another for its teachers, in addition to its plan for all other employees. States generally have their own special program for state police, and another plan for all other state employees. Additionally, some states administer a state-wide pension plan for local government employees or teachers.

S. 4 AND PUBLIC EMPLOYEES

The purpose of the Williams-Javits proposal known as S. 4, is to strengthen and improve the protections and interests of participants and beneficiaries of private pension and welfare plans. Even with government workers not covered, there might be some spinoff effort at the state level here and there, as a result of federal legislation affecting private pensions, to bring about a modicum of uniformity and regulation in local government pensions. But we believe full coverage for public employees under the federal bill is the only way to guarantee equity for public workers.

If the committee feels it needs additional data on public employee pension plans, then we would urge immediate fundings and authorization for the necessary studies and analysis *prior to* enacting S. 4. Such a study could be completed and the data assembled in time for this Congress to consider the policy questions raised by inclusion of public pension plans under pension reform legislation.

We fear that such a study *after* legislation for private pension programs has been enacted—as the Senate Labor Committee has proposed would lead to long delays.

We see no reason why public employees should not enjoy the same protections accorded their neighbors who work for private companies. It's worth noting that the Executive Branch has never failed to include our people in legislation that is restrictive. Thus, we were included along with all other workers in the federal wage and price control policy announced by the President in August of 1971, and in the various incarnations of that policy which have come down since then.

Yet we continue to see a reluctance on the part of many congressmen and federal officials to extend to state and local government workers the benefits which other workers take for granted. For example, nearly four decades after the Fair Labor Standards Act was passed, we still are fighting for amendments which would guarantee public employees minimum wage and overtime protection.

In asking for inclusion in the beneficial as well as the restrictive we are asserting that public employees are entitled to the same rights and protections as other workers receive. That we work for government makes little difference when we go to the grocery store or try to pay our rent or medical bills. It should

BEST COPY AVAILABLE

make no difference to you, who are concerned with assuring that Americans achieve justice on the job.

We want to be covered by progressive federal pension reform legislation. But we believe that there are shortcomings in S. 4 which this subcommittee should correct before sending it to the floor. I shall focus on the three topics that concern us most:

1. *Portability.*—With the exception of the limited intrastate portability features built into retirement plans in several states, most public employees have no portability in their seniority or retirement rights. Thus, a man who works for city government in Philadelphia and who leaves to assume a similar job in county or state government, may have to start from zero in amassing eligibility for pension benefits.

Increasingly we are experiencing in state and local government, the involuntary transfer of workers from one jurisdiction to another, as the state assumes control of local education or welfare programs, for example. Without an effective portability program, public employees with many years on the job and who have not yet vested in their pension programs may lose credits in the course of their job transfer.

The portability provision of S. 4 does not deal with this very serious problem even for workers in private industry. It permits *voluntary* participation by employers. We would predict that unless participation is *mandatory*, a great many workers will be left out in the cold. We note that the proposal by Congressman Dent does make participation obligatory. We would like to see S. 4 strengthened in the same way.

Equally serious, in our opinion, is the limitation of portability in S. 4 to the transfer of *vested* pension credits. Most public employees cannot vest in their pension plans until after 10, 15 or even more years of service. Unless portability is extended to include the transfer of all accrued pension credits—*non-vested* as well as *vested*—portability becomes a meaningless concept. As other witnesses have noted, portability of *vested* benefits is not a particularly significant step. It merely means that the retiree will receive one pension check instead of two or three.

In Milwaukee, the county administers welfare programs, but the Wisconsin Legislature is considering legislation that would orovide for a state takeover. The county employees' retirement plan requires ten years service for vesting.

At this point, the legislation being discussed in Madison does not contemplate allowing county employees with less than 10 years service to transfer that seniority into the state retirement system. They would simply be forced to wipe the slate clean, to start over.

Had the Nixon Administration welfare "reform" package or Senator Ribicoff's welfare proposal passed the Congress we would have faced this sort of problem in every state.

Congress has recognized the desirability of pension mobility in framing the federal pension program. I believe an individual can move from the military to a federal job in the executive branch, to the legislative branch, to the Cabinet—carrying pension credits all along the way.

And you've done something else: you've built in a very reasonable cost-of-living adjustment mechanism for federal pension recipients. I'd like to see that same enlightenment and sensitivity applied to private and non-federal public pension regulation.

2. *Vesting.*—As I have indicated, vesting provisions in public sector pensions are weak. As our society becomes more mobile, as government services shift from one jurisdiction to another, as fiscal problems require the shutting down of some public service programs and the laying off or transferring of public workers, more and more employees sacrifice their chance to earn and collect pension benefits. We believe that any federal pension reform legislation must set forth vesting requirements which will make it more likely that career workers will, at the end of their careers, collect a pension.

The vesting requirement in S. 4 would not substantially improve upon the present situation. Under S. 4, an employee would be 30 per cent vested after eight years of credited service, increasing 10 per cent for each year thereafter, so that after 15 years of credited service he would be 100 per cent vested. However, employers are free to exclude employees under the age of 25 from participating in the plan.

This has two detrimental effects. First, it discriminates against younger workers solely on the grounds of age—a policy which runs counter to national policy. But, simultaneously, it indirectly discriminates against older workers by making it more financially attractive to an employer to hire younger employees in the knowledge that he will not have to contribute to their pension plan.

I suggest to you that the middle-aged worker and the older worker have enough problems in their competition with younger workers in the job market. It seems unwise to exacerbate their difficulties by enforcing an age minimum in calculating pension credits.

Under the Williams-Javits Bill, an employe hired at age 21 may have to wait 12 years before he is 30 per cent vested and 19 years before he is fully vested. (By *vested,* I refer to an employee's guarantee of a non-forfeitable right to the employer's contributions made on his behalf to the pension fund, should his employment end before he is eligible for retirement benefits. Full or 100 per cent vesting is the guarantee of the entire amount of employer contributions.)

He may wait four years before he is eligible to become a member of the plan, another eight years before he is 30 per cent vested and another seven years before he is fully vested. Some existing public employee pension plans have these minimum age restrictions, some as high as age 30. Congress should not perpetuate these inequities; it should erase them.

We urge that S. 4 be amended to provide for 50 per cent vesting of an employee after three years of service, increasing 10 per cent for each year thereafter, so after eight years of service a worker would be fully vested. We believe this policy should be available to all employees, regardless of age.

Here is an instance, however, where public sector pensions may not require such stringent regulations. It is true that many government pension programs are not adequately funded. An example that comes to mind immediately is the plan in force for several thousand workers employed in Detroit by the transit authority known as Detroit Streets and Railroads. DSR had a pension program for its employees which was separate and distinct from the city employees' retirement plan.

When the city assumed jurisdiction over DSR as a product of the Urban Mass Transit Act, it also assumed responsibility for DSR employee pension. But the city has had financial difficulties in recent years, and it has not resisted the temptation of holding back on pension contributions to deal with other fiscal needs.

3. *Funding.*—The funding and reporting requirements of S. 4 represent perhaps the strongest and most positive aspect of the bill. A sound, uniform funding policy coupled with strict and systematic reporting and disclosure of assets and liabilities of the pension plans covered by the law, would do a great deal to reduce the possibility of private pension plan termination. It would insure against repetition of the horror stories which were so widely circulated at the outset of these congressional inquiries into pension programs. It would end the dreadful practice of "dumping."

As this committee well knows, an irresponsible employer who manipulates workers out of a pension effectively dumps them into the public trough. We spend billions each year on food stamps, Medicaid and other assistance programs to help retired workers who can't live off their federal Social Security payments and who have no pension.

We fully support the provisions of S. 4 which would require reporting on the assets, liabilities and handling of public employee pensions. Moreover, we believe the fiduciary responsibility provisions should be strengthened to that applicable under common law. Members of the subcommittee no doubt recall the revelations in the *Washington Post* of last February concerning the handling of more than $1 billion in Maryland state employee retirement funds. It was disclosed that as much as $17.2 million in state retirement funds were being held in non-interest accounts. A good portion of that sum was on deposit in a bank in which the state treasurer—custodian of the state retirement funds—had a personal interest. The disclosure and reporting sections of S. 4, coupled with a stronger fiduciary responsibility provision, will be useful in preventing outrageous abuses such as the Maryland case.

We support the *principle* of requiring full funding of pension costs. However, we think there is legitimacy to the argument that since a state or local governmental body is deemed perpetual with relatively unrestricted taxing power, the need for bringing public employee pensions up-to-date in their funding is not as pressing as in the private sector, where a sudden downturn in the economy or an unexpected market development can end the life of a company on short notice.

We would urge that public pensions be treated apart from private pensions in this instance, but that greater fiduciary responsibility be demanded of state and local government. As a practical matter, we are torn between the idea of fully-funded public pensions and the reality which is that the burden of "catch up" funding could wipe out any chance for improving public pensions for years to come.

Perhaps this committee can formulate an appropriate formula for insuring that there are adequate reserves available for public pensions,

OTHER PROVISIONS

S. 4 requires that pension plans covered under the act insure their unfunded vested liabilities incurred prior to and after enactment of the bill. This would protect plan participants against losing their vested benefits in the event that the plan is terminated.

We believe this reinsurance proposal is a sound concept that should be an integral part of any private pensions reform program. However, because public sector pensions have not traditionally faced the threat of termination, we see no need to include the public sector under plan termination insurance. We do think, however, that as an alternative the state or local governments should be required to certify their obligation to stand behind public pensions.

The three-year tooling-up period built into S. 4 prior to its full effectiveness is unnecessarily long. As testimony before this subcommittee has dramatized the need is great and immediate.

We believe that placing full enforcement authority at the federal level, as S. 4 proposes, is the only logical and efficient way to guarantee compliance with the act.

SUMMARY

AFSCME strongly supports this subcommittee's goal of making private plans more responsive to the needs of the employees who contribute to them, and to assuring that those covered by pension plans will, in fact, have a pension to collect upon retirement.

We urge the subcommittee in the strongest terms to extend the principles of S. 4 to cover public employees as well as private sector workers.

We urge that S. 4 be mended to strengthen its portability features—making coverage mandatory rather than voluntary, and insuring that accrued seniority can be transferred as well as vested pension credits.

We further urge that vesting requirements in S. 4 be tightened to erase discriminatory age requirements and to make early vesting possible for every worker.

We suggest to the subcommittee that while all pension plans—public and private—should be subject to rigorous public disclosure and reporting laws, the rather permanent status of most government bodies and the special nature of government funding procedures require a special sensitivity in regulating public pension funding.

We ask that full funding of public pensions be the stated goal of this legislation, but that the legitimate differences between public and private employers be considered in the framing of requirements to bring pension funding up-to-date.

I appreciate this opportunity to appear before your subcommittee. Our staff will be happy to work with you in developing or supporting any of the points I have made which you may care to explore further.

AMERICAN DENTAL ASSOCIATION,
Washington, D.C., June 21, 1973.

HON. GAYLORD P. NELSON,
Chairman, Subcommittee on Private Pension Plans of the Senate Finance Committee, 221 Russell Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: In 1972, the American Dental Association strongly recommended favorable consideration of legislation to improve the Keogh Act-Retirement program for self-employed persons. Those improvements have been embodied in S. 1631 introduced in the 93rd Congress by Senator Curtis. We continue to endorse the provisions of the bill that would increase the attractiveness of the self-employed retirement provisions of the Federal Tax Code and hope you will make these views part of the hearing record on pension plan reform.

The Association estimates that less than 10 per cent of dentists are incorporated. For this reason, the Association, as the representative of the vast majority of the nation's dentists, is especially interested in legislation that applies to self-employed persons.

Section 4 of S. 1631 which the Association strongly endorses would amend Section 404(e) of the Internal Revenue Code to permit a self-employed person to deduct his annual contribution to an IRS approved retirement plan up to a maximum of 15 per cent of his net income or $7,500 whichever is less. Today the self-employed person is limited to an annual contribution of 10 per cent of $2,500 whichever is less.

After spending six to eight years obtaining his professional credentials, the dentist is typically 25 years of age or older when he enters practice. The average dentist devotes the critical first ten years to slowly building a practice and working to reduce the substantial debt incurred to establish his practice facility. Simultaneously, many dentists entering practice have a substantial educational debt to retire, while facing increasingly rising living costs related to purchasing a home and raising a family. Professional dental income reaches its maximum level between the relatively early ages of 40 and 49, after which the unusually severe physical demands tend to level off the net income earnings.

A recent analysis of dentists' income, prepared by the Association's Bureau of Economic Research and Statistics, shows that a sharp reduction occurs after age 59. This is apparently attributable to the physical demands on the practicing dentist previously noted. For this reason, he is compelled to limit his practice schedule thereby reducing his income from dental practice. Thus, the typical dentist has about 25 years in which to create his retirement fund. The deductions proposed by the Administration for self-employed retirement plan contributions are realistically geared to these somewhat unusual needs.

In addition, it should be pointed out that employees of dentists also would be eligible beneficiaries of the proposed revised law. That group consists of some 155,000 dental hygienists, assistants and other employees in the dental office.

The Association believes that the enactment of the self-employed provisions of S. 1631 will provide all professionals with a significant benefit implicit in the Act. It is estimated that fewer than 10 per cent (1970 figures indicate that it was 3.1 per cent) of dentists had incorporated. This is true despite the fact that each of the 50 states as well as the District of Columbia have adopted legislation permitting professional incorporation. As the Committee knows, corporate retirement plans today provide significantly better tax advantages than do the Keogh Plans for self-employed persons. Although the Association has no policy against dental incorporation, it appears obvious that the additional burden of complying with the statutory and managerial requirements, as opposed to the principal task of caring for the patient, has deterred many dentists from seriously considering this alternative. The Association is convinced that future consideration of the corporation alternatives will be substantially diminished if dentists can obtain retirement benefits as self-employed persons reasonably equivalent to those benefits available to the corporate employee today.

In summary then, the American Dental Association urges early enactment of Section 4 of S. 1631 which permits a self-employed person to increase his annual contribution to an IRS approved retirement plan. The typical dentist has a limited period of high earning years and little opportunity to establish capital assets from the business of practicing his profession. The Administration's plan would assist dentists and other self-employed persons in developing a reasonable reserve for their later years of low earning capacity and their retired years. The Association believes that this is a worthy public policy goal.

In behalf of the American Dental Association, I thank you and the Committee for the opportunity to submit our views on pension plan reform measures that affect self-employed dentists.

Sincerely yours,

Louis A. Saporito, D.D.S.,
President.

Pension Reform

(By Howard Young[1])

This statement is submitted in response to the Subcommittee's invitation for written comments in connection with its hearings of May 21–23, 1973.

Without discounting the importance of other matters included in various proposed bills, this statement focuses on the issues of vesting (with some comments

[1] Mr. Young is an independent, self-employed actuary (details concerning his professional qualifications and activities are submitted in support of this statement) : this is a personal statement by Mr. Young, and is not presented on behalf of any client or other party.

on the related issue of portability) and plan termination insurance (with some comments on the related issue of funding).

This statement is organized as follows:

The importance of *requiring* vesting and termination insurance, as opposed to *encouraging* such provisions through tax rules.

The inadequacies of proposals based on benefits to be accrued in the future.

Comments specifically related to vesting and portability.

Comments specifically related to termination insurance and funding.

Concluding comments.

THE IMPORTANCE OF REQUIRING VESTING AND TERMINATION INSURANCE AS OPPOSED ENCOURAGING SUCH PROVISIONS THROUGH TAX RULES

There has been considerable controversy as to whether any new requirements should be administered by the Department of the Treasury, Department of Labor, or some other agency. While there are several considerations involved, a major question is whether the new requirements would be conditions for "qualification" under the tax law, or whether they would be requirements imposed on all plans (subject to specified exceptions) as is now done under the Welfare and Pension Plans Disclosure Act. The Senate Committee on Labor and Public Welfare has concluded that new requirements concerning vesting and termination insurance are needed (I agree with that conclusion); in order to effectively implement that conclusion, such requirements should be a condition of the plan's legality rather than one for favorable tax treatment.

Even though the incentive for favorable tax treament might be an effective one for most situations, there are cases in which it is reasonable to assume that incentive would be insufficient. The problem would be particularly acute with respect to termination insurance. If an employer with an existing pension plan (which presumably was covered by plan termination insurance) experienced a year with no taxable income, payment of the insurance premium might be omitted (just as plan contributions are now "skipped" in some such situations), since no tax deduction is available that year. Since the non-payment of one, or several, insurance premiums could result in loss of termination insurance protection, employees would have no real assurance that their benefits are secure. The provision of insurance protection must not be a function of whether or not the employer has sufficient tax incentive to pay the current premium; it must be continuous coverage which is in effect as long as the plan functions. Undoubtedly, there is less chance of intermittant application of vesting requirements even if only based on tax qualification. Nevertheless, the conclusion that vesting should be required is based on considerations of the employees' equitable interest in plan benefits; thus that interest should not be dependent on the employer's choice whether or not to satisfy tax qualification rules. Just as the fiduciary and disclosure rules concerning a pension plan are required—whether or not the employer chooses to satisfy tax qualification requirements—the vesting standard enacted should be a mandatory plan provision.

It should be recognized that the matter of vesting and termination insurance requirements is of a different nature than the more basic question of whether or not to establish a pension plan. The latter is a voluntary act on the part of the employer—or the result of mutual agreement between parties in collective bargaining—and may be encouraged (even though not required) by tax incentives. To use this as an argument (as some have done) that all provisions should have a similar degree of voluntary choice ignores the widely accepted principle that certain minimum standards of performance are applicable to agreements, even though the agreements were entered into voluntarily. For example: while an employer may have a choice whether or not to install a particular machine, if he decides to use the machine it must meet certain safety standards. Similarly: while the adoption of a group life insurance program may be voluntary, any such program must satisfy certain requirements (e.g. provision of a conversion option to terminating employees). Numerous other illustrations could be cited—the Disclosure Act is, of course, the most relevant one—the point is that vesting and termination insurance are minimum quality standards which should be required; in the absence of meeting such standards the plan should not be permitted to operate.

THE INADEQUACIES OF PROPOSALS BASED ON BENEFITS TO BE ACCRUED IN THE FUTURE

There is a fundamental difference of approach, among the proposals under consideration, with respect to benefits accrued prior to the effective date of any new legislation. For example: under S1631 vesting requirements would not apply to benefits accrued during plan years beginning before 1975 (subject to certain exceptions); S4 and S1179 impose some vesting requirements with respect to such benefits. Similarly, a point of contention is whether termination insurance should apply to benefits already accrued.

While there is theoretical merit to proposals which would apply only to future benefit accruals, it is obvious that such an arrangement would give little protection, if any, to those employees who have the greatest immediate need for the reforms involved. If "justice delayed is justice denied", then it should be clear that pension reform which applies only to future benefits would—for a very large number of employees—be no reform at all.

It is also important to recognize the effect of extending this "legislate for future service only" concept to the question of basic benefit accruals, as some have proposed. The Administration's proposal (as incorporated in S. 161) illustrates this in the proposed tax deductibility of employee contributions. The Fact Sheet accompanying the President's message of April 11, 1973, contained contained the following example:

Annual pension beginning at age 65 (assuming an average lifespan)[1]

Age when $1,500 contributions begin:	
40	$7,500
45	5,200
50	3,375
55	1,950
60	900

[1] Pensions are straight-life pension for males payable in monthly installments. A 5 percent interest rate is assumed.

At first glance, it would appear thatsignificant results can be achieved even if benefit accruals are based only on future srevice (that is implicit in the concept of determining benefits based on specified contributions to be saved in the future). However, that conclusion changes if reasonable assumptions are made concerning the employee's earnings level.

The example above assumes that interest will be earned annually at a 5% rate. A widely accepted "rule of thumb" is that interest will approximately equal 3% plus the inflation rate; plus a consistent assumption would be a 2% inflation rate. A consistent wage rate assumption would be the assumed inflation rate (2%) plus the productivity rate (assumed 2½%), or 4½%.

Now consider several alternatives as to the employee's earnings at the start of the savings program; (1) $7,500 annually, this is the lowest rate for which $1,500 savings would be deductible; (2) $15,000 annually, the amount required so that the $1,500 savings rate does not exceed 10% of earnings (a "high" savings goal for most people); and (3) $30,0000 annually, arbitrarily used as probably more realistic if assumed savings for retirement are $1,500.

The table below shows the ratio of annual annuity (as estimated in the President's Fact Sheet) to the final pre-retirement salary, using these assumptions.

Age contribution begin	Annual pension [1]	If initial salary is		If initial salary is $15,000		If initial salary is $30,000	
		Final salary [2]	Pension as percent	Final salary [2]	Pension as percent	Final salary [2]	Pension as percent
40	$7,500	$21,570	35	$43,140	17	$86,280	9
45	5,200	17,309	30	34,619	15	69,237	8
50	3,375	13,889	24	27,779	12	55,557	6
55	1,950	11,146	17	22,292	9	44,583	4
60	900	8,944	10	17,888	5	35,775	3

[1] See preceding table for assumptions.

[2] Assumes 4½ percent annual pay increase.

Thus aside from any question as to whether the tax deductibility of employee contributions is a desirable allocation of tax resources, it should be clear that such a provision must not be relied upon to "solve" the problem of pension security. Similarly, proposals which merely improve the status of benefits to be earned in the future will not do the job.

What is needed is: (1) adequate Social Security to provide every employee with a satisfactory base pension (it seems odd that concern is expressed about the level of OASDI because FICA taxes are equal to a total for employee and employer of approximately 12% of pay, up to the maximum, but the Administration proposes a tax deduction plan in which employees are presumed to save up to 20% of pay subject to the maximum), and (2) legislative arrangements which will assist the private pension system in effectively implementing the tools available to it, including the provision for, and periodic updating of, benefits for "past service".

COMMENTS SPECIFICALLY RELATED TO VESTING AND PORTABILITY

Since the three major bills bfore the Senate (S4, S1179, and S1631) each provide for significant vesting requirements, I assume there is adequate consensus on the appropriateness of assuring employees protection against loss of benefits if they terminate employment prior to retirement. However, further consideration needs to be given to the issues of an appropriate vesting standard, the effective date, the impact of employee-contributions, portability, central record keeping, and erosion of benefit values.

Three major alternative vesting standards are under consideration: graduated vesting based on service as in S4 and S1179, zero-to-full vesting based on service as in House Bill HR2, and the Rule of 50 as in S1631. Depending on the circumstances of an individual employee, any of the three approaches could provide the best or the worst result. Thus no one rule can be characterized as "best". However, the Rule of 50 is significantly different from the others in that it would allow extended periods of service prior to age 40 to be forfeited particularly since S1631 allows all service before age 30 to be ignored. Since none of the alternatives suggested is clearly superior to all the others, and since it is recognized in most proposals that some variances may be desirable, the following concept is suggested; require that vesting occur as of the time when the employee's accrued benefit equals some specified portion (e.g. 10%) of his then current pay rate.[3] This proposal is based on the concept that vesting will not be required if the loss of benefit is relatively small (e.g. less than 10% of pay) regardless of the age or service of the employee; also that in plans where the basic benefit is low compared to pay, vesting would occur later and thus divert less money from the amounts available for basic benefits.

Most of the legislative proposals provide for a "transition" or "adaptation" period with respect to the implementation of the vesting requirements; presumably this is intended to soften the cost impact on the plan. Of course, this also has the undesirable effect of not providing protection to employees who terminate prior to the effective date. It is important to recognize that the funding provisions could permit this tempering of cost impact even with more rapid implementation of the vesting requirements. For example, new vesting requirements could apply to any employee who terminates after a specified date, but the funding requirements could permit that any costs due solely to the new vesting requirements be deferred for a specified period. At that latter date, the accrued vesting cost would become a "past service" cost and would be amortized over a fairly long time period. I am not suggesting specific legislation on this, but merely pointing out that the impact of the vesting requirements does not have to be deferred because of cost impact; of course, new vesting requirements will have very little short term effect on actual benefit payments.

When a plan requires employee contributions, vesting is frequently "conditional"; that is, if a terminating employee—who otherwise satisfies the vesting requirements—withdraws his contributions, he loses all benefits. Experience indicates that in such situations the vast majority of employees withdraw their contributions, even though they lose substantial employer financed benefits. Permitting this situation to continue will undercut the effectiveness of any mandatory vesting requirement. This would be further compounded under S1631 since an avowed goal of the new tax deductibility is to encourage employee contributions for retirement. Vesting should not be dependent on the employee's choice with respect to withdrawal of his own contributions.

[3] Where a plan benefit is defined as a fixed amount per year of service, or otherwise not directly related to pay, it should be permissible to use average pay rates to define when the specified percentage is achieved.

Portability is a concept closely related to vesting, although it involves many other features. The administration of a portability program would involve procedures and rules much more complicated than all the other items under consideration. As a single illustration: procedures would be needed to effectively equate the value of benefits under any plan with those under any other plan. Subject to the comments below, I believe that adequate vesting, funding and termination insurance provisions will provide those aspects of portability which are most desirable; so that a separate portability program is unnecessary. (In fact, it seems to me that portability was originally suggested as an alternative to vesting, funding and termination insurance requirements.) In addition, if in the future it appears that a portability program would in fact be desirable, it will be possible to apply it to benefits already vested so that no real loss should occur as the result of deferring action on portability.

One desirable aspect of portability is the consolidation of record keeping which would occur. This would reduce the probability that an individual would lose benefits because of forgetting them or otherwise. This goal can easily be achieved by requiring that information on vested benefits be included in the individual's Social Security record. Then, when he applies for Social Security, he will be reminded of his benefit accruals; that reminder should include information on the procedure for applying for those benefits. No funds would be transmitted; no elaborate procedures are involved; only a notification statement from the plan to the Social Security Administration.

Another aspect of portability is the possibility of protection against erosion of vested benefits due to increases in the cost and standard of living. Of course, this is a problem which is also applicable to benefits under certain plans whether or not the participant terminates before retirement. Many employers cannot be expected to bear the risk of protecting plan participants against increases in the cost and standard of living. The only available alternative—the variable annuity—may, or may not, do the job for any individual: thus, it puts the risk on the individual. Further work is needed on this problem. For many years, it has been suggested that the government issue bonds the value of which would increase to provide cost and standard of living protection. If such investments were available, a pension plan could be expected to include this protection in its provisions. In any event, the problem of benefit erosion should be met directly, rather than through an intermediary mechanism with other difficulties such as a portability program.

COMMENTS SPECIFICALLY RELATED TO TERMINATION INSURANCE AND FUNDING

With the possible exception of the proposed legislation on fiduciary responsibility—concerning which there seems to be little controversy—the most important pension reform issue before the Congress is that of termination insurance. This is so because other matters—such as vesting or funding—can be improved by the employer, or the parties to the collective bargaining agreement covering the pension plan. However, there is no generally available mechanism to meet the problem of inadequate assets in the event of plan termination.

Extensive testimony has been presented to Congress specifying the types of situations in which plan terminations have occurred and employees have lost significant benefit accruals. There is no need to repeat or summarize that testimony. Perhaps the need for termination insurance can best be characterized by the following two quotations:

On December 8, 1971, President Nixon is reported to have stated: ". . . even one worker whose retirement security is destroyed by the termination of a plan is one too many".

In its statement of February 15, 1973 to the Senate Subcommittee on Labor, the American Life Insurance Association expressed various reservations about the proposal for termination insurance, but also stated: "Complete protection of these rights—which we concede is an admirable objective—can probably be obtained only through some sort of plan termination protection program."

To one who has advocated such a program since the first proposal by Senator Hartke in 1964, it has been very interesting to observe the basis for objection expressed by those in opposition.

In the early years, the primary argument was that such a program was not feasible. For various reasons, including refinements that have been made in the legislative proposal,[3] this type of opposition has diminished; there now appears

[3] Senator Hartke pointed out that his proposals were intended to serve as a basis for study, rather than as a completely defined program.

to be a reasonable consensus (although admittedly there are significant reservations) that such a program can function effectively if enacted along the lines proposed in S4.

Currently the primary opposition arguments seem to be that the magnitude of benefit losses is insufficient to justify the establishment of a termination insurance program. While there may not be general support for the President's reference to "one worker" as an adequate test of need for the program, the Treasury-Labor Departments' February 1973 interim report of the "Study of Pension Plan Terminations, 1972" shows that terminations reported during the first seven months of 1972 involved a loss of benefits to 8,400 individuals; the present value of benefits lost was $20 million. The average loss per individual was $2,400.

Is $20 million a significant amount? For comparison consider the current major scandal involving Equity Funding; coincidentally, the estimate of possible loss by the reinsurers has been reported as $20 million.

Is a loss of $2,400 significant to an individual employee? That will, of course, depend on each individual's status; any comparison with other financial data is artificial and reflects the biases of the comparer. Nevertheless, as a single illustration that the amount is not trivial, it is interesting to note that the average payment to life insurance beneficiaries in the United States was $2,685 in 1971.[4]

The above data does not "prove" that there is sufficient need for legislation establishing a termination insurance program. The problem is not statistical; rather it is a matter of reinforcing the confidence which employees have in the pension system, and making sure the system works. I suggest that there has been sufficient qualitative and quantitative evidence accumulated to suppport the case for such a program. Further deferral of establishment of such a program will result in loss of benefits by additional plan participants.

Funding is closely related to termination insurance, because they are both intended to enhance the security of benefit expectations, and because it is reasonable to assume that improved funding requirements will assist the functioning of the termination insurance program. There appears to be fairly widespread consensus on the desirability of additional funding requirements. Therefore, my comment on this subject is only to emphasize the interrelationship of two points made above:

(1) Use of future service benefits only will generally be unsatisfactory, because that will not provide adequate benefits. Therefore, additional unfunded past service liabilities will continually be created under many plans.

(2) Any reasonable funding requirements will not provide full assurance that benefits will be secure in the event of plan termination.

Improved funding requirements are desirable; a termination insurance program is essential.

CONCLUDING COMMENTS

In summary, the major points of this statement are:

Mandatory requirements for vesting, termination insurance and funding are needed; a portability program is not needed. (This statement does not discuss other issues such as fiduciary responsibility or disclosure.)

Vesting and termination insurance provisions should apply whether or not the plan meets the "qualification" rules for favorable tax treatment.

Vesting and termination insurance requirements should apply to benefits accrued before and after the effective date of legislation.

Encouraging, through tax deductions, individual savings for retirement will not significantly help most employees. We need adequate Social Security benefits, and legislation to assist private pension plans to function effectively.

A minimum vesting standard based on the amount of accrued benefit (in relation to pay), rather than age or service, is suggested.

The vesting requirement should be implemented quickly; any desired "cushioning" of the cost effect can be achieved in the funding requirements.

Vesting should not be subject to loss due to withdrawal of employee contributions.

Vesting benefits should be recorded on the individual's Social Security record.

The government should issue securities which will reflect increases in the cost and standard of living, or develop other means to prevent erosion of benefit values.

[4] Life Insurance Fact Book, 1972.

Termination insurance is essential; a program along he lines proposed in S4 should be established now.

A separate memorandum is being attached to my statement with some "technical comments" on the issues of vesting, funding and termination insurance. If any additional details are desired with respect to any portion of this statement, I will be happy to discuss those with the Subcommitee or its staff.

Professional Data

Self-employed, independent actuary.
Member, American Academy of Actuaries.
Fellow, Society of Actuaries.
Fellow, Canadian Institute of Actuaries.
Member, Mathematical Association of America.
Member, American Pension Conference.
Member, Amelcan Risk and Insurance Association.
B.S. Mathematics, City College of New York.
M.A. Economics, University of Michigan.
Phi Betta Kappa.

Experience.—Metropolitan Life Insurance Company, New York, from 1952–1960 doing various actuarial functions in individual life and health and accident insurance policies, with the exception of two years from 1953–55 which were spent as an Army Infantry Officer with duty in Korea.

Joined the staff of the United Auto Workers in 1960 as Actuarial Consultant; became Director of the Information Systems Department in 1968. (Supplementary information is attached.)

Joined the staff of League Life Insurance Company in 1971. (Supplementary information is attached.)

Appointment at various times (most reventiy 1972) as a lecturer in insurance and actuarial subjects at the University of Michigan.

Publications

Second Annual Pension Trust Conference, Graduate School of Business Administration, New York University: "The Unions' Attitude Concerning Pension Investments"—1961.

National Foundation of Health, Welfare & Pension Plans, Inc.: "The Effect of Technological and Population Mix Changes on 1964 Pension Bargaining by the UAW"—1964.

Social Security Conference, Canadian Labor Congress: "Negotiations arising out of the Canada Pension Plan and other Pension Legislation"—March, 1965.

Society of Actuaries: "A Government Guarantee Fund for Private Pensions"—1965.

Congressional Record: "Reinsurance for Private Pension Plans"—September, 1965.

American Risk & Insurance Association: "Panel Discussion on the Future of Private Pensions"—August, 1966.

Pension & Welfare News: "The National Industrial Group Pension Plan"—September, 1966.

Various portions of "Early Retirement, the Decision and the Experience", Barfield & Morgan, Institute for Social Research, the University of Michigan, 1969.

Appendix C of "Guaranty Fund for Private Pension Obligations", McGill Pension Research Council, 1970.

Miscellaneous Discussions: Transactions, Society of Actuaries; Journal of Risk and Insurance.

Article on Pension Termination Insurance for "Pensions" magazine, Fall, 1972.

Committees and Boards

Members, Pension Research Council (Wharton School)

Member of Advisory Council on Employee Welfare and Pension Benefit Plans (U.S. Department of Labor) 1964–1968.

Consultant to Advisory Council on Social Security Financing, Actuarial Subcommittee (U.S. Department of Health, Education and Welfare) (1964).

Consultant to the U.S. Department of Labor on pension reinsurance programs (1971).

ADDITIONAL COMMENTS ON TERMINATION INSURANCE AND FUNDING

1. In S4, Section 3 (24), "normal service cost" is specified based on an actuarial cost method in use as of a specific date; is it assumed that the Secretary will have authority to permit revisions in that method where appropriate?

2. In S4, Section 104 (c) excludes money purchase plans from the termination insurance and funding requirements; however, such plans (as defined) can have unfunded past service liabilities. Such liabilities should be subject to those requirements.

3. (Minor point) In S4, Section 210 (c) (3) refers to "experience deficiencies"; no such deficiency can exist with respect to the initial report on the plan. Similarly, in Section 210 (d) (1) estimated costs for a five-year period are specified; it would be preferable to make this paragraph comparable to Section 210 (c) (1).[5]

4. In S4, the allocations referred to in Section 211 (a) should be adjusted for any recent amendment which is not covered by termination insurance. That is, the increased assets which are due to those amendments should not serve to duce the benefits from the termination insurance fund.[6]

5. In S4, the "new plan" concept of Section 217 (e) (3) would result in a "stretch out" of the funding amortization period and a new 3 year non-protection period for termination insurance; neither of these is desirable.

6. In S4, the voluntary coverage available under Section 401 (c) might be changed to involve a longer non-coverage peirod (than the 3 years in Section 402) in order to protect against anti-selection.

7. In S4, the $500 limit in Section 402 (b) (1) (A) should be "dynamic" so that it can continue to be adequate in the future without requiring additional legislation; for example, it might be increased by the same formula as applies to the FICA taxable wage base. Also, as a further protection against anti-selection, the dollar limit should apply to the total benefit which any individual might collect from plans covered by termination insurance. Also, it is not clear whether the average wage referred to could be calculated over fewer than five years if that number of years did not elapse after the registration date, or if some "zero earnings years" would have to be hypothecated to determine a five year average. Finally, the application of the limits referred to in Section 402 (b) (1) (A) to lump-sum benefits as specified in Section 402(b)(1)(B) is ambiguous.[7]

8. (Minor point) In S4, the first reference to "date of its establishment" in Section 402 (b)(2) seems ambiguous; there doesn't appear to be any way a plan could be registered prior to its establishment, so it seems intended that the three year period begin with date of registration (with the exception specified later in that Section).

9. In S4, the "75% funding" criteria specified in Section 403 (b)(2)(B) is too severe for plans only a little more han five years old. tI would seem more consistent to simply apply the "5% rule" for all plans, e.g. if a plan were 10 years old its vested liabilities would have to be 50% funded. In determining the plan's "age", appropriate adjustment should be permissible to reflect amendments, i.e. a plan which was established 10 years ago and amended 5 years ago should not be subject to the same test as a plan which is comparable except for the amendment.

While I am recommending deletion of the "75% funding" test, it should be recognized that the language of the bill appears to be inconsistent with the Committee's intent as stated on page 25 of its report. The report states that the test is whether the plan is 75% funded; the bill specifies that assets are to be 75% of unfunded vested liabilities. The bill language would be satisfied if assets are 43% of vested liabilities (i.e. 43% funded). (This also applies to Section 407(b) of S 1179).

10. The Committee report on S4 states that Section 404 is intended to permit "protecting the program from undue exposure owing to delays, manipulation, or unforeseen economic hazards following plan termination". Perhaps the language of the bill itself could make this more explicit and also permit the Secretary to deny claims where he determines that the plan was established or amended solely in contemplation of an insurance claim. Such denial should be subject to court review, if requested by a plan participant.

[5] These comments also apply to proposed paragraph (j)(2)(C) and (j)(3)(A) of Section 323 of S1179.

[6] This also applies to proposed paragraph (e) of Section 323 of S1179.

[7] Some of these comments also apply to Section 405(b) of S1179.

11. In S4, it should be clear that Section 404(b) provides for payment of specified plan benefits, rather than for a "liability" estimated to be sufficient to provide such benefits. That is, subsequent experience should not serve to prevent payment of full benefits, due to insufficiency of the estimated "liability".

12. In S4, it should be clear that Section 404(c) permits the Insurance Fund to retain any assets of the terminating plan, rather than forcing liquidation at possibly depressed prices. (Section 406(d) might be interpreted to require liquidation and investment in government guaranteed securities.) (This comment also applies to Section 405(f) of S 1179.)

13. In S4, the liability specified in Section 405(b) should be contingent on the employer's (or a successor's) profitability subsequent to plan termination, rather than on net worth; a mechanism to do this is outlined below. It seems to me that, unless the libality is subject to such a rule, many employers may have great difficulty raising necessary capital because their creditors would be concerned about the effect of this pension liability in the event of default.

One method of assessing the charge against profits might be as follows:

1. After determining the lump sum charge that should be made against the employer,[6] calculate a level payment to amortize this charge, plus interest, over a specified period (e.g. 10 years). For illustration, assume the level payment is $100,000 per year.

2. Each year a payment of $100,000 would be due the insurance fund from the employer. *However*, in any year the employer's *maximum* required payment would be x% of profits (i.e. taxable income for US corporate income tax purposes).

3. In the event that the profit limit prevents payment of the required amount due, the remainder would cumulate with interest.

4. Any amount still owed a fixed number of years after the plan termination (e.g. 15 years; this period should be longer than the amortization period used in (1) above) would be written off as uncollectible.

14. S1179, the period provided in proposed paragraph (j) (1) (c) (see Section 323) to amortize an experience deficiency could result in substantial lengthening of the funding period if actuarial assumptions produce understatements of liabilities. For example, if a deficiency shows up after 15 years of amortizing the initial liability, that deficiency will be amortizable over the "average remaining working life of the employees" rather than over the remaining 15 years.

15. S1179, that portion of Section 407 which would allow "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" would introduce an element of cost variation that does not seem desirable. Even if it is assumed that such likelihood can be reasonably estimated, it is not clear that the particular employer (or employees) involved should bear increased cost based on that estimate.

Additional Comments on Vesting Proposals

(Note: These comments are intended to cover points which are essentially "technical"; major issues (e.g. vesting formula) are not covered.)

1. S4 provides (in Section 108) for vesting certificates to be sent to the Secretary of Labor; Section 101(e) calls for cooperation with other agencies. These certificates should be recorded on the individual's Social Security file; that procedure is referred to in the report on S4 by the Committee on Labor and Public Welfare, it should be incorporated in the legislation.

2. In S4, Section 202(a)(2) requires only "future service" vesting with respect to benefits due to future plan amendments or new plans. The requirement should be for "past and future service" vesting.

3. In S4, Section 202(b)(2) conditions certain vesting requirements on whether "an employer has contributed to the plan with respect to such service". In many plans there is no way to uniquely determine whether employer contributions have been made for specified individuals in any year. The concept of eligibility to participate has been defined in Section 201; all service during which an employee is a plan participant should count toward vesting, without regard to a determination of whether employer contributions were made for those years. (This comment also applies to S1179, proposed paragraph 12(c)(ii) in Section 322.)

4. In S4, Section 202(b)(3) treats a reemployed participant who had acquired

[6] The term "employer" always means "employer or its successors".

a 100% vested benefit much differently than one who had acquired a 90% (or smaller) vested benefit. This is inequitable. While the concern over employment effects may be valid, it would seem that the application of the one year service rule until the reemployed person is again able to participate in the plan would be sufficient. Service which was 100% vested should count toward additional vesting after reemployment just as service does which is 90% (or less) vested.

5. In S1179, the vesting requirement in the new proposed paragraph 12(A) (see Section 322 of the bill) should apply to service before and after establishment of the plan even if the participant is less than age 45 on the effective date of that paragraph.

6. In S1631, the "conditional vesting" provided for in proposed paragraph 12 (B), (see Section 2(a)(2) of the bill) should be deleted. For comparison, see Section 203(f) of HR 2.

7. In S1631, the use of a 15 year minimum for the denominator, in the proposed paragraph 12(D), (see Section 2(a)(2) of the bill) means that for an employee, hired after age 50, the accrued benefit will generally be less than the true accrued benefit. While the use of 40 as a maximum for that denominator could similarly have the effect of overstating the accrued benefit, that would only apply to someone who had been hired before age 25 and became vested; a less significant situation.

8. In S1631, the proposed paragraph 14 (see Section 2(a)(2) of the bill) would generally limit vesting requirements to "future service" only; all service should be covered.

MILLER & CHEVALIER,
Washington, D.C., July 6, 1973.

HON. GAYLORD NELSON,
Chairman, Subcommittee on Private Pension Plan, Senate Finance Committee, U.S. Senate, Washington, D.C.

DEAR SENATOR: Thank you for your letter. I was interested in Mr. Cummings remarks. I do not think that the cause of useful analysis is served by describing my suggestions as intended to "weaken" the proposals. That surely was not my intention.

With respect to plan terminations, Mr. Cummings begs the question when he starts with the premise that employers have made pension "promises." Many employers have explicitly negotiated with their unions on the basis that they would meet certain funding requirements, but that they would not assume corporate liability for unfunded past service benefits. I have tried to find a way to preserve for these companies the bargain they have made over the years. I support imposition of rigid funding requirements, which may be far beyond those to which they have agreed, because experience has shown that pension beneficiaries need the protection of uniform federal funding standards. It is quite another matter, however, to impose a huge liability on companies for past actions when they consciously acted, with full concurrence of representatives of their employees, to avoid such liability at that time.

As for fiduciary responsibility, Mr. Cummings and I simply have different views as to the effectiveness of various enforcement systems. He is quite wrong, and thoroughly out of his element, if he is suggesting that fiduciary standards imposed on charitable fiduciaries under our income tax system are not effective. The changes made in the Tax Reform Act of 1969 utilizing a penalty tax structure for enforcement in the case of private foundations have proven very effective. At that time, Dr. Woodworth, Assistant Secretary Cohen and I all considered the effectiveness of a system of enforcement by court action, which is the underlying enforcement mechanism in S. 4. There were extensive discussions with the Department of Justice. The matter was thoroughly analyzed before the Ways and Means Committee, and the Committee decided upon the penalty tax structure. It has worked well.

The various examples given by Mr. Cummings on page three of his letter do not particularly inspire confidence in me. The enforcement mechanisms in those instances have frequently been ineffective.

I am interested in a system which actually works in practice, even though it is not the traditional way of enforcing responsibilities through court action. While the private pension system needs a great deal of overhaul, it has been an effective private savings system and has grown immensely over the past fifty years. The only regulation has been through the tax system. I can see every reason to amplify this proven successful form of regulation to enforce new federal standards that are adopted. What Mr. Cummings misses is that penalty taxes are not designed to *punish* the fiduciary. They are so severe that they *force* the fiduciary to do his duty in the first instance. Thus, the pension beneficiaries are indeed effectively protected; they need not await the delay and uncertainty of court proceedings to enjoy their rights.

Sincerely yours,

JOHN S. NOLAN.

JUNE 26, 1973.

Hon. FREDERIC W. HICKMAN,
Assistant Secretary for Tax Policy, Department of the Treasury, Treasury Building, Washington, D.C.

DEAR MR. HICKMAN: In the course of the review of the pension area being conducted by the Private Pension Plans Subcommittee of the Senate Finance Committee, we have been studying the various proposals made with respect to "portability" of qualified plan retirement benefits. One of the proposals that has been made is the establishment of a central portability fund, to which a plan participant could have his retirement plan credits transferred.

Under this proposal, when the participant leaves an employer whose retirement plan is a member of the central portability fund, the employee would be permitted to require that the present value of his vested retirement benefits be transferred from the trust under the plan of his former employer to the central portability fund. These amounts would be retained in the central fund until the participant orders that they be transferred to the retirement trust of his new employer (if that new employer is also a member of the central portability fund) or until benefits are payable at age 65 or death. (This is essentially the proposal contained in Sec. 301 et seq. of S. 4.)

We have been given to understand that the Internal Revenue Service has ruled that, under certain circumstances, transfers of interests of plan participants from one qualified trust forming part of a retirement plan to another qualified trust forming part of another plan, are not to result in recognization of taxable income. We have been told that the basis of these rulings is that the amounts transferred are considered as neither received by nor made available to the participants, since those amounts are retained in qualified trusts maintained by the participants' employers.

However, it has been suggested that the proposed central portability fund under S. 4 might not constitute a qualified trust under section 401 of the Internal Revenue Code, since the fund would be established and maintained by the Federal Government and not by the employer of the fund's participants (and perhaps also because of the fund's likely failure to meet the Code's antidiscrimination requirements.) If it would not be a qualified trust, perhaps an amendment of the Code would be needed to ensure that employees would not be taxed on transfers from a qualified trust to the central fund. We would appreciate the Treasury's views on whether, under present tax law, the proposed central portability fund would constitute a qualified trust and whether an employee could arrange a tax-free transfer of his retirement plan benefits from the trust maintained by a former employer to the central portability fund.

Sincerely yours,

GAYLORD NELSON,
Chairman, Subcommittee on
Private Pension Plans.

THE DEPARTMENT OF THE TREASURY,
Washington, D.C., July 10, 1973.

Hon. GAYLORD NELSON,
Chairman, Subcommittee on Private Pensions Plans, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for your letter of June 26, 1973 inquiring about the tax consequences of a transfer of funds pursuant to a voluntary portability program.

Under the program you describe, when a participant in a retirement plan leaves an employer who participates in the portability program, the employee would have the right to elect to have the present value of his vested retirement benefits transferred from the trust under the plan of his former employer to the central portability fund. This amount would be retained in the fund until the participant elects to have it transferred to the retirement trust of his new employer (if that new employer also participates in the portability-program) or until benefits are payable at age 65 or death.

Section 402 of the Internal Revenue Code provides the rules for taxation of the beneficiary of a qualified employees' trust. The basic rule is that the amount actually distributed or made available to any distributee is taxable to him, in the year when distributed or made available, under section 72 (relating to annuities). When an amount is transferred at a participant's request from an employees' trust to a portability fund, there arises a question whether the amount is "made available" within the meaning of section 402.

As you have indicated, the Internal Revenue Service has ruled that, under certain circumstances, transfers of interests of plan participants from a qualified trust forming part of a retirement plan to another qualified trust forming part of another retirement plan are not to result in recognition of taxable income. However, these rulings do not apply to a transfer to anything other than a qualified trust, and it is doubtful whether the portability-fund would be considered to be a qualified trust. Moreover, the rulings do not apply when the participant has the option to receive his benefits immediately.

Constructive receipt is a very uncertain area of the tax law. However, we think that is is likely that a voluntary portability program of the type you describe would result in constructive receipt. The main argument against constructive receipt is that the enactment of the voluntary portability program would itself be an implied amendment of section 402 of the Internal Revenue Code since the purpose of the voluntary portability program would be thwarted if section 402 were not amended.

If a portability program of the type you describe is established, the tax law should be amended to provide that there would be no current taxation in the situation described, because of the substantial probability that constructive receipt would otherwise occur. Consideration should also be given to amending the tax law to provide that the portability fund would be exempt from income tax and to provide specific rules governing the taxation of distributions from the portability fund and the gift and estate tax consequences of transfers of amou:ıts in the portability fund.

Sincerely yours,

FREDERIC W. HICKMAN,
Assistant Secretary.

AMERICAN PAPER INSTITUTE,
New York, N.Y.

HON. GAYLORD NELSON,
Senate Committee on Finance,
Old Senate Office Building,
Washington, D.C.

DEAR SENATOR NELSON: As President of the American Paper Institute which represents the vast majority of pulp, paper and paperboard producers in the United States, I would like to take this opportunity to communicate to you our position on pension reform, an area now under study by the distinguished Senate Finance Committee.

The following comments represent the consensus view of API member companies who responded to surveys we conducted last year when the 92nd Congress held hearings on this highly important subject, and to a current survey conducted only two weeks ago.

First, API supports the concept of a minimum federal *vesting* standard for private pension plans, either by implementing a "Rule of 50" (50 percent vesting when age and years in the plan total 50), or any reasonable alternative. We would support the application of vesting requirements to benefits accrued both before as well as after the effective date of legislation.

API also supports a federal funding standard, either a requirement for *funding* over a period of forty (40) years (or less if the company so chooses) of past and prior service liabilities, as determined using acceptable actuarial methods and assumptions selected by the company—or any other actuarially equivalent funding requirement.

On *reinsurance*, we believe that insurance costs should not be imposed on plans that meet vesting and funding requirements established by law.

Concerning *portability*, API believes it is an unnecessary concept because its basic objective is adequately achieved by reasonable provisions for vesting of pension benefits.

We support *taw deductions* to individuals for personal savings for retirement, higher standards for *fiduciary responsibility*, and meaningful *disclosure* of constructive, useful employee benefit data.

We also support *federal preemption* of pension legislation, continuation of plan administration by the Internal Revenue Service, and flexibility with respect to allowing companies to select reasonable and proper *actuarial assumptions and methods.*

I think the positive thrust of the above comments reflects the paper industry's support of pension reform legislation. We commend you and your Committee for its work in this area and hope our comments will be of assistance during your deliberations.

Sincerely yours,

EDWIN A. LOCKE, Jr., *President.*

KIMBERLY-CLARK CORP.,
June 21, 1973.

HON. GAYLORD NELSON,
U.S. Senate,
Washington, D.C.

DEAR SENATOR NELSON: In reviewing the several proposals pending before the Senate Private Pension Plans Subcommittee, we would like to make the following brief points:

1. Insurance against termination of plans.—Kimberly-Clark, while supporting most of the points covered by the various bills as to funding, vesting, etc., cannot support legislation which includes a requirement that all pension plans carry termination insurance. We do not believe that soundly financed pension funds should be required to carry the cost of insuring those which are not in a strong financial condition. Those companies that are financially strong could and should prove to the appropriate regulatory agency that they are complying with the law and that their retirement systems are adequately funded.

2. Portability.—In setting up a pensic·ı plan an employer expects to encourage employees to remain with the company f›r long periods of time. With portability an emp'›yee would have little to lose by moving from company to company. With adequate vesting provisions portability, we feel, is not necessary.

3. Interstate operations.—Some provision should be included in all pending legislation which would standardize retirement system requirements when a company has plants located in several states. This would obviate the necessity of having several different plans for each location.

4. Union plan coverage.—We believe that any pension legislation should cover the Union Plans as well as Employee Plans. This is justified because the companies pay the costs of such plans and will be identified with such plans if they fail. We do not believe this is covered in pending legislation and may have been an oversight.

We hope that these points will be considered for inclusion in the Subcommittee's report to the Senate.

Thank you for the time that you have given us to present our views on this very important matter.

Sincerely yours,

PAUL A. JONES,
Staff Vice President.

STATEMENT OF THE NATIONAL HEALTH AND WELFARE RETIREMENT ASSOCIATION, INC. SUBMITTED BY DONALD S. GRUBBS, JR., F.S.A., VICE PRESIDENT AND ACTUARY

COST OF PLAN TERMINATION INSURANCE

The Departments of Labor and Treasury have recently released their "Study of Pension Plan Terminations, 1972—Interim Report." This is the first significant survey of data on plan terminations and sheds some light on the cost of plan termination insurance.

The study indicates that, at the 1972 rate, 3% of pension plan participants would have some benefit loss due to plan termination during 30 years of coverage (p. 33). While it is comforting to know that the percentage is not higher, this shows a definite need for plan termination insurance.

Projecting the interim 7 month report for a full year, we see that 14,000 persons per year are losing benefits through plan termination, with losses of $35,000,000 of value of benefits. Of this loss approximately $20,000,000 is for benefits presently vested and $15,000,000 is for benefits not presently vested. Part of this $15,000,000 not vested would have been vested under the vesting provisions of S. 4 or similar legislation, so that perhaps $30,000,000 of the $35,000,000 loss would have been vested under S. 4.

Under S. 4 such losses would be paid by a combination of (1) recovery from solvent employers with benefit losses, and (2) premiums from all employers with vested unfunded liabilities. The recent study shows that 92% of the losses were in plans where the employer's net worth exceeds the value of the benefits lost and 75% were in plans where the employer's net worth exceeded 10 times the claimant losses. The report points out some limitations in determining net worth. But the value of vested benefits under S. 4 would be less than the total value of benefits included in the study. Considering all of the provisions of the bill, I estimate that at least 90% of the $35,000,000 loss would be recovered from employers with benefit losses, leaving only $3,500,000 annually needed from premiums from all employers. While this is a very rough approximation, I believe it is a conservative one. The government's cost of administering the premium collection procedure might exceed the $3,500,000 needed, and the employer's costs in administering the premium collection procedure, including additional actuarial calculations, would certainly exceed $3,500,000. One principle of both insurance and taxation is that the cost of collecting premiums (or taxes) should be a small percent of the amount collected. It would therefore make sense to finance the plan termination insurance out of general revenues, rather than with premiums from all employers.

I recommend that the plan termination insurance be financed from general revenues rather than premiums.

AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.,
Washington, D.C., June 11, 1973.

Re Subcommittee on Private Pension Plans: Statement of Position of The American Textile Manufacturers Institute (ATMI) Concerning Proposed Pension Legislation.

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

DEAR MR. CHAIRMAN: Following are the comments and suggestions formulated by the Tax Committee of The American Textile Manufacturers Institute (ATMI) on the proposed legislation under consideration by the Subcommittee on Private Pension Plans:

(1) *Eligibility.* ATMI supports the eligibility rules contained in S. 1631. More rapid eligibility is impractical for profit sharing plans in high-turnover industries.

(2) *Vesting.* ATMI believes that none of the proposed bills contains a satisfactory solution to legislated vesting. While the Institute has no objection to reasonable legislative rules in this area, it believes that the diversity found in private pension plans, which is a response to varying geographical and industrial economic conditions, is healthy and should be supported by vesting legislation which permits plans to comply with any of several alternate schedules. Such alternative schedules might include:

(a) A schedule which takes into account age as well as years of service, such as is reflected in S. 1631.

(b) A schedule which has a relatively long waiting period for vesting to begin but which vests fully over a relatively short period thereafter.

(c) A schedule which commences vesting relatively quickly, but vests over a relatively long period, such as is proposed by S. 1179.

(d) Class year vesting over a relatively short period, such as 5 years.

All compulsory-vesting rules should apply only to benefits accruing after the enactment of such rules. Required vesting of past service at a rate not anticipated when benefits were set may be unacceptably costly to many employers and is grossly unfair in that it may produce the greatest hardships in those cases where the highest benefit levels have been in effect for the longest time. Curtailments adversely affecting fully vested long service employees might well result.

(3) *Funding.* ATMI endorses the approach of S. 1631 that required funding should be limited to current costs and unfunded vested liabilities.

(4) *Termination Insurance.* ATMI is opposed to legislation on this point, including corollary proposals for employer liability in the case of plan termination. Terminations even now affect only a very small percentage of covered workers.

Improved funding of vested benefits should reduce unexpected losses of benefits in the future to a very modest level which will not justify the vast additional regulatory complexities which would accompany these proposals.

(5) *Portability.* ATMI is opposed to the provisions of S. 4 which would create a "clearinghouse" to handle voluntary portability. It is believed that this step would eventually lead to an undesirable degree of pressure for uniformity among plans, which would have disadvantages for covered employees outweighing any advantages gained from consolidation of vested benefits. Improved vesting and funding will solve most of the problems at which portability proposals are directed.

(6) *Disclosure.* In discussions of these proposals little notice has been given to the fact that the Department of Labor only a few months ago has issued tough new regulations with greatly expanded reporting requirements making much of what is contained in proposed bills unnecessary.

ATMI urges that Congress avoid the mistake of over reaction to past laxity in enforcement of disclosure rules. Reporting which is too detailed may actually be counterproductive. The reporting burdens on plan administrators are already immensely complex and time consuming.

(7) *Fiduciary Standards.* ATMI is generally favorable towards a uniform federal rule in this area which would preempt state laws. Such rules should not, however, be so tightly drawn as to discourage aggressive plan management.

(8) *Enforcement.* The approach taken by S. 1179 and S. 1631 is vastly preferable to that of S. 4, which would be less efficient and would inevitably lead to burdensome and confusing dual regulation.

"Accordingly, ATMI strongly recommends that the Internal Revenue Service continue to administer any new provisions which may be added to the law dealing with eligibility, vesting, funding, etc. The administration and enforcement by another agency would be wasteful and inefficient both from the standpoint of employer compliance and duplication of bureaucratic effort."

(9) *Proposals for Deductible Employee Contributions and Individual Retirement Accounts.* ATMI is in favor of this feature of S. 1631. The proposal would provide a desirable incentive to employees to save for their retirement. The ATMI Tax Committee is concerned, however, that the offset feature in this proposal, which reduces the allowable deduction in relation to employer-provided retirement benefits, would place an unwarranted burden on the employer to advise employees concerning the applicable offset level. The proposal seeks to avoid this by adopting a presumption that employer-financed benefits do not exceed 7 percent of the employee's earned income. However, this figure is unrealistically high, and would not alleviate the problem in the textile industry. The ATMI Tax Committee recommends reducing the presumption to 4 percent.

Very truly yours,

CLAUDE FARRAR,
Chairman, Tax Committee.

HOUSEHOLD FINANCE CORP.,
Washington, D.C., June 1, 1973.

Mr. TOM VAIL,
Chief Counsel, Senate Committee on Finance, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. VAIL: Should the Senate Committee on Finance determine that amendments be offered to S. 4 as reported from the Senate Committee on Labor and Public Welfare, we respectfully suggest that the Committee consider the following suggestions:

VESTING

Vesting is thought of conceptually as a percentage of retirement benefits to be paid at the normal retirement age of 65. Presently, benefits vest in either equal or unequal portions or percentages over a period of years of service or after reaching a specified age and years of service, or they may vest all at once after reaching a specified age and years of service.

Some employers also provide an "early retirement benefit" (usually at a reduced amount), and in some cases, employers provide early retirement benefits greater that what the actuarially reduced benefits would be upon normal retirement.

We have found that the significant factors affecting the cost of providing vested benefits is the rate of termination of eligible employees according to age and service. When our retirement plan is compared with any of the existing vesting standards found in either S. 4, H.R. 2, or the Administration proposals, we have discovered that, to maintain the same level of benefits, any of the proposed plans would necessitate a substantial increase in our pension costs. These costs are due to the shorter vesting periods of the above proposals in combination with our present early retirement benefits.

For example, our employees may retire at age 50 after 15 years of service with a benefit commencing at age 50, equal to 25% of the last five years of salary. The benefits are 100% employer financed. Under the existing proposals, we would be required to either change our benefit plan or pay this benefit (not at age 65) but at age 50 to any eligible employee meeting the proposed vesting standards.

We feel that consideration should be given to the concept of longer vesting periods for plans which provide for early retirement especially when the early retirement benefit is greater than an actuarially reduced benefit would be. We suggest that the vesting period be lengthened proportionately for each year that a plan permits the retirement benefits to be received before the normal retirement age of 65.

PROFIT SHARING

An employee stock ownership or profit sharing plan benefits both the employee and the employer; the employee by providing a means to increase his assets and of knowing that he has a share in his employer's profits; and the employer from the knowledge that the employee is building a sound future with his employment benefit which would prevent excessive, costly employee turnover. The basic idea behind a profit sharing plan would be lost if there were a requirement that funds be invested in noncompany securities or the plan be treated as a pension plan, when a bone fide pension plan is already provided by the employer.

In the event that diversification of employee stock plans was required or were treated as pension plans under vesting standards, our opinion is that the incentives for employers could be to discontinue such plans because the purpose for which such plans were created would no longer be possible to achieve.

This is especially true in employee benefit packages where the entire cost of the benefit (as in our case) is paid by the employer. Where substantial benefits accrue to employees under a pension plan, it would be punitive to require diversification or early vesting under a stock ownership plan.

I have attached an example of language which would exclude profit sharing plans from the definition of employee pension benefit plan when a pension plan is provided by the employer meeting certain standards of eligibility and amount of benefits. The figures, of course, would have to be adjusted to meet different eligibility ages and years to acquire 100% vesting if more than 10 following eligibility.

In conclusion, we feel that any pension plan legislation should do two things: 1) provide an incentive for employer financed plans and 2) provide an incentive for early retirement. Although it may not be possible to achieve a lengthening of the vesting period for all plans, consideration should be given to lengthening of the vesting period for 100% employer financed plans or plans where there is an early retirement benefit. A good way to encourage such benefits would be to extend the vesting period for 100% employer financed or early retirement plans.

We strongly object to the requirement that employee stock ownership plans be treated as pension plans when the employer provides a bona fide pension plan in addition to the stock plan and both plans are 100% employer financed.

I sincerely appreciate this opportunity to submit our viewpoint.

Sincerely,

J. THOMAS NELSON.

Amend the definition of "employee pension benefit plan" by adding the following:

"The term also includes any deferred profit-sharing plan which provides benefits at or after retirement unless a pension plan, as defined in the preceding sentence, is also maintained by the employer or employee organization, or both, and such pension plan (a) contains no conditions upon participation of a full time employee in such a plan other than a period of employment no longer than two years or the attainment of an age no higher than age thirty, whichever last occurs; and (b) provides after 10 years of service under the plan, annual benefits upon normal retirement equal to at least 10% of a participant's average annual base compensation earned during such years of plan participation. For each full year of plan participation in excess of 10, a participant shall receive an additional benefit upon retirement that shall be at least 1% of such participant's average annual base compensation earned during such participant's total years of participation."

ATO,
Willoughby, Ohio, June 1, 1973.

Subject: S-4, S-1179, and S-1631.

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

DEAR SENATOR LONG: As administrator of some thirty-five pension plans, in my opinion there is much contained in the above proposed statutes that constitutes unnecessary legislation which in the long term will be an added cost burden on American business.

In complexity, the subject of pensions are like the ordinary automobile insurance contract. I think too many people are trying to sound like experts on a complex subject of which they really know very little. Generally, aside from the question of misuse of funds by a minority few the private pension system has been doing a good job.

In my opinion the only real weakness in the system is that companies and unions have been permitted to negotiate substantial increases in benefit levels without a mandatory commensurate funding program. The federal government must share a major responsibility for permitting this to happen. Congress has abdicated it's legislative responsibilities to the Internal Revenue Service and IRS regulations do not require full funding. Recently on my way to the office I heard over the radio a talk by Leonard Woodcock of the recent UAW convention. He stated that the pension trust would only pay for 50% of the benefits accrued—yet he was urging the union to establish as its goal the negotiation of even higher benefit levels.

The purpose of this letter however, is not to cover ground that has been covered by other people, rather to point out one problem that I have noticed as not being adequately covered by those considering this legislation, namely the issue of compliance with federal disclosure act reporting operating to preempt state legislation in this area. *It should preempt state law.* Permit me to explain.

As an example, in our company the preparation and filing of a disclosure act report costs between $200 to $500 per pension plan. In larger plans of other companies I expect this amount is even greater. Our experience with the Wisconsin and New York statutes is that it costs an additional $100 to $300 to prepare and file the separate state reports. This is so even though the content of the two reports is very similar.

State insurance commissioners were attempting to introduce in the various states and have passed a model bill formulated by a sub-committee of the National Association of Insurance Commissioners. According to trade publications, a bill of this nature has been introduced in the California legislation as an example. In a multi-division national pension plan with such state legislation, we find ourselves faced with the additional expense of making filings in each of the states where generally twenty-five or more of the pension plan participants reside. You can thus have a total possible expense on such a plan of several thousand dollars. I would rather see these dollars spent on benefits, than to pay actuarial and state filing fees.

I would urge that in your legislation you provide that compliance with the federal disclosure act requirements, preempt the necessity of making a state filing under any similar state statute.

It seems far better to spend these funds on benefits rather than on the support of company pension plan administrators, state insurance and banking department employee administrators.

Thank you for your attention to this matter.

Sincerely yours.

M. D. FURMAN,
Corporate Risk Manager.

FIRST INVESTMENT ANNUITY COMPANY OF AMERICA,
May 29, 1973.

Re S. 4, S. 1179 and S. 1631.

Mr. TOM VAIL,
Chief Counsel, Committee on Finance, U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR SIR: In accordance with the announcement of the Chairman of the Senate Finance Subcommittee on private pension plans, I should like to present out views on certain aspects of the above referred to bills which are now under consideration by that Subcommittee.

I am President and Chairman of the Board of Investment Annuity, Inc. and of First Investment Annuity Company of America, better known as FIAC. The Company is headquartered at 650 Swedesford Road, Wayne, Pennsylvania 19087.

FIAC is chartered as a life insurance company under the laws of the Commonwealth of Pennsylvania and is licensed to operate in 41 states but its present activities involve only the underwriting of annuities. We have introduced a new concept in such underwriting, FIAC underwriters the mortality or longevity guarantees of annuities but allows the client or his investment advisor to choose the investments underlying his personal annuity account. In other words, the annuitant is never locked into an insurance company's money management in order to obtain a guarantee of lifetime income payment. When the individual retires, he receives payment of income for life but the amount of income varies from year to year to reflect the investment results in his annuity account.

FIAC annuities are ideal for small employers and for retirement plans covering the self-employed. We believe they will also be ideal for individuals who may wish to establish their own qualified individual retirement accounts if the proposed legislation becomes law.

Since FIAC does not sell life insurance or securities, we are not members of the American Life Insurance Association or of the Investment Company Institute. Hence, we take this opportunity to present our views which are limited to those provisions of the bills governing qualified individual retirement accounts.

DIRECT PURCHASE OF ANNUITY CONTRACTS

We are not absolutely certain that S. 1631 would permit an individual to establish a qualified retirement account by the direct purchase of an annuity contract from a life insurance company without the use of a trust or similar arrangement. We note reference to an annuity in S. 1631 on page 22 beginning at line 24, that reads as follows: "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". We think this sentence would permit such direct purchase but we prefer the precise language of S. 1179 (page 23, line 23) in the proposed new section 409, relating to individual retirement accounts. We recommend, therefore, that in any legislation adopted the description of a qualified individual retirement account read somewhat as follows: "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. . . ."

CONTRIBUTIONS TO EXISTING ANNUITY CONTRACTS

A reading of both S. 1179 and S. 1631 leads us to believe that provision has not been made to permit individuals, subsequent to the date of enactment of the proposed legislation, to make tax deductible contributions to existing annuity contracts. The absence of such a provision will work a hardship on the hundreds of individuals in this country who carry individual annuity contracts issued by life insurance companies to provide income for their retirement years. Should this proposed legislation become law, it would be natural for them to seek to apply the proposed allowable deduction to the premiums which they now pay on these annuity contracts. If such a provision is not enacted and if these individuals consider the current premiums which they are paying to represent the maximum amount which they can set aside for retirement, they must either forego the proposed allowable deduction or discontinue premium payments under their present annuity contracts and buy new ones. In either case, the individual suffers. If he discontinues his present annuity contract he incurs loading charges and the cash value of the discontinued annuity contract will not normally purchase a new annuity contract of comparable value to him. The situation might be even worse if the present contract happened to be a retirement income contract containing a life insurance element and the individual might no longer be insurable.

We do not believe the Treasury Department would encounter any insurmountable problems if such a provision were enacted. It would be necessary to amend section 805(d)(1) to provide that the definition of "pension plan reserves" would exclude those reserves attributable to contributions to existing annunity contracts which were made prior to enactment of the legislation. We do not believe it would be an impossible task for the insurance companies to make such an allocation. The adoption of such a provision would also require an amendment to section 72(c)(1) of the Code defining "investment in the contract" to be sure that such definition does not include amounts which were deductible under the proposed new section of the Code permitting such deduction. It is our understanding that most, if not all, insurance companies prepare for their annuitant taxpayers the computation of the amount of annuity payment which is to be reported as taxable income on their federal income tax returns.

EMPLOYER CONTRIBUTIONS TO MONEY PURCHASE PENSION PLANS

Section 7(h) of S. 1631 would add a new section 409 to the Internal Revenue Code which would limit to 20% of compensation the amount of employer contribution to a money purchase pension plan which the employee may exclude from his current gross income. Enactment of this provision would represent a radical departure from the long established principle that deductible contributions to and benefits derived from a qualified pension plan must meet the test of reasonableness. The Income Tax Regulations on reasonableness have consistently held that what constitutes reasonableness depends on all the facts and circumstances in a particular case. We see no justification for singling out one small segment of the whole broad area of reasonableness, including reasonable compensation, by placing a numerical value on that segment. We therefore suggest that the present procedures applied to tests for reasonableness be allowed to remain in effect.

If the reason for proposing this unprecedented treatment of employer contributions to pension plans covering all employees where the tax status of the employer is not involved is based on a fear that money purchase pension plans encourage unreasonably high benefits for employees in the proscribed group, we suggest that the fear is unfounded. By and large, money purchase pension plans tend to create reverse discrimination by providing higher benefits for employees entering the plan at a young age as contrasted with employees in the older age group when the plan is adopted because younger employees have a longer time to accumulate benefits which are generally based on future service only. For example, the retirement benefit at age 65 for an employee age 35 on the date of adoption of a money purchase pension plan would generally be more than twice the benefit for an employee age 50 on such date even though both employees had the same number of years of service with the employer at retirement. Since the higher-paid employees are generally found in the group of older employees, the money purchase pension plan benefit-wise discriminates against these employees in favor of the younger and generally lower paid employees.

Respectfully yours,

W. THOMAS KELLY,
President and Chairman of the Board.

FIRST INVESTMENT ANNUITY COMPANY OF AMERICA,
May 31, 1973.

Re Section 3401(a) of the Code.

Mr. TOM VAIL,
Chief Counsel, Committee on Finance, U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR SIR: Section 3(e)(11) of S. 1631 would amend section 3401(a) of the Internal Revenue Code to exclude contributions to a qualified individual retirement account from the definition of wages for purposes of withholding of income tax at the source. Since it is proposed to amend this section, we would like to take this opportunity to request a further exemption from withholding for that portion of the premium paid by an employer for current life insurance protection which is part of an annuity referred to in section 403(b) of the Code for the following reasons.

Revenue Ruling 70-453 (1970 CB 287) holds that the portion of the premium used to purchase current life insurance protection as part of a so-called tax-sheltered annuity is subject to withholding under section 3402 of the Code because section 3401 does not provide an exception from withholding for insurance of this type. We currently participate in the underwriting of tax-sheltered annuity programs described in section 403(b) of the Code for approximately 2,321 school districts and educational institutions covering almost 18,000 individuals. Our experience has been that most school boards find the withholding requirement applicable to the insurance portion of the annuity premium to be so burdensome that they prohibit their employees from choosing an annuity contract which contains a life insurance element. Thus, many hundreds of employees who desire to provide life insurance protection for their families while they are saving to provide income for their retirement years are denied the opportunity to fulfill this desire.

We are not critical of the Internal Revenue Service in arriving at the conclusion expressed in Revenue Ruling 70-453 because we realize that the Service is bound by statute. However, we doubt that it was the deliberate intent of the Congress to subject the life insurance portion of the annuity premium to the withholding of tax provision of the Code. Rather we think it was an oversight in that the Congress may not have realized that the general term "annuity contract" might encompass a contract which provides a combination of annuity income and current life insurance protection. Further, we do not believe the Congress would be adverse to excluding such life insurance premium from withholding because it grants exclusion to such premiums under other types of employee benefit plans which provide benefits under contracts combining the elements of annuity income and life insurance protection. Nor do we believe the Internal Revenue Service would object to extending the exclusion from withholding to such premiums so long as the taxable amounts are reported.

Respectfully yours,

W. Thomas Kelly,
President and Chairman of the Board.

Towers, Perrin, Forster & Crosby, Inc,
Philadelphia, Pa., May 30, 1973.

Re pension legislation.
Thomas L. C. Vail, Esq.,
Chief Counsel, Committee on Finance, Dirksen Senate Office Building, Washington, D.C.

Dear Mr. Vail: I am taking this opportunity to accept your offer for written statements for inclusion in the current testimony on pension reform legislation.

The issue I wish to discuss is a minor one relative to the overall pension issues but an important one for many companies. I do not believe this point is covered in any of the specific bills before your Committee.

My comments concern Section 404(a)(7), Limit of Deduction. This Section provides that in the event there are two or more qualified trusts, the total amount which may be claimed for tax deduction cannot exceed 25% of compensation otherwise paid or accrued during the taxable year for persons who are beneficiaries of the trusts. I believe this first appeared in the Code in 1954. We recommend that this overall limitation be raised to at least 30%. A higher percentage could be justified.

In 1954, when this limitation was imposed, pension plans were in their infancy. Benefits provided by the plans were low not only in dollar amounts ($1.50 per month per year of service for most UAW plans), but also relative to the pay the employees received at that time. Generally, pensions were not available until a person reached a normal retirement age of 65 or even later. Any benefit taken prior to normal retirement age of 65 was drastically reduced. Vesting of pension benefits at that time was almost nonexistent. Very few plans provided benefits in event of disability. For many plans, the employer costs were kept low by requiring the employees to contribute. All this is by way of observing why pension plan costs in the early 50's were a small percent of the covered payroll of the employees. There was adequate margin in the 25% to allow companies to provide meaningful benefits through profit sharing and thrift plans in addition to a competitive pension plan.

Since the early 50's, we have seen significant increases in pension costs due to the various factors enumerated above. Many plans now provide either full benefits or subsidized benefits in event employees retired prior to age 65. Full benefits at age 62 or even age 60 are not uncommon, particularly for long service employees. Vesting is becoming much more prevalent with many plans now providing full vesting after ten years of service. The general adequacy of the benefits is now significantly greater than it was 20 years ago. Most plans are now noncontributory. Many plans also provide for incidental benefits such as death benefits prior to retirement and survivors' benefits after retirement. Disability benefits are common additions to many pension plans. Thus there has been a significant increase in the cost of pensions as a percent of payroll—more than doubling for most companies in the last 20 years.

The 25% overall limitation does not apply to many situations, but where it does it severely limits the ability of the companies to compensate employees in the same manner they were able to do when this rule was adopted in 1954. Many companies now have pension plans with accrual costs in excess of 20% of payroll. Obviously, for companies with these pension plans it is impossible for them to provide a profit sharing plan on a qualified basis. This problem will be compounded if the proposed legislation is passed requiring additional costs for more liberal vesting and more rapid funding.

The conclusion we reach is that it would be logical at this time to increase the 25% limitation.

This same section of the Code allows for a 5% carryover of excess contributions. If the basic percent is made adequate there may be no need to continue the carryover provision.

If you or your associates would like to discuss this further with me, please let me know.

Sincerely,

Preston C. Bassett.

Statement of Norman H. Tarver, Superintendent, Equity Market Research

Proposals for the Improvement of the Private Pension Plan System

Statement submitted to the Hearings held by the Subcommittee on Private Pension Plans of the Senate Finance Committee on June 21, 22 and 23, 1973, on Senator Bentsen's Bill S. 1179, Senator Curtis' Bill S. 1631 and the principles and policies embodied in Senators Williams' and Javits' Bill S. 4.

List of Contents

Introduction.
Pension Philosophy.
Broad Social Review.
Uniformity.
Employee Benefit Plans Commission.
- Need.
- Cost Savings.
- Social Viewpoint.
- Name of Commission.
- Structure of E.B.P. Commission.
- Ontario Pension Commission.
- Consumer Products Safety Commission.
- Scope of Jurisdiction of E.B.P. Commission.

Participation and Vesting.
Vesting of Past Service Benefits.
Locking-In Feature.
Maturity Date.
Tax-Free Transfers—Portability.
Distribution on Termination of Plan.
Central Pension Registry Office.

Funding.
Plan Termination Insurance.
Income Tax Treatment of Lump Sum Distributions to Employees.
Income Tax Treatment of Death Benefits.
Estate Tax Treatment on Death Benefits.
Tax Credits for QIRA Plans.
Carry-Over Period.
Excess Contributions under Keogh Plans.
Excess Contributions under QIRA Plans.
Premature Distribution under QIRA Plans.
Salaried-Only Plans.
Small Employers.
Tax Deferred 403(b) Annuity Contracts.
Limits on Pensions and/or Contributions.
Appendix "A".*
Appendix "B".*
Appendix "C".*

*Appendixes A, a discussion of personal retirement savings plans, B, an excerpt from Mr. Tarver's statement on S. 2 in 1972, and C, possible revisions of the Internal Revenue Code, were made a part of the official files of the Subcommittee.

Supplementary statement commenting on statements of Professor Halperin and Professor Bernstein.

Proposals for the Improvement of the Private Pension Plan System

INTRODUCTION

I appreciate very much being given this opportunity to make a submission to these Hearings, particularly when I am not a citizen of this country.

My name is Norman H. Tarver. I am a Canadian citizen and resident, employed for more than 40 years by The Manufacturers Life Insurance Company in Toronto, Canada.

My employer is a Canadian mutual life insurance company licensed to do business in 49 of the 50 States and in the District of Columbia, and has been operating in this country for almost 70 years. It has almost 50 branch offices from coast to coast in the United States and does more than 50% of its total business here. Manufacturers Life ranks in the top 20 life insurance companies in the United States.

Manufacturers Life has long been involved in the private pension plan market and has had a long and successful experience in the annuity field.

Personally I have been involved with private pension plans for almost 30 years, in the early years mostly with Canadian plans but for about 15 years almost entirely with United States plans. I am a member of the American Pension Conference and have served on committees of the American Life Insurance Association.

I am not an actuary, attorney or accountant, but rather a person with long practical experience in private pension plans.

Although such is my background, I wish to emphasize that, in presenting this statement, I am doing so purely as an individual. I am not presenting it on behalf of my employer nor on behalf of any association or organization. My employer is aware of my presentation and has generously paid for my expenses in connection with my submission.

I believe whole-heartedly in the present Social Security System and at the same time in the basic philosophy of the private pension plan system. However, I believe that the latter can and should be improved.

In June, 1972, I was privileged to be able to testify at the Senate Labor Subcommittee Hearings on Bill S. 2. As this Bill was a predecessor of Bill S. 4, the provisions of which are included in the topics being considered at these Hearings, I would appreciate the Subcommittee giving consideration to the various comments and suggestions included in the statement I submitted to those Hearings. My testimony commences at Page 498 of the record of those Hearings.

PENSION PHILOSOPHY

As a fundamental principle, I believe that every worker and spouse should be encouraged to accrue during their income-earning years savings of sufficient magnitude that they will be able throughout their retirement years to maintain a standard of living reasonably related to the standard that they maintained in their income-earning years.

Social Security will, of course, provide a basic and integral part of the savings accrued for retirement. I believe in the philosophy that Social Security income should be adequate to maintain a basic standard of living for every worker and spouse and that any improvement in retirement income beyond that basic standard of living should be developed by the worker and/or his employer on their own initiative but that the worker and/or his employer should be encouraged to provide such improvement.

BROAD SOCIAL REVIEW

I feel that a broad review from a social point of view should be given at this time by Congress to all of the many aspects of the private pension plan system. Making a change in one aspect of the system can have serious effects on other aspects.

This broad look by Congress would provide an opportunity to reconsider the basic philosophy on which the system should be developed. I submit that the real reason for new pension legislation, which I am quite convinced is coming, is the need to reconsider the system from a social point of view and that it is most difficult for a social program to be fully developed by a taxing authority, because in many instances conflicts of interest are involved.

I feel that the contents of Bills S. 4, S. 1631, and S. 1179 and S.R. 2 and H.R. 462 and all the other Bills now before Congress should not be looked at separately. Each of many aspects, including the ideas of permitting an individual to establish his own pension plan, should be developed in proper relationship with all other aspects.

In general, I feel that Bill S. 1179 is a very good Bill and that it has been carefully developed. It fits in well with the considerations I have described. For this reason, it forms a good base on which the Finance Committee can develop pension reform legislation.

I would like to suggest a number of features that could be added to Bill S. 1179 in order that it will do a better job of securing the reforms that are needed in the private pension plan system. Also I would like to submit some suggestions for amending several provisions contained in Bill S. 1179.

UNIFORMITY

Assuming that the Internal Revenue Code is amended to provide for Qualified Individual Retirement Accounts (QIRA), the Code will then provide for deferment of income tax in respect to the following types of retirement plans, accounts and contracts:

(1) Corporate Employer Pension Plans under Sections 401(a) and 404(a)(2);

(2) Corporate Employer Profit Sharing Plans under Section 401(a) and 404(a)(2);

(3) Self-Employed Pension Plans under Sections 401(a), 401(c), 401(d), 401(e) and 404(a)(2);

(4) Self-Employed Profit-Sharing Plans under Sections 401(a), 401(c), 401(d), 401(e) and 404(a)(2);

(5) Employer Bond Purchase Plans under Section 405(a);

(6) Tax Option Corporation Plans under Sections 401(a), 404(a)(2) and 1379;

(7) Qualified Individual Retirement Accounts (QIRA) under Section 409(a);

(8) Tax Deferred Annuity Contracts under Section 403(b).

To varying degrees, different requirements, rules, restrictions, limitations, benefits, tax treatments are imposed on and granted to each of these plans, accounts and contracts. The result is a very considerable lack of consistency and a considerable degree of discrimination applied to the different types of taxpayers involved in them. In many cases, there seems to be no important reason for maintaining these differences, at least not from a social point of view. Probably many of the differences developed as a result of tax considerations that were felt to be necessary by the persons involved in developing various Bills at various times.

I suggest that it would now be very worthwhile to examine all the facets of all these various types of plans, accounts and contracts with a view to eliminating as many discrepancies and inconsistencies as possible. As much uniformity in qualification requirements and tax treatments as possible would be highly desirable.

In this review of the various qualification requirements and tax treatments, I would urge that they be considered from a social point of view more than from a tax point of view. The private pension plan system is a social system which to date has been encouraged and developed under tax legislation.

Some of the suggestions submitted in this statement are for the purposes of securing uniformity. No doubt numerous other amendments could be made in the Internal Revenue Code and in other codes and acts to secure more uniformity.

Employee Benefit Plan Commission

NEED

At the present time, the regulation of the private pension plan system is divided mainly between two federal departments, as follows:

(1) The Treasury Department (including the Internal Revenue Service);

(2) The Labor Department under the authority of the Welfare and Pension Plans Disclosure Act.

Various Bills that have been submitted to the 93rd Congress would add considerably to the total regulatory responsibility to be exercised but would leave the regulatory activities mainly in these same two departments. However, the division of activities would be altered depending on which Bills become law, as follows:

(a) The Williams-Javits Bill S. 4 would leave the regulatory responsibility of the Treasury Department and the Internal Revenue Service as at present but would add greatly to the regulatory responsibility of the Labor Department: in effect almost all plans would be subject to dual qualifications;

(b) Congressman Dent's Bill H.R. 2 would have much the same effect as Bill S. 4;

(c) However, coupled with Bill S. 4 or Bill H.R. 2 there would likely be a Bill like part of S. 1631 (H.R. 7157) or like part of Bill S. 1179 which would add to the regulatory responsibility of the Treasury Department and the Internal Revenue Service in respect to the qualifications of QIRA plans;

(d) The Administration Bills S. 1631 (H.R. 7157) and S. 1557 (H.R. 6900) would add considerable responsibility to both the Treasury Department and the Labor Department;

(e) Senator Bentsen's Bill S. 1179 would add greatly to the regulatory responsibilities of the Treasury Department but would leave those of the Labor Department as at present;

(f) However, coupled with Bill S. 1179 there would likely be a Bill like S. 1557 (H.R. 6900) which would add considerably to the regulatory responsibilities of the Labor Department.

Thus, no matter which of the proposed Bills eventually becomes law, it is evident that the regulatory responsibilities of both the Treasury Department and the Labor Department would be considerably enlarged. Confusion and unnecessary overlapping and therefore unnecessary costs already exist (both inside and outside the government) because of the splitting of activities between the two departments. Enlarging the activities of the two departments is bound to increase the confusion, overlapping and costs.

Therefore, I strongly urge that almost all of the regulatory responsibilities of the federal government be brought together into one agency, a new Employee Benefit Plans Commission.

COST SAVINGS

Senator Lloyd Bentsen has rightly stated that it is imperative that an attempt be made to streamline the operation of the federal government as much as possible and that pension reform is no exception. I submit that the best way to streamline the federal government's regulatory activities in respect to the private pension plan system would be to bring together all of such activities into one agency. For this purpose I suggest that the personnel now performing such activities in both the Labor Department and the Treasury Department (including the Internal Revenue Service) be transferred to the new Employee Benefit Plans Commission. This would permit the retention of the experience and expertise now exising in the two Departments.

At the same time, establishing a new agency would permit the streamlining of procedures, the simplification of various forms and reports and the elimination of dual and parallel procedures. It would also permit the development of a common "language" for the private pension plan system.

SOCIAL VIEWPOINT

Another very important point is that establishing a new regulatory agency would permit the growth of a social viewpoint as contrasted with a taxing viewpoint. At present the Treasury Department and the Internal Revenue Service seem prone to interpret the law in as narrow and strict a manner as possible when drafting Regulations and Rulings, at all times keeping more in mind the effect on tax revenues than the effect on the social welfare of the participants in the private pension plan system.

Admittedly striving for a new viewpoint will not come easily when existing personnel is used by the new agency but it is much more likely to come through a new agency under a new director than through the continuation of regulation by the existing Departments.

NAME OF COMMISSION

It is suggested that the name of such Commission should be as simple and concise as possible and yet of sufficient breadth to encompass the whole field of its jurisdiction.

This field of jurisdiction would, within the philosophy outlined above, embrace all the private pension plan system as it is now constituted. Under existing Disclosure Laws now administered by the Department of Labor but which would be transferred to this Commission certain other employee welfare plans would be included as well as pension plans. In future years, the field of jurisdiction of the new Commission could very well extend over an even-wider range of employee benefit and welfare plans.

With this range of jurisdiction in mind, I suggest that the name of the Commission should be the "Employee Benefit Plans Commission." This name is reasonably concise and yet wide enough in scope to embrace and demonstrate all of the field with which the Commission will be concerned.

No doubt, whatever name is selected for the Commission, the name will in everyday parlance be abbreviated. The suggested name lends itself to such abbreviation by the use of "E.B.P. Commission" or the "E.B.P.C." in the same manner as the Securities and Exchange Commission is commonly referred to as the "S.E.C.".

STRUCTURE OF E.B.P. COMMISSION

Under Bill S. 2, the E.B.P. Commission would have been a branch of the executive much like the Securities and Exchange Commission (S.E.C.), with 5 Commissioners being appointed by the President with the advice and consent of the Senate. One of the 5 Commissioners would be appointed by the President to be Chairman of the E.B.P. Commission.

It is suggested that the E.B.P. Commission would be more appetizing to the public and to the employers and employees whose moneys and interests would be involved if the E.B.P. Commission had an appearance somewhat like the National Association of Securities Dealers (N.A.S.D.). I am not suggesting that the E.B.P. Commission should be an independent body like N.A.S.D. nor am I suggesting that there should be two bodies, such as there is to regulate the activities of the securities industry (SE.C. plus N.A.S.D.).

What I am suggesting is a structure along these lines:

(1) An E.B.P. Commission comprised of a group of 15 Commissioners appointed by the President of the United States with the advice and consent of the Senate, the individuals being selected to represent at least the following interests:

(a) Treasury Department.
(b) Labor Department.
(c) Commerce Department.
(d) Congress.
(e) Life insurance industry.
(f) Banking industry.
(g) Investment companies industry.
(h) Labor unions.
(i) Pension actuaries and consultants.
(j) Securities industry.
(k) Large employers.
(l) Small employers.
(m) Self-employed individuals.
(n) General public.

(2) The Chairman of the E.B.P. Commission would be appointed by the President with the advice and consent of the Senate.

(3) All members of the E.B.P. Commission, except the Chairman and the Director, would serve on a part-time non-salaried basis but would be compensated for out-of-pocket expenses by the E.B.P. Commission.

(4) Members of the E.B.P. Commission would be appointed for 3 year periods (except that initially some of them would be appointed for 1 and 2 year periods in order to obtain continuity).

(5) The E.B.P. Commission would be charged with the broad interpretation of the law and with establishing policy on a national scale, taking into account the interests of all the parties involved in the Private Pension Plan System.

(6) The E.B.P. Commission would have the power to establish whatever Advisory Committees it decided would be useful to it to provide information, advice and recommendations on the wide range of segments within the sphere of the responsibilities and interests of the E.B.P. Commission. For example, the following Advisory Committees might be established:

(a) Disclosure Requirements Advisory Committee.
(b) Fiduciary Advisory Committee.
(c) Actuarial Advisory Committee.
(d) Life Insurance Industry Advisory Committee.
(e) Banking Industry Advisory Committee.
(f) Investment Company Industry Advisory Committee.
(g) Securities Industry Advisory Committee.

(7) The members of these Advisory Committees would be comprised of individuals appointed by the E.B.P. Commission who would be experts in the various fields and who would serve without remuneration from the E.B.P. Commission, except for out-of-pocket expenses.

(8) The administrative head of the E.B.P. Commission would be a "Director", who would be a full-time salaried member of the E.B.P. Commission, appointed by and responsible to the E.B.P. Commission.

(9) The Director would have a full-time salaried staff to provide the expertise needed in the various segments of the work of the E.B.P. Commission, such staff to be appointed by and responsible to the Director.

ONTARIO PENSION COMMISSION

The structure recommended above is somewhat similar to the structure of the "Ontario Pension Commission" set up by the Ontario Government under the terms of the Pension Benefits Act of 1965, However, the proposed structure is more elaborate because of the much larger size of the United States and because of the much more complex nature of the private pension plan system in the United States. It is suggested that it would be useful to make a study of the Ontario Pension Benefits Act of 1965 and of the structure and methods of operation of the Ontario Pension Commission. See Appendix A, B and C of the statement I submitted to the Senate Labor Subcommittee Hearings on Bill S.3598.

An excellent description of the Ontario Pension Benefits Act of 1965 is contained in a booklet "Canadian Regulation of Pension Plans" by Frank M. Kleiler, at that time Deputy Assistant Secretary for Planning and Evaluation, Department of Labor, 1970, published by the U.S. Department of Labor, Washington, D.C.

CONSUMER PRODUCT SAFETY COMMISSION

The proposed E.B.P. Commission would be much like the Consumer Products Safety Commission which was authorized by Congress in 1972 by Public Law 92–573. Section 4 of that law provides for the establishment of the Commission, Section 28 provides for establishment of an Advisory Council and Section 30 provides for the transfer of functions, personnel, property, records, etc. from other departments and agencies to the newly created commission.

Section 30 also provides that all determinations, rulings, regulations, and the like of any of the departments and agencies pertaining to the functions transferred to the new agency will continue to be operative.

SCOPE OF JURISDICTION OF E.B.P. COMMISSION

I suggest that the philosophy on which the Bill should be based is that the E.B.P. Commission should take over as many of the regulatory activities of the

Federal Government in the private pension plan area as it is possible to place with or transfer to it. Similarly, as much as possible of any regulatory activities of the Federal Government in respect to other employee welfare and benefit plans should also be transferred and placed within the jurisdiction of the E.B.P. Commission.

Applying this basic philosophy would mean that all regulatory activities in respect to all pension plans, profit-sharing plans, plans for self-employer individuals, professional corporation plans and tax-deferred 403(d) annuities would be within the jurisdiction of the E.B.P. Commission. This would mean transferring from the Department of the Treasury, the Internal Revenue Servcie, the Department of Labor, the Department of Commerce, the Securities and Exchange Commission and any other department or agency now exercising some regulatory jurisdiction all of their activities and concerns, except that the accounting operations in respect to tax deductions and taxation of distributions would remain within the jurisdiction of the Internal Revenue Service. Provision for such tax treatment would be retained in the Internal Revenue Code. References to pension plans, profit-sharing plans, etc., would be removed from other federal laws.

The area of plan qualification (both initially and subsequently) would be transferred from the Internal Revenue Service to the E.B.P. Commission. Such transfer would mean that the Commission would have supervision over all plans of all sizes, which I submit is highly desirable. To split the jurisdiction of qualification and registration between two government agencies would be very confusing. To have one agency concerned with qualifications of all plans and another agency concerned with registration of only plans that are above an arbitrarily selected line would compound the confusion considerably, especially when plans could move up and/or down across such line, perhaps several times during their lifetimes.

I strongly urge that the Bill be designed so that the public would be required to deal with only one federal regulatory agency, regardless of the size or the nature of the plan involved.

Transferring responsibility for all regulatory activities to the E.B.P. Commission does not necessarily mean that all regulations would have to apply equally to all plans. The Disclosure Law requirements could be applied differently (as now) to different sizes or types of plans. The vesting and funding requirements and the provisions for plan termination insurance could also be applied differently to different sizes and types of plans, if such were deemed wise by Congress. The important point to keep in mind is that the regulatory activities, no matter how they might vary, would be administered by only one federal government agency, the E.B.P. Commission.

With the transfer of the administration of the Disclosure Laws from the Labor Department to the E.B.P. Commission, the Commission would have jurisdictions to the extent of such laws over certain other employee welfare plans.

Bills S. 1179 and S. 1631 would provide for "Qualified Individual Retirement Accounts". It is suggested that the registration and regulation of these plans should be within the jurisdiction of the E.B.P. Commission.

If the Tax Deferred Annuities now permitted under Section 403(b) of the Internal Revenue Code continue to be available, then it is suggested that the registration and regulation of them should be included in the jurisdiction of the E.B.P. Commission.

If a Central Pension Registry Office were established as suggested later in this statement, such Office should be under the jurisdiction of the E.B.P. Commission.

Participation and Vesting

Section 401(a)(11) as provided in Section 321 of Bill S. 1179 would require an eligivility to participate of a 1-year waiting period or attainment of age 30, which ever is later.

Section 401(a)(12) as provided in Section 321 of Bill S. 1179 would require at least 25% vesting by the end of 5 years of participation at the latest and attainment of 100% vesting by the end of 20 years of participation of the latest.

Combining these two requirements, it would mean that participation and vesting would occur no later than the following:

TABLE 1

Employment starting age	Participation starting age	Vesting starting age	Initial degree of vesting (percent)	100 percent vesting starting age
20	30	35	25	50
25	30	35	25	50
30	31	36	25	51
35	36	41	25	56
40	41	46	25	61
44	45	50	25	65
45	46	51	25 (26)	66 (65)
50	51	56	25 (36)	71 (65)
55	56	61	25 (56)	76 (65)
60	61	66 (65)	25 (100)	81 (65)

This means that no employee commencing employment after age 44 would attain 100% vesting before retirement, unless the vesting schedule is modified at high ages to graduate to 100% at age 65. In Table (4) below, I have demonstrated a way in which the vesting schedule in Bill S. 1179 could be graduated to 100% at age 65 for employment starting ages 45 to 64. In Table (1) above, the figures in brackets are taken from Table (4).

A very important consideration for selecting eligibility requirements for participation and a vesting schedule is the question of the effect of mobility among workers. Increasing mobility is now causing many workers to secure little or no vested benefits. An important criterion for judging a vesting schedule is therefore the results obtained by an Employee who changes jobs several times in his working career.

With this consideration in mind I have attempted to analyze the effect of the ~~operation~~ of the various vesting schedules that have been proposed. Tables (6), (7), (8) and (9) have been included for this purpose. The various vesting schedules analyzed are as follows:

RULE OF 50 (BILL S. 1631)

This type of vesting would provide for 50% vesting when the years of participation to the date of termination of employment plus the attained age at that date total 50 or more. If the total of "years plus age" equals more than 50, then for each additional year of participation an additional 10% is added. In order to have the vesting schedule operate smoothly at high ages, the schedule in the Bill has arbitrarily been adjusted as shown in Table (2).

TABLE 2.—ADJUSTMENT FOR RULE OF 50 SCHEDULE, PERCENTAGE OF VESTING AT SUCCESSIVE TERMINATION AGES

[In percent]

Participation starting age	At end of 1 year	At end of 2 years	At end of 3 years	At end of 4 years	At end of 5 years	At end of 6 years
49 to 59	50	60	70	80	90	100
60	60	70	80	90	100	
61	70	80	90	100		
62	80	90	100			
63	90	100				
64	100					

TEN-YEAR VESTING (BILL H.R. 2)

This type of vesting would provide for 100% vesting after 10 years of service. In order to have the vesting schedule operate monthly at high ages, the period of 10 years in the Bill has been arbitrarily reduced gradually to 1 year above age 55.

WILLIAMS-JAVITS VESTING (BILL S. 4)

This type of vesting would provide for 30% vesting after 8 years of participation increasing by 10% for each successive year of participation to 100% vesting after 15 years of participation. In order to have smooth operation at high ages, the schedule in the Bill has been arbitrarily adjusted as shown in Table (3).

TABLE 3.—ADJUSTMENT FOR WILLIAMS-JAVITS SCHEDULE, PERCENTAGE OF VESTING AT SUCCESSIVE TERMINATION AGES

[In percent]

Participation starting age	At age 58	At age 59	At age 60	At age 61	At age 62	At age 63	At age 64	At age 65
50	30	40	50	60	70	80	90	100
51	30	40	50	60	70	80	90	100
52	30	40	50	60	70	80	90	100
53	30	40	50	60	70	80	90	100
54	30	40	50	60	70	80	90	100
55	30	40	50	60	70	80	90	100
56	30	40	50	60	70	80	90	100
57	30	40	50	60	70	80	90	100
58		40	50	60	70	80	90	100
59			50	60	70	80	90	100
60				60	70	80	90	100
61					70	80	90	100
62						80	90	100
63							90	100
64								100

BENTSEN BILL (BILL S. 1179)

This type of vesting would provide for 25% vesting after 5 years of participation increasing by 5% for each successive year of participation to 100% vesting after 20 years of participation. In order to have smoother operation at high ages, the schedule in the Bill has been arbitrarily adjusted as shown in Table (4).

TABLE 4

ADJUSTMENT FOR BENTSEN SCHEDULE

PERCENTAGE OF VESTING AT SUCCESSIVE TERMINATION AGES

PARTICIPATION STARTING AGE	AT AGE 50	AT AGE 51	AT AGE 52	AT AGE 53	AT AGE 54	AT AGE 55	AT AGE 56	AT AGE 57	AT AGE 58	AT AGE 59	AT AGE 60	AT AGE 61	AT AGE 62	AT AGE 63	AT AGE 64	AT AGE 65
45	25%	30%	35%	40%	45%	50%	55%	60%	65%	70%	75%	80%	85%	90%	95%	100%
46	-	26%	32%	37%	42%	47%	53%	58%	63%	68%	74%	79%	84%	89%	95%	100%
47	-	-	28%	33%	39%	44%	50%	56%	61%	67%	72%	78%	83%	89%	94%	100%
48	-	-	-	29%	35%	41%	47%	53%	59%	65%	71%	77%	82%	88%	94%	100%
49	-	-	-	-	31%	38%	44%	49%	55%	62%	68%	74%	80%	88%	94%	100%
50	-	-	-	-	-	33%	40%	47%	53%	60%	67%	73%	80%	87%	93%	100%
51	-	-	-	-	-	-	36%	43%	50%	57%	64%	71%	79%	86%	93%	100%
52	-	-	-	-	-	-	-	38%	46%	54%	62%	69%	77%	85%	92%	100%
53	-	-	-	-	-	-	-	-	42%	50%	58%	67%	76%	84%	92%	100%
54	-	-	-	-	-	-	-	-	-	45%	55%	64%	73%	82%	91%	100%
55	-	-	-	-	-	-	-	-	-	-	50%	60%	70%	80%	90%	100%
56	-	-	-	-	-	-	-	-	-	-	-	56%	67%	78%	89%	100%
57	-	-	-	-	-	-	-	-	-	-	-	-	63%	75%	88%	100%
58	-	-	-	-	-	-	-	-	-	-	-	-	-	71%	86%	100%
59	-	-	-	-	-	-	-	-	-	-	-	-	-	-	83%	100%
60	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100%
61	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100%
62	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100%
63	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100%
64	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100%
65	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100%

MODIFIED RULE OF 45 VESTING (PROPOSED)

Under this vesting schedule (which I am submitting for consideration) vesting would be somewhat like that under the Rule of 50 proposed in the Administration Bill S. 1631 (H.R. 7157) but the 50% vesting point would be determined by a total of 45 for the years of service plus the attained age and the graduation would go both down from 50% to 10% and up from 50% to 100%. At the higher ages the schedule would be adjusted so as to reach 100% at age 65. This proposed schedule is demonstrated in Table (5) on Page 15. The Modified Rule of 45 is a hybrid between the Rule of 50 schedule and the schedule in Bill S. 4, which I believe would do a better job than either of those schedules.

ELIGIBILITY REQUIREMENTS (PROPOSED)

Combined with the Modified Rule of 45 vesting schedule, I suggest that the eligibility requirements for participation provided in Section 401(a)(11) as provided in Section 321 of Bill S. 1179 be changed to the following:

Employment starting age:	*Waiting period (years)*
20 through 24	3
25 through 29	2
30 and up	1

(With no minimum or maximum age limitations.)

COMPARISONS

Tables (6), (7), (8) and (9) analyze the five vesting schedules described above in companion with the pertinent eligibility requirements included in the four Bills and as proposed above.

Tables (7), (8) and (9) have been prepared in order to demonstrate how the five vesting schedules would operate in respect to a worker who moves from job to job throughout his working career. For the sake of comparison, immediate vesting has also been included. Also, because a Rule of 35 vesting schedule has been included in Section 401(d)(2)(A) as provided by Section 2(b)(2) of Bill S. 1631, Rule of 35 vesting has been included in Tables (7), (8) and (9).

From these tables the following conclusions seem appropriate:

(a) If an Employee moves frequently from job to job,

(1) Bill H.R. 2 would provide him with little or no vested benefits;

(2) Bill S. 4 would provide him with only slightly more benefits than Bill H.R. 2;

(3) Bill S. 1179 and Bill S. 1631 would provide him with more vested benefits particularly in the latter half of his working career;

(4) The Modified Rule of 45 would provide good vesting particularly at younger ages.

(b) If an Employee moves only a few times in his career,

(1) Bill .H.R. 2 will provide much the same vested benefits as immediate vesting;

(2) Bill S. 4, Bill S. 1631 and Modified Rule of 45 would all provide very good vested benefits;

(3) Bill S. 1179 would provide rather poor vesting considering the years spent on various jobs.

(See Pages 16, 17, 18 and 19 for Tables (6), (7), (8), (9)).

TABLE (5)

MODIFIED RULE OF 45

Employment Starting Age	Percentage of Vesting at Successive Termination Ages																																			
	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65
20	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
21	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
22	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
23	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
24	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
25	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
26	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
27	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
28	-	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
29	-	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
30	-	-	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
31	-	-	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
32	-	-	-	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
33	-	-	-	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
34	-	-	-	-	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
35	-	-	-	-	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
36	-	-	-	-	-	-	-	-	10	20	30	40	50	60	70	80	90	100	100	100	200	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
37	-	-	-	-	-	-	-	-	-	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
38	-	-	-	-	-	-	-	-	-	-	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
39	-	-	-	-	-	-	-	-	-	-	-	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
40	-	-	-	-	-	-	-	-	-	-	-	-	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
41	-	-	-	-	-	-	-	-	-	-	-	-	-	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
42	-	-	-	-	-	-	-	-	-	-	-	-	-	-	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
43	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
44	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
45	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
46	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100	100
47	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100	100
48	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100	100
49	-	-	-								-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100
50	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100
51	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100	100
52	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100	100
53	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100	100
54	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100	100
55	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100	100
56	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100	100
57	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100	100
58	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100	100
59	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	60	70	80	90	100
60	-	-	-								-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	60	70	80	90	100
61	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	70	80	90	100
62	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	80	90	100
63	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	90	100
64	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100
65	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100

EXAMPLE

For an employee commencing employment at age 32 and terminating employment at age 40, his vested benefit would be 60% of the value or benefit credited to him by age 40.

TABLE (6)

TYPE OF VESTING	EMPLOYMENT STARTING AGE	MINIMUM NUMBER OF YEARS FOR COMMENCEMENT OF VESTING	EARLIEST AGE FOR COMMENCEMENT OF VESTING	DEGREE OF VESTING AT COMMENCEMENT OF VESTING	EARLIEST AGE AT WHICH VESTING BECOMES 100%
Rule of 50 (Assuming Eligibility Requirements and Table (2) Adjustments)	20	17	37	50%	42
	30	12	42	50%	47
	40	7	47	50%	52
	50	3	53	50%	58
	60	3	63	50%	65
Representative Dent's Bill H.R.2 (Assuming 10 years vesting)	20	10	30	100%	30
	30	10	40	100%	40
	40	10	50	100%	50
	50	10	60	100%	60
	60	5	65	100%	65
Senators Williams & Javits Bill S.4 (Assuming Eligibility Requirements and Table (3) Adjustments)	20	9	29	30%	44
	30	9	39	30%	54
	40	9	49	30%	64
	50	9	59	30%	65
	60	1	61	60%	65
Senator Bentsen's Bill S. 1179 (Assuming Eligibility Requirements & Table (4) Adjustments	20	15	35	25%	50
	30	6	36	25%	51
	40	5	45	25%	60
	50	5	55	33%	65
	60	5	65	100%	65
Modified Rule of 45 (Based on Table (5))	20	9	29	10%	38
	30	4	34	10%	43
	40	1	41	30%	48
	50	1	51	50%	56
	60	1	61	60%	65

TABLE (7)

SIX JOBS GRADUALLY GETTING LONGER

JOB	EMPLOYMENT STARTING AGE	YEARS OF SERVICE	LEAVING AGE	EXTENT OF VESTING						
				IMMEDIATE	RULE OF 35 BILL S.1631	RULE OF 50 BILL S.1631	DENT BILL H.R.2 (10 yrs)	WILLIAMS-JAVITS BILL S.4	BENTSEN BILL S.1179	MODIFIED RULE OF 45
First	20	5	25	100%	0%	0%	0%	0%	0%	0%
Second	25	6	31	100%	60%	0%	0%	0%	0%	10%
Third	31	7	38	100%	100%	0%	0%	0%	30%	50%
Fourth	38	8	46	100%	100%	60%	0%	0%	35%	90%
Fifth	46	9	55	100%	100%	100%	0%	30%	40%	100%
Sixth	55	10	65	100%	100%	100%	100%	100%	100%	100%
TOTAL VESTING				600%	460%	260%	100%	130%	205%	350%

TABLE (8)

SIX JOBS GRADUALLY GETTING SHORTER

JOB	EMPLOYMENT STARTING AGE	YEARS OF SERVICE	LEAVING AGE	EXTENT OF VESTING						
				IMMEDIATE	RULE OF 35 BILL S.1631	RULE OF 50 BILL S.1631	DENT BILL H.R. 2 (10 Yrs.)	WILLIAMS-JAVITS BILL S.4	BENTSEN BILL S.1179	MODIFIED RULE OF 45
First	20	10	30	100%	70%	0%	100%	40%	0%	20%
Second	30	9	39	100%	100%	0%	0%	30%	40%	60%
Third	39	8	47	100%	100%	70%	0%	0%	35%	100%
Fourth	47	7	54	100%	100%	100%	0%	0%	30%	100%
Fifth	55	6	61	100%	100%	100%	0%	0%	56%	100%
Sixth	60	5	65	100%	100%	100%	100%	100%	100%	100%
TOTAL VESTING				600%	570%	370%	200%	170%	261%	480%

TABLE (9)

THREE JOBS GRADUALLY GETTING LONGER

				EXTENT OF VESTING						
JOB	EMPLOYMENT STARTING AGE	YEARS OF SERVICE	LEAVING AGE	IMMEDIATE	RULE OF 35 BILL S.1631	RULE OF 50 BILL S.1631	DENT BILL H.R. 2 (10 Yrs.)	WILLAIMS-JAVITS BILL S.4	BENTSEN BILL S.1179	MODIFIED RULE OF 45
First	20	10	30	100%	70%	0%	100%	40%	0%	20%
Second	30	15	45	100%	100%	100%	100%	90%	70%	100%
Third	45	20	65	100%	100%	100%	100%	100%	100%	100%
TOTAL VESTING				300%	270%	200%	300%	230%	170%	220%
Figures doubled in order to facilitate comparison with **Tables** (8) and (9)				600%	540%	400%	600%	460%	340%	440%

Combining the proposed eligibility requirements with the proposed Modified Rule of 45 vesting schedule, we would have the following:

TABLE 10

Employment starting age	Participation starting age	Vesting starting age	Initial degree of vesting (percent)	100 percent vesting starting age
20	23	29	10	38
25	27	31	10	40
30	31	34	10	43
35	36	36	10	45
40	41	41	30	48
45	46	46	50	51
50	51	51	50	56
55	56	56	50	61
60	61	61	60	65

Comparing this table with Table (1), it will be seen that the Modified Rule of 45 starts vesting at an earlier age at a smaller percentage and that it attains full vesting at an earlier age.

Although vesting of 50% or 60% at 1 year after employment may seem rather high, it must be remembered that this is 50% or 60% of not very much in value.

VESTING OF PAST SERVICE BENEFITS

Section 401(a)(12) as provided in Section 322 of Bill S. 1179 would require vesting of only benefits accruing in respect to service subsequent to the establishment of a plan, except that for an Employee age 45 or more on the effective date of the Bill all benefits accrued prior to such date must vest.

For Employees age 45 or more on the effective date, this would perhaps be satisfactory but it would mean discrimination against Employees under age 45 at that time. For example, an Employee age 44 on the effective date might have much more service than an Employee age 45 but the former would be credited with only benefits accruing after the effective date apparently.

I suggest that 401(a)(12) be amended to provide for the vesting schedule to apply to all benefits that have accrued at the effective date, subject to any deferment permitted by the Secretary under the terms of 401(a)(12)(B). Discrimination could be avoided in this way.

LOCKING—IN FEATURE

Section 401(a)(14) as provided in Section 322 of Bill S. 1179 requires that the Employee's interest be non-assignable. This restriction seems to apply to only the period while the Employee's interest remains in the plan.

This provision is much like that now contained in Section 401(g) of the Code, which requires an annuity contract owned by other than a trustee to be non-transferable.

I suggest that 401(a)(14) and/or 401(g) be amended to require the Employee's interest (whether in the form of an annuity contract or otherwise) to be non-assignable at all times.

In fact, I would suggest that any vested interest that an Employee receives should be non-commutable as well as non-assignable and non-transferable (subject to such interest being transferable to another type of tax-deferred plan, account or contract). This would prevent a terminating Employee from "cashing-in" his vested interest before retirement. For a more complete discussion of "locking-in" please see Pages 548 through 552 of the records of the Senate Labor Subcommittee Hearings on Bill S. 3598.

MATURITY DATE

Section 401(a)(15) as provided in Section 322 of Bill S. 1179 would require that any vested benefit arising out of a normal qualified plan must be distributed no later than the Normal Retirement Age specified in the plan.

Most plans permit an Employee and his Employer to agree to defer the receipt of a retirement benefit to some date after Normal Retirement Age. The Internal Revenue Code now contains no restrictions applicable to normal qualified plans in respect to the maturity date.

The Code requires that a Keogh plan provide that an Owner-Employee must receive or commence to receive his retirement benefit no later than age 70½. See Section 401(1)(9) of the Code.

Under 409(a)(5) as provided in Section 342 of Bill S. 1179, an Employer's interest in a QIRA must be distributed or commence to be distributed no later than age 70½. A similar provision is contained in the Administration Bill S. 1631 (H.R. 7157).

I suggest that the vested benefits and the retirement benefits be permitted to be deferred to any age not later than age 70½ by which time such benefits must be distributed or commence to be distributed. There seems to be no reason why there should not be uniformity among all types of plans, accounts and contracts on this point.

TAX-FREE TRANSFERS—PORTABILITY

At the present time, the full amount of a lump sum distributed by a qualified pension or profit sharing plan under Sections 402(a)(1) and 403(a)(1) of the Internal Revenue Code can be transferred tax-free to an annuity contract under Section 72(h) of the Code, subject to certain conditions. No other type of tax-free transfer is permitted.

Under Sections 301 through 305 in Title III of Bill S. 4 provision would be made for tax-free transfers of vested benefits from 401(a) and 404(a)(2) plans to a "Special Fund" to be established and operated by the Secretary of Labor. Subsequently, the Employee could, if he wishes and if it is feasible, arrange for his vested benefit to be transferred tax-free from the "Special Fund" to another 401(a) or 404(a)(2) plan or to a single premium annuity purchased from a life insurance company. Title I of Bill H.R. 462 contains similar provisions.

Under proposed Sections 219(c), 72(p)(2), 402(a)(6), 402(a)(7)(A), 403(a)(4)(C) and 403(a)(5)(A) as they would be amended by Sections 3(a), 3(c), 5(a) and 5(b) of the Administration Bill S. 1631 (H.R. 7157) provision would be made for several types of tax-free transfers, as follows:

(a) From one QIRA to another QIRA;

(b) From a 401(a) plan to a QIRA, another 401(a) plan or a 404(a)(2) plan;

(c) From a 404(a)(2) plan to a QIRA, another 404(a)(2) plan or a 401(a) plan. However, no provision would be included for the following types of tax-free transfers:

(1) From a QIRA to a 401(a) plan, a 404(a)(2) plan, a 405(a) plan or a 403(b) annuity contract;

(2) From a 405(a) plan to a QIRA, a 401(a) plan, a 404(a)(2) plan or a 403(b) annuity contract;

(3) From a 403(b) annuity contract to a QIRA, a 401(a) plan, a 404(a)(2) plan or a 405(a) plan.

All of the tax-free transfers under (a), (b) and (c) above as provided for Bill S. 1631 (H.R. 7157) would require transfer of only the full lump sum distribution (i.e. a part only of the lump sum could not be transferred).

Under Section 409(d)(2) as provided in Section 342 of the Bill S. 1179, tax-free transfers would be permitted between one QIRA and another QIRA of the full lump sum distribution or any part of it.

I suggest that 409(d)(2) be expanded to cover the full range of possible transfers, into and out of QIRA's, at the same time retaining the present provision that all or any part of the lump sum distribution may be transferred tax-free.

In addition, I suggest that a new section or sections be added to Bill S. 1179 that would amend the Internal Revenue Code so as to permit all of the types of transfers listed in (a), (b), (c) and (1), (2) and (3) above that all or any part of the lump sum distribution may be transferred tax-free. Included in this would be transfers into and out of Keogh plans from and to any of the various other plans, accounts and contradts.

If the Code is amended as suggested, it should be made clear that receipt of a lump sum distribuiton from one plan by a taxpayer and the transfer of part or all of it to another plan will not constitute actual or constructive receipt of the amount transferred even though the moneys involved may pass through the hands of the taxpayer.

If the Internal Revenue Code is amended as suggested, then I feel that it would be unnecessary to provide for the establishment of a "Special Fund" as contained in Bill S. 4. The wide range of tax-free transfers that would be available would be more useful to the Employee.

DISTRIBUTION ON TERMINATION OF PLAN

Sections 402(a)(1) and 40(a)(1) of the Internal Revenue Code provide that any distribution made to anyone under a qualified plan is taxable to him in the year of distribution. However, if this distribution is a total distribution and if it is made in respect to an employee's death or termination of employment, an ncome-avergaing option under Section 72(n) is available to the recipient of the distribution.

A corollary of this provision for an optional method of taxation is that, if the distribution does not result from a termination of employment but from a termination of a plan, the special income-averaging option in Section 72(n) is not available. Moreover, the "three-year-spread" for the taxation of an annuity that is provided under Section 72(d) is also not available for a distribution resulting from a plan termination.

Quite frequently a termination of a plan occurs only a short time before or after termination of employment. As a matter of fact, a termination of a plan and a termination of employment frequently result from the same cause and are in essence parts of the same event. Moreover, the question of which action (termination of plan or termination of employment) occurs first is little more than a technicality and in many cases an accidental and unconsidered technicality.

From a legal and social point of view, I suggest that, in many (if not in all) cases, the same tax treatment should be granted to a total distribution on plan termination as for a total distribution on employment termination.

Thus I would suggest that Section 402(a)(1) and 403(a)(1) of the Code should be amended to include plan termination and that the tax-free transfer provision discussed above apply equally to distributions on termination of plans.

CENTRAL PENSION REGISTRY OFFICE

During the course of his working career an employee is likely to work for several employers and to participate in several pension and/or profit sharing plans. Thus when he (or she) reaches retirement, he could have to his credit several pieces of pension benefits scattered among the various plans that he participated in. At retirement, he will need to arrange for these several pieces to commence to be paid. Unless he is a particularly careful man throughout his career, he will experience difficulties in keeping track of the various pension credits and at retirement in making arrangements for them to commence.

It is likely that, for at least some of the pieces of pension, he will have received certificates informing him of the details. However, during the course of many years various things could have happened in respect to his certificates, for example:

(a) A certificate could have been lost or destroyed.

(b) An employer could have gone out of business but his plan have continued under the custody of a trustee.

(c) The trustee of a plan could have been changed from one entity to another.

(d) An employer and his plan could have changed their names.

(e) An employer could have moved.

(f) An employer could have merged into another employer.

(g) The trustee of a plan could have changed its name and/or its address.

Any of these and other events (e.g. the failure to receive a certificate in the first place) could have occurred with the result that the retiring employee might encounter considerable difficulty in locating the whereabouts of a particular pension credit and might not be able to arrange for it to commence to be paid.

Therefore I suggest that provision be included in Bill S. 1179 for the establishment of a Central Pension Registry Office and that all administrators of all plans be required to supply to such Office details of all vested pension credits. Such Office would then be required to maintain a permanent record of such details and to assist a retiring worker to arrange for the commencement of his pension benefits.

QIRA accounts which would be provided for in Sections 341 through 345 of Bill S. 1179 would need to be qualified and recorded. I suggest that the Central Pension Registry Office could be used to maintain a registry of QIRA accounts.

FUNDING

The Internal Revenue Code in Section 404(a)(1)(C) at present limits tax deductions in any one year in respect to contributions for past service benefits under a pension plan to not more than one-tenth of the original outstanding liability. The theory for this limitation apparently is that an employer should not be permitted to pick and choose from a tax point of view when he would discharge his past service liability. It would seem that from a social point of view, this limitation is very short-sighted. It would seem to be very desirable socially to have as many pension plans as possible as close to being fully funded as possible.

Therefore I recommend that the Internal Revenue Code be amended to permit an employer to take tax deduction in respect to any amount contributed up to the full amount of the outstanding past service liability or experience deficiency.

Otherwise I have no comments or suggestions to make in connection with funding except to say that I am pleased to see provision in Section 401(j)(4) as provided under Section 328 of Bill S. 1179 that level premium funding under life insurance company individual contracts would be acceptable.

PLAN TERMINATION INSURANCE

Although this type of insurance involves problems and uncertainties, I feel that it is important that an insurance program should be undertaken. No doubt as the years pass, it will be necessary to make amendments in it to arrive at a smoothly working program.

The provisions contained in Sections 401 through 407 as provided by Section 345 of Bill S. 1179 seem to be well designed, except for one aspect. Section 405(a) states that the insurance benefit will be paid "upon the termination of a member plan." There seems to be no definition in the Bill as to what constitutes a termination of a plan. This point becomes particularly important when an Employer partially terminates a plan.

In this connection, Section 402(a) of Bill S. 4 uses the expression "complete or substantial termination . . . . as determined by the Secretary." Admittedly this is not a clear-cut definition but at least it recognizes that there can be partial terminations and it provides for an authority to make decisions as to whether there are insured partial terminations.

There is probably just as much need for insurance under partial plan terminations as under complete plan terminations. This is largely intelligent guessing because no statistics seem to be available in respect to partial terminations.

I suggest that Section 405(a) of Bill S. 1179 be amended to include a wording like that in Section 402(a) of Bill S. 4, with the result that the insurance program would be expanded to undertake coverage of partial plan terminations.

It is realized that Section 401(e) as provided in Section 328 of Bill S. 1179 uses the expression "termination or substantial termination (as determined by the Secretary or his delegate)." However, this Section 401(e) seems to be related to the vesting schedule to be used in case of a plan termination rather than being related to the insurance risk to be covered under Section 405(a).

INCOME TAX TREATMENT OF LUMP SUM DISTRIBUTIONS TO EMPLOYEES

Under "Locking-In Feature," I have suggested that the vested benefit should be non-commutable so that an Employee would not be able to "cash-in" the distribution he becomes entitled to and would have to receive his vested interest in the form of a retirement income.

If such suggestion is not adopted, then I suggest that the Subcommittee give careful consideration to the methods used for taxing distributions to Employees from the various types of tax-deferred plans, accounts and contracts. In particular I suggest that the taxing provisions contained in Sections 72(e), 72(n), 72(m), 402(a)(1), 402(a)(2), 403(a)(1), 404(a)(2) and 1379(b) be reviewed with a view to obtaining the following objectives:

(a) Consistency of treatment among the various kinds of taxpayers.

(b) Consistency of treatment among the various types of retirement plans, accounts and contracts listed under "Uniformity" above.

(c) Simplification of the tax treatments and procedures to reduce expenses for all concerned.

All of this review, I suggest, should be done with a view to obtaining the maximum social benefits consistent with protection of the tax revenue. The present provisions for taxing various distributions are highly complex and contain many inconsistencies.

Under Section 409(d) of the Code as it would be provided by Section 342 of Bill S. 1179, a distribution to an Employee under a QIRA plan would be treated for tax purposes as a distribution to an Owner-Employee under a Keogh Plan.

BEST COPY AVAILABLE

Provision for a similar tax treatment is included in Section 408(d) as provided in Section 8(b) of Bill S. 1631. I suggest that a distribution under a QIRA plan associated with a regular 401(a) plan should be treated like a distribution to an ordinary Employee out of a regular corporate qualified plan.

A vested benefit that becomes vested in n Employee in a normal qualified plan is not available to him while he remains in the plan. Even though the benefit under a QIRA would be immediately and fully vested in the Employee, I suggest that it should be treated like the benefit that vests in him relative to the Employer's contributions. That is to say, it should be unavailable to him until he leaves the plan. I suggest that it then be treated taxwise like the vested benefit arising from the Employer's contributions.

Throwing the vested benefit arising from the Employee's contributions and the vested benefit arising from the Employer's contributions together into one distribution would greatly simplify the administration of pension plans, would reduce the cost of administration and would encourage Employers and Employees to make full use of QIRA's. Any procedure that will encourage Employees to set aside savings for retirement is certainly socially desirable.

INCOME TAX TREATMENT OF DEATH BENEFITS

Like the distributions to Employees, the income tax treatments applied to the benefits paid on the deaths of Employees under the various types of tax-deferred plans, accounts and contracts are complicated and inconsistent.

Under Section 101(b)(1), (2) and (3) of the Internal Revenue Code, death benefits arising out of the various plans, accounts and contracts listed under "Uniformity" above are subject to income tax. However, death benefits arising from certain annuities given income tax relief under Section 403(b) are treated differently to the majority of such annuities. Similar death benefits under Keogh plans in respect to self-employed persons are treated differently to those in respect to ordinary Employees.

Section 409 as provided in Section 342 of Bill S. 1179 seems to contain no provision in respect to the taxing of a death benefit arising out of a QIRA plan. On the other hand, Section 101(b)(2)(B) of the Code would be amended by Section 3(e)(4) of Bill S. 1631 to provide that a death benefit under a QIRA plan would be treated like a death benefit relative to a self-employed person under a Keogh plan. Thus the tax treatment under a QIRA plan would be different to that given to the death benefit under a normal qualified plan.

Although Section 1379 of the Code relative to certain qualified plans in respect to "electing small business corporation" contains some special requirements that results in these plans being treated somewhat like Keogh plans, the death benefits under these plans are treated like those from regular qualified plans.

I suggest that these various inconsistencies are unnecessary and that all death benefits from all types of tax deferred plans, accounts and contracts should be given the same income tax treatments.

ESTATE TAX TREATMENT OF DEATH BENEFITS

Like the income tax treatments applied to various death benefits, the estate tax treatments applied to the death benefits paid under the various types of tax-deferred plans are complicated and inconsistent.

Under Section 2039(c) of the Code, death benefits arising out of the various plans, accounts and contracts listed under "Uniformity" are generally exempt from estate tax to the extent they result from Employer contributions. However, death benefits arising from certain annuities given income tax relief under Section 403(b) are not exempt and so are treated differently from the majority of such annuities. Similar death benefits under Keogh plans in respect to self-employed persons are treated differently.

Neither Bill S. 1179 nor Bill S. 1631 seems to contain any provision amending Section 2039(c) of the Code. Presumably the intention is that the death benefits arising out of QIRA plans would not be exempt from estate tax, which would mean treating these death benefits differently to those arising from normal qualified plans.

I suggest that these inconsistencies are unnecessary and that all death benefits from all types of tax deferred plans, accounts and contracts should be given the same estate tax treatments.

TAX CREDITS FOR QIRA PLANS

I am ~~pleased to~~ see that provision has been included in Bills S. 1179 and S. 1631 whereby Employees would be able to make contributions to "Qualified Individual Retirement Accounts" (QIRA) and to secure tax credits in respect to them. I have long advocated that the Internal Revenue Code be amended to encourage individual Employees to set aside savings for retirement.

In October and November, 1972, I presented a paper at two conferences discussing the first version (Bill H.R. 12272) of the Administration Bill S. 1631 and submitted 11 proposals for dicussion. A copy of that paper is included as Appendix "A" to this statement. Of the 11 proposals, I believe 2 (Nos. 3 and 5) have been adequately included in the new Bill. A third proposal (No. 10) has been partially included. I still recommend the inclusion of the balance of No. 10 and of the remaining proposals.

I am very pleased to see the provision in Section 42 for a tax credit in lieu of a deduction from adjusted gross income as would be provided by Section 219 as provided by Section 3(a) of Bill S. 1631 (H.R. 7157). Since this tax credit met~~hod would~~ not interfere with the standard deduction procedure now included in Section 141 of the Code, it is much to be preferred for Employees in the lower income brackets.

However, I feel that the limits provided in Section 42(b)(1) are too small and that the offsetting procedure with respect to Employer contributions defined in Section 42(b)(2) is too severe and too complicated.

Regarding the size of the tax credit, I suggest that there be two limits as follows:—

(a) If the Employer of the Employee is contributing on his behalf to a qualified 401(a) or 404(a)(2) plan or to a 403(b) annuity contract, the Employee can contribute to a QIRA plan any amount up to the lesser of $3,000 or 20% of earned income, which would be translated into a tax credit at a rate of 25%.

(b) If the Employer of the Employee is not contributing on his behalf to a qualified 401(a) or 404(a)(2) plan or to a 403(b) annuity contract, the Employee can contribute to a QIRA plan any amount up to the lesser of $4,000 or 20% of earned income, which would be translated into a tax credit at a rate of 25%.

This would mean a tax credit of not more than $750 if there are Employer contributions or not more than $1,000 if there are no such contributions. This method would be much simpler to administer than the method described in Section 42(b)(2) because the actual amount of Employer contributions would ~~not need to~~ be calculated. Even the use of the 7% rate for Employer contributions is not as simple as the two-level method suggested.

Moreover, the limits of $750 and $1,000 are more reasonable than the $375 limit in Section 42(b)(1) when one takes into account the fact that contributions for a QIRA plan are not likely to commence before an Employee attains age 45 or 50 with contributions running for only 15 or 20 years.

Annual contributions of $4,000 per year (producing a tax credit of $1,000 per year) for 20 years (age 45 to 65) with 6% compound interest would produce an annual retirement pension at 65 of about $16,000 per year for life. This can be considered an extreme example since it is based on high interest rate for a long period and on a life annuity without any refund period. To be able to contribute $4,000 per year an Employee would have to earn $20,000 or more every year for 20 years, and be able to set aside savings of $4,000 every year. Also he would have to be employed for all of the 20 years by an Employer with no pension plan. An annual pension no greater than 80% of earned income is not exorbitant. It can therefore be assumed that, even with contributions as large as $4,000 per year, the contributions will provide only reasonable retirement pensions when compared with earned incomes.

Moreover, contributions limits of $3,000 and $4,000 are quite reasonable when compared with the limit of $7,500 proposed for Keogh Plans by the Administration in Bill S. 1631 (H.R. 7157).

Carry-over period

Under Section 7(g)(4) of the Administration Bill S. 1631 (H.R. 7157), Section 404(a)(6) of the Internal Revenue Code would be amended to permit contributions made by an Employer to a 401(a) plan or a 404(a)(2) plan (including a Keogh plan) to be made any time up to the filing date of the Employer's Income

Tax Reform (i.e. April 15 for a cash basis taxpayer) and have such contributions count for the taxable year covered by the Income Tax Return.

I believe that this is an excellent provision, especially for Keogh plans, and therefore suggest that such provision should be included in Bill S. 1179.

Regarding QIRA plans, please set the discussion under "Excess Contributions under QIRA Plans" below.

Many individuals, even though they may be basically employees, have income other than wages. They may be receiving interest or dividends on investments or other income not includible in "earned income" and it may be a variable amount. In the case of a self-employed person or a person partially self-employed, he cannot know until a taxable year is over what his actual "earned income" amounts to. Moreover, even is a taxpayer knows before the taxable year ends exactly what his earned income amounts to, he may know what his expenses amount to. For all these reasons a taxpayer may not know before the end of a taxable year what amount he will be able to contribute to a QIRA plan.

EXCESS CONTRIBUTIONS UNDER KEOGH PLANS

Sections 401(e)(1), (2) and (3) of the Internal Revenue Code spell out in much detail the limits permitted for contributions on behalf of an Owner-Employee, the procedures to be followed if excess contributions are made, unintentionally or wilfully, and the penalties imposed on the Owner-Employee for having made excess contributions.

The concept used as a basis for Section 401(e) seems to be that it is wrong for excess contributions to be made, that they must be got rid of as quickly as possible and, if they are not got rid of, the Owner-Employee must be severely penalized.

Requiring the excess contributions to be refunded is an expensive procedure for the insurance company and other respositories of Keogh plan funds, which expense must be passed along to the taxpayer.

I suggest that excess contributions are not a serious matter and that, providing a reasonable penalty is imposed on them, there is no real need to require them to be got rid of. Therefore, as a penalty that would be sufficient to discourage an Owner-Employee from making an excessive contribution, I suggest the following:

(a) That no tax deduction for excess contributions be allowed at the time they are made.

(b) That excess contributions be "locked-in" along with the legitimate contributions and be withdrawable only with the benefits from the legitimate contributions.

(c) That the benefits arising from the excess contributions be taxed in the same way as the benefits from legitimate contributions.

Procedurally this treatment of excess contributions would be much simpler and the penalties imposed should be severe enough to result in almost no excess contributions being made. Double taxation of the excess contributions together with such contributions being unavailable to the Owner-Employee for years to come are severe penalties.

Thus, I suggest that Section 401(e) of the Code be completely rewritten to carry out the procedures described in (a), (b) and (c) above. Further I suggest that the penalty provided in 401(e)(2)(E) of requiring the Keogh plan insofar as the Owner-Employee is concerned to be terminated and of not permitting him to start another one for 5 years is unnecessary.

As an alternative, if the carry-over period discussed above is provided in Section 404(a)(6) of the Code, and if the excess contributions is made in the carryover period, it should be feasible to treat the excess contributions as a payment on account of the succeeding taxable year (i.e. the taxable year in which the excess is actually made). This would provide a very much simpler treatment of the excess contributions.

EXCESS CONTRIBUTIONS UNDER QIRA PLANS

Section 342 of Bill S. 1179 would add Section 409(b)(2) to the Internal Revenue Code, which would render Section 401(e)(2) and (3) of the Code applicable to QIRA plans. As a result an excess contribution to a QIRA plan would need to be refunded and penalties would be imposed on the Employee owning the QIRA plan.

Requiring excess contributions under a QIRA plan to be treated like excess contributions under a Keogh plan raises the objections discussed above.

Section 8(a) of Bill S. 1631 (H.R. 7157) would provide in Section 219(f) that a contribution to a QIRA plan can be made any time up to the filing date of the Employee's Income Tax Return for a particular taxable year and have it counted for that year. Judging by years of experience in Canada with Registered Retirement Savings Plans (much like QIRA plans), it is most likely that by far the major portion of the contributions to QIRA plans will be made in the carry-over period between the end of the taxable year and the filing dates of the Income Tax Returns.

Instead of requiring an excess contribution to be refunded under 401(e)(2) and (8), it would be very much simpler to permit the excess contribution to be applied on account of the contribution for the next taxable year.

Therefore I suggest:

(1) That Section 409(b)(2) be deleted from Section 342 of Bill S. 1179.

(2) That a section like Section 219(f) now included in Section 8(a) of Bill S. 1631 (H.R. 7157) be added to Bill S. 1179.

(8) That, if Section 401(e) of the Code is rewritten as discussed in connection with excess contributions under Keogh plans, it provide for excess contributions under QIRA plans to be similarly treated.

PREMATURE DISTRIBUTION UNDER A QIRA PLAN

In the event of a premature distribution under a Keogh Plan, two penalties are imposed on the Owner-Employee as follows:

(a) Under Section 72(n)(5) of the Internal Revenue Code, the full amount of the distribution is taxable in the year of distribution under either of two methods depending on the size of the distribution;

(b) Under Section 401(d)(5)(C) of the Code, the Owner-Employee is barred from participating in a Keogh Plan for the next 5 years.

It is suggested that, in event of a premature distribution under a QIRA plan, only two penalties like those for a premature distribution under a Keogh Plan should be imposed, namely:

(1) Include the full distribution in the gross income for the taxable year of the distribution (except any part of it that is transferred to another qualified plan);

(2) Bar the Employee from securing tax credits in respect to contributions to any type of qualified plan for the next 5 years.

It is suggested that these two penalties would be severe enough and that the 30% tax penalty proposed in Section 72(p)(2) as provided in Section 342 of Bill S. 1179 is much too severe and unnecessary.

SALARIED-ONLY PLANS

Subsections (3) and (4) of Section 401(a) of the Internal Revenue Code establish the criteria on which discrimination among eligible Employees is determined. The Internal Revenue Service applies these criteria very strictly when deciding whether a plan can be qualified.

A situation that has been a source of repeated trouble over the years is where an Employer has both union and non-union Employees, the latter generally being salaried. Frequently a union will negotiate an agreement which does not include a pension plan. If the Employer then attempts to establish a pension plan for the non-union Employees, the I.R.S. requires the plan to be open to all Employees, union and non-union. Since the union does not wish to have a pension plan and the Employer does not wish to provide a benefit that is not provided for in the union agreement, the criteria in 401(a) (3) and (4) usually prevents the Employer from establishing a plan for its non-union Employees, which, of course, is harmful from a social point of view.

Section 7(b) of the Administration Bill S. 1631 (H.R. 7157) would amend 401(a)(3)(A) of the Code to provide that, when the percentages are being applied, the union Employees who do not wish to be covered by a pension plan may be omitted.

I suggest that an amendment along the same lines be included in Bill S. 1179.

SMALL EMPLOYERS

Appended to this statement are two memorandums labelled "Part O" and "Proposed Sections 401 and 404 of the Internal Revenue Code." (Appendices "B" and "C").

Part "O" discusses at some length the need for something to be done to assist small Employers to establish pension plans for their Employees. It makes some suggestions for a tax incentive to encourage them to do so.

The other memorandum is intended to demonstrate how Sections 401 and 404 of the Code might be worded to carry out all the suggestions in Part "O".

I would urge that consideration be given to amending Sections 401 and 404 of the Code to initiate some program along the lines proposed in Part "O".

TAX DEFERRED 403(B) ANNUITY CONTRACTS

Section 403(b) of the Internal Revenue Code permits a particular kind of employer to purchase an annuity contract for an employee and to make contributions to it without such contributions being treated as income received by the employee.

The employer must be in either of these two classes:

(1) An organization that comes within the meaning of Section 501(c)(3) of the Code, which means an organization operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes or for the prevention of cruelty to children or animals;

(2) A public educational institution within the meaning of Section 151(e)(4) of the Code, which means any public primary, secondary or college level educational institution.

Although there are many employers within the range of these two classes and although they have many employees, proportionate to the total body of employees in the country, these employees are not a large group.

Section 403(b) states that the annuity contract must be purchased by the employer. Even so, almost all of the moneys used for contributions for these contracts are really employees' moneys. This situation has developed because the Internal Revenue Service has permitted an employee and his employer to agree to a reduction in pay with the reduction being used as a contribution to the annuity contract. By this means the employee obtains what is in effect a deduction from gross income for tax purposes, because his gross income is reduced.

In effect, 403(b) annuity contracts have been and are vehicles somewhat like QIRA plans for only a select group of Employees. Assuming QIRA plans with reasonable limits become available, I am in favor of removing Section 403(b) from the Code. There seems to be no reason why a select group of Employees should be treated differently than Employees generally. They should be subject to the same limits, restrictions and tax treatments as Employees generally.

If a 501(c)(3) Employer wishes to make contributions for retirement pensions for its Employees there is no reason why it cannot establish a qualified plan under Sections 401(a) or 404(a)(2) of the Code. It is true that a 501(c)(3) organization is not a taxpayer but that is no reason for not establishing a qualified plan. Moreover, using a qualified plan would require an Employer to not exercise any discrimination among its Employees which it can do under Section 403(b).

Even if Section 403(b) is not removed from the Code, I suggest that an Employee of one of the Employers described above should not be permitted to arrange for the purchase of a 403(b) annuity contract by agreeing with his Employer to reduce his earned income. He should be required to use the QIRA method.

LIMITS ON PENSIONS AND/OR CONTRIBUTIONS

At the present time, the Internal Revenue Code provides in Section 401(e)(1)(B) that contributions to a Keogh Plan in respect to an owner-employee may not exceed the lesser of $2,500 or 10 percent of earned income.

Similarly, at the present time, Section 1379(b) of the Code provides that contributions to a pension plan established by an "electing small business corporation" in respect to a shareholder-employee may not exceed the lesser of $2,500 or 10 percent of his compensation from such corporation.

At the present time, Section 403(b)(2) of the Code provides that contributions made by an employer for a tax deferred annuity contract for an employee may not exceed an "exclusion allowance" calculated in accordance with a complicated formula applied to the employee's compensation.

Aside from these existing limitations, the Code does not contain any limitations on either the contributions that an employer or an employee may make or on the pensions that may be provided for an employee.

Bill S. 1631 (H.R. 7157) in Section 4(a)(2) would raise the limits for an owner-employee to $7,500 and 15%, respectively. Similarly, in Section 4(b) it would raise the limits for a shareholder-employee to the same limits. Bill S. 1631 as submitted does not contain any provision for changing the limitations in Section 403(b)(2).

Section 7(h) of Bill S. 1631 would insert a new Section 409 which would limit the deduction that an employer may obtain under a money-purchase type of pension plan to not more than 20% of the compensation paid to an employee by the employer.

Bill S. 1179 does not contain any provision for changing any of the limits presently included in the Code.

At the beginning of this statement (Page 1), I outlined a basic pension philosophy, in which I stated that I felt that every worker and/or his employer should be encouraged to accrue reasonable savings for his retirement. However, because the encouragement that is provided for a particular taxpayer through the tax deduction granted to the worker and/or his employer is in effect provided by the body of taxpayers in general, it is only reasonable that the encouragement should not be granted beyond some reasonable point. Having in mind that the tax relief is provided by taxpayers who do not secure such relief as well as by those who do, a limit on the relief would be particularly reasonable and equitable.

Therefore I submit that, as a part of the pension philosophy referred to above, the amount of the contributions that may be used for tax deduction should be limited, regardless of which party makes such contributions. The problem is to determine what is the reasonable point beyond which tax deduction should not be allowed.

One approach would be to set a maximum amount of pension in the law and then limit the contributions for which tax deduction is available to whatever amount would accrue savings sufficient to procure a pension not larger than the prescribed amount. In theory this would seem to be a fairly simple solution but to attempt to put it into practice would be highly complicated and therefore expensive to the taxpayer and/or his employer. To mention only a few of the complications:

(a) There are pension plans based on defined benefit formulae under which contributions are determined by calculation as those necessary to accrue savings sufficient to procure a pension determined by a specific formula;

(b) There are pension plans based on contributions determined by a specified formula under which the pension payable is that procured by the accumulated savings: the size of the pension depends on the interest and appreciation added to the contributions and the rates used to convert the savings into pension payments;

(c) There are profit sharing plans similar to the pension plans described in (b);

(d) In addition to qualified pension and profit sharing plans for regular incorporated business, there are Keogh (H.R. 10) plans and tax-deferred 403(b) annuities;

(e) If the law is suitably amended, there would be tax deductions for employee contribution to regular qualified plans as well as for employer contributions;

(f) Also, if the law is suitably amended, there would be tax deductions for contributions to Qualified Individual Retirement Accounts (QIRA).

To attempt to establish one overall limit applicable to any and all the combinations of the different plans and the variations possible under (a) through (f) would be immensely complicated.

Therefore, the only practical solution, I suggest, is to set separate limits for the different plans and situations described under (a) and (f) above. This would not provide a perfectly integrated solution but it should provide a practicable and workable solution.

Insofar as all of the retirement plans, accounts and contracts defined under "Uniformity" on Pages 2 and 3 are concerned, I suggest that there should be separate deduction limits for each of:

(a) the part of the plan supported by the employer's contributions, and (b) the part of the plan supported by the employee's contributions.

For the part supported by the employer's contributions, I suggest that the deduction available should be any amount required by the formula in the plan but not exceeding whatever would be needed to procure a pension equal to the least of the following:

(a) An annual pension of $50,000;

(b) A pension equal to 60 percent of the average annual remuneration in the last 5 years preceding retirement;

(c) A pension equal to 2 percent of the average remuneration in the last 5 years preceding retirement multiplied by the total number of years of service with the employer up to 30 years.

I suggest that the employer should have the privilege of taking deductions for any amount he chooses to contribute so long as there exists an outstanding liability.

I should mention that a profit sharing plan is included in the list under "Uniformity" (Page 2). In essence, a profit sharing plan is just another type of a pension plan. A profit sharing plan and a pension plan are provided for under the same sections of the Internal Revenue Code. The purpose of both plans is the same—to encourage the accumulation of funds for the purpose of providing retirement incomes for participants. I view a profit sharing plan as a pension plan with a different method of determining the employer's contributions to it.

For the part supported by the employee's contributions, I suggest that the deduction available should be any amount that the employee contributes up to $3,000 per year, without any offset in respect to his employer's contributions. Part of these employee contributions could be mandatory, if the plan is so designed, with the balance being voluntary. Or the plan could have no mandatory employee contributions, in which case all of the deduction limit could be used for voluntary contributions.

The limits described above are suggested for the following reasons:

(1) It is reasonable to put a limit on the benefits that may be provided, because the contributions are deductible from income so that no tax is payable currently and, even though tax is payable on the benefits derived from such contributions, such tax is almost always at a lower rate than the tax on the contributions would have been. The tax that is not paid on the contributions is in essence paid by the general body of taxpayers. It is only fair and reasonable that there should be a reasonable ceiling put on the contributions and deductions permitted.

(2) The limit on employee deductions should be high enough to encourage employee savings and at the same time should not be unreasonably high because of the tax relief provided at the expense of the general body of taxpayers.

(3) The limit on employee deductions should be as simple and understandable as possible. For this reason, the limit should also operate independently from the employer contributions.

As discussed on Page 32, I have suggested that Section 403(b) should be removed from the Code if reasonable limits are provided for QIRA plans. However, if Section 403(b) is not removed, I suggest that a contribution limitation along the lines proposed above should be substituted for the limitation on the "exclusion allowance" prescribed in Section 403(b)(2).

Supplementary Statement by Norman H. Tarver

Commenting on: (a) Statement submitted on May 31, 1973, by Professor Daniel Halperin to the First Panel Discussion on Private Pension Plan Reform;

(b) Statement submitted on June 4, 1973, by Professor Merton Bernstein to the Second Panel Discussion on Private Pension Plan Reform.

Appended to the statement that I submitted for inclusion in the records of the Hearings held on May 21, 22 and 23 by the Subcommittee on Private Pension Plans is Appendix "A", "Personal Retirement Savings Plans", which is a paper I presented at a meeting held in October, 1972, by the American Law Institute and the American Bar Association.

Included in Appendix "A" are a series of 8 tables that analyze statistics relative to the private pension plan system in Canada, particularly with respect to Employee contributions. I refer to Tables Nos. 4 through 11 on Pages 60 through 67 of my statement.

At the "Second Panel Discussion" that the Subcommittee held on June 4, 1973, Professor Merton C. Bernstein presented a paper discussing many aspects of the private pension plan system. On Page 8 of his paper under the heading "Expanding Coverage—The Administrative and Bentsen Proposals—and Real Reform", Professor Bernstein included a copy of Table No. 5 of my paper in Appendix "A" and made some comments based on the statistics in it. I feel that his comments and analysis are incomplete and therefore that the inferences he draws are misleading.

Before commenting on his comments, I would like to describe briefly an aspect of the Canadian private pension plan system. In Canada, Employees have been able to secure tax deductions for contributions to employer pension plans for many years. Also, for 16 years individuals with earned income have been able to secure tax deduction for contributions to personal retirement savings plans. Tables Nos. 4 and 5 in Appendix "A" give statistics respecting these two types of contributions.

Because employees have been able to secure deductions for contributions to employer plans, it is the "normal way of life" in Canada for such plans to require employees to contribute. About 80% of all plans are set up on this basis.

Under Bills S. 1179 and S. 1631; there would be provision for employees to secure tax deduction or credit for contributions to employer pension plans and for individuals with earned income to secure tax deduction or credit for contributions to individual savings plans. In other words the concept is basically the same as now exists in Canada. In each case an overall limit covers or would cover the combined contributions. Therefore to visualize the probable result in the United States, I feel that one should look at the combined results of the two types of contributions in Canada. In other words, I feel that Professor Bernstein should have looked at both Table No. 4 and Table No. 5.

To facilitate this, I have prepared a new Table No. 12 which combines the figures for 1969 from Table No. 4 and Table No. 5. I believe that the figures in Table No. 12 give a better picture of the circumstances in Canada.

Professor Bernstein states that fewer than 1% of the taxpayers in the income bracket under $5,000 made contributions to personal savings plans (R.S.P.'s) which is true. However, from Table No. 4 it will be seen that 12.8% of these same taxpayers made contributions to employer pension plans. Table No. 12 demonstrates that 11.3% of these taxpayers made tax deductible contributions to retirement plans of one type or another.

Professor Bernstein states that Canadians in income brackets under $15,000 contributed a total of $86 millions to R.S.P.'s in 1969 and that those in brackets over $15,000 contributed a total of $97.2 millions, which also is true. However, Table 12 demonstrates that Canadians in brackets under $15,000 contributed a total of $626 millions to retirement plans and that those in brackets over $15,000 contributed a total of only $196 millions to such plans. This is quite a different picture from that portrayed by Professor Bernstein. Instead over 50% of the contributions being made by taxpayers in income brackets over $15,000 as stated by Professor Bernstein actually over 75% of the contributions were made by taxpayers in income brackets under $15,000.

It is a fact, of course, that Canadian taxpayers in higher brackets contribute more in dollars that those in lower brackets. Table No. 12 shows that the average number of dollars range from $112.58 per year to $1,665.17. However, Table No. 12 also demonstrates that proportionate to taxable income the rates of contributions are remarkably uniform, ranging between 4 and 5% of taxable income.

Overall, Table No. 12 shows that about 27% of all Canadian taxpayers made contributions to retirement plans in 1969. From Table No. 12 we can calculate that 26% of taxpayers in income brackets under $15,000 did so. Thus, although the proportion of taxpayers making contributions in the lower brackets is almost the same as the proportion for all taxpayers, it is nevertheless true that a greater proportion of taxpayers in the higher brackets do make contributions.

Even so, with more than 75% of the total contributions being made by taxpayers with taxable income under $15,000, I feel that it cannot be stated that the concept in its operation is mostly for the well-to-do.

At the "First Panel Discussion" on May 31, 1973, Professor Daniel Halperin presented a paper which discussed mostly the need for benefit limits. This is a concept with which I agree and advocated in my submission.

However, in his paper he makes reference to the Canadian experience with personal savings plans (R.S.P.'s). Although he does not refer to my Table No. 5, two of the figures he used seem to be derived from such Table. He states that over 35% of taxpayers in income brackets over $25,000 made contributions to R.S.P.'s, which is true. He also states that only about 1.2% of taxpayers in income brackets under $10,000 made contributions to R.S.P.'s, which is also true.

Professor Halperin, like Professor Bernstein, overlooks the statistics in Table No. 4 and thus draws what is, I feel, an incorrect picture of what is likely to develop from Bill S. 1179 or Bill S. 1631.

From Table No. 12 we can calculate that in 1969 about 24% of all Canadian taxpayers in income brackets under $10,000 made contributions to retirement plans rather than only 1.2% as stated by Professor Halperin. Moreover, 54% of the total of all contributions made by all taxpayers were made by taxpayers in income brackets under $10,000.

My personal feeling is that, if a Bill like S. 1179 or S. 1631 becomes law with reasonable deduction limits, the long-term result will be that many plans will require employee contributions. In Canada, it is the normal custom for employees to be required to make contributions to pension plans as a condition of employment. For example, I have contributed 5% of salary to my employer's pension plan since 1928 when I started to work even though my starting salary was only $60.00 per month. I believe that in time such will become the custom in the United States, particularly among small employers, the area where coverage is now desperately needed.

TABLE NO. 12.—COMBINED STATISTICS FOR REGISTERED RETIREMENT PENSION PLANS AND REGISTERED RETIREMENT SAVINGS PLANS IN CANADA

(Annual employee contributions by income brackets for taxation year 1969)

Annual income	Total number of income tax returns	Percentage of returns in income bracket	Total number of income tax returns bearing employee contributions to pension plans	Percentage of returns bearing employee contributions in income bracket	Percentage of all income tax returns that bore employee contributions	Total amount of all employee pension plan contributions	Average annual employee pension plan contributions	Average income in bracket	Average employee pension plan contributions as a percentage of income in bracket
Under $5,000	5,054,052	56.9	568,818	24.3	11.3	$64,000,000	$112.58	$2,481	4.5
$5,000 to $10,000	2,996,659	33.7	1,357,493	57.3	45.3	378,777,000	279.03	7,028	4.0
$10,000 to $15,000	580,383	6.5	345,885	13.4	59.6	183,396,000	530.22	11,803	4.5
$15,000 to $25,000	180,547	2.0	124,151	3.9	68.8	115,801,000	932.74	18,343	5.1
Over $25,000	70,425	.8	47,961	1.0	68.1	79,863,000	1,665.17	41,486	4.01
Totals and averages	8,882,066	100.0	2,444,308	100.0	27.5	821,837,000	336.22	5,232	(1)

[1] Not available.

Note: Based on Table 15 of "Taxation Statistics," Catalogue No. Rv. 44–1970 and 1971, published by the Department of National Revenue Ottawa, Canada, the latest figures available.

CREDIT UNION NATIONAL ASSOCIATION, INC.,
Washington, D.C., May 14, 1973.

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

DEAR MR. CHAIRMAN: This statement is presented on behalf of the Credit Union National Association, Inc., concerning S. 1631, a bill to strengthen and improve the private retirement system.

Our organization wishes to lend its support to the "Retirement Benefits Tax Act" and particularly those provisions which would permit a tax deduction to an employee who sets aside a portion of his earned income into an individual retirement savings account.

The Credit Union National Association, Inc., is an association composed of both Federal and state chartered credit unions. Nine out of ten U.S. credit unions are represented in our membership, with approximately the same ratio of Federal and state credit unions represented. Presently there are 23,084 credit unions in the United States with over 26,198,000 members. Of these 23,084 credit unions, 13,812 are Federal credit unions chartered and supervised by the National Credit Union Administration and operate under the provisions of the Federal Credit Union Act (12 USC 1751–1790). The remaining 10,387 state credit unions are chartered by the several states and operate under the various state statutes.

We are interested in this legislation because the majority of the credit unions in the United States are occupation oriented, i.e. they serve members who have as their "common bond" a single employer. There is a strong likelihood that we have credit union members for whom retirement savings plans are either unavailable or inadequate. For these principal reasons and consistent with long established credit union philosophy of encouraging thrift and savings among our members, we support this tax incentive for the employed to put aside more money for retirement. Such additional "savings" would, in our opinion, significantly enhance the ability of many employees to live their retirement years with dignity rather than merely existing or subsisting, which is too often the case.

Our review of S. 1631 indicates that the current language does not authorize an individual to establish an individual retirement savings account in a credit union. It is therefore requested that you give consideration to amending S. 1631 to have credit unions specifically included, and that Sections 581 of the Internal Revenue Code be amended to include credit unions as qualified depositories for trust funds. In the event the bill is changed to include credit unions as being qualified to receive funds in a retirement savings account, we would suggest a conforming amendment to the Federal Credit Union Act to obviate any question as to the atuhority of Federal credit unions to receive such funds.

In the event you desire further information with regard to our comments in this statement, we will be happy to comply to your consideration of these comments and recommended changes will be sincerely appreciated.

Respectfully,

WILFRED F. BROXTERMAN,
Executive Assistant, Managing Director.

TESTIMONY OF MEYER BERNSTEIN, PUBLIC AFFAIRS DIRECTOR, UNITED MINE WORKERS OF AMERICA AND HARRY HUGE, ESQ., ARNOLD AND PORTER, WASHINGTON, D.C., SPECIAL COUNSEL TO UMWA PRESIDENT ARNOLD MILLER ON WELFARE FUND MATTERS

In early 1969, the wife of a disabled coal miner in Quinwood, West Virginia, wrote to Harry Huge complaining about the fact that her husband, and hundreds like him, did not receive pension or medical benefits from the United Mine Workers of America Welfare and Retirement Fund of 1950 (the "UMW Welfare Fund"). The letter recited bitterly the many long years that her husband had spent in the mines, and how he and other miners had been destroyed physically, and sometimes emotionally, by this most brutal of all industries. These men, all members of the UMWA, felt a sense of betrayal toward the Union and Fund which they had helped create.

These miners knew only that they had worked long and hard in the coal industry and now, when they most needed it, the "welfare and retirement benefits" that the Fund had promised weren't there. All of these pensioners, who had been rejected, had received denial letter after denial letter from what seemed like a Kafkaesque bureaucracy in far-off Washington, D.C. And these miners asked a very simple question—How can we have worked so long only to be faced with regulations which deny so many of us our retirement income?

From those beginnings developed the case of *Willie Ray Blankenship* v. *W. A. (Tony) Boyle.* It has been called in the words of one commentator "one of the most massive cases in American legal history" and a "classic in the law of trusts". When Mr. Huge first started to work on this case, he did not know any of the things that he later found out, and then only after months of very intensive investigation. Mr. Huge had to sort through Welfare Fund reports at the Labor Department in Silver Spring; banking records of the Comptroller of the Currency; Union reports, also at the Department of Labor in Silver Spring; and the files at the Security and Exchange Commission. Those reports revealed some very dry facts, like the fact that the Union owned 740,000 shares of a bank; that the Welfare Fund at the end of its fiscal year in 1968 had on deposit $67,000,000 in accounts drawing no interest, and some $50,000,000 in time deposits; and there was a bank which had on its Board of Directors the Comptroller and General Counsel of that same Welfare Fund. Nowhere did it state in any of the records at the Department of Labor or the public reports issued by this Welfare Fund that that money was kept in the Union-owned bank as part of an overall scheme to benefit the bank and the Union to the detriment of these beneficiaries. But, as Mr. Huge was soon to learn, that was only the top of the iceberg.

Blankenship v. *Boyle* is now over. It finished just three weeks ago, when Judge Gerhard A. Gesell signed an Order which will permit up to 20,000 old and retired coal miners who had been denied to now receive their welfare and retirement benefits. Before that most important Order of this case was signed, there were two separate trials, each lasting approximately a month, spread over a 3-year period; countless depositions; and more than 15,000 hours of legal time spent by counsel over nearly a 4-year period. Trustees were removed and held personally liable for damages; broad equitable decrees were enforced; and $11,500,000 was won for the Welfare Fund. And most importantly, some 20,000 beneficiaries who had been wrongfully denied their benefits will now receive them. The first checks to coal miners are supposed to go into the mail sometime this week.

We recite these facts only to give some perspective to the enormous effort and cost—and the human suffering behind the need for such effort—to reform just one of this country's private pension plans. But it is ours—and the coal miners reformed it—or are reforming it. The *Blankenship* case is merely the most *public* example of the need for a pension reform bill like you are considering. It should not be up to—in the words of Judge Gesell— ". . . Willie Ray Blankenship and a small band of miners . . ." to have to come forward once every 20 years in every industry and location in order to reform a pension fund. What is needed, and what the UMWA, President Miller, Vice President Trbovich, Secretary-Treasurer Patrick, and the other leaders of the United Mine Workers of America urge upon you is that you write and pass the strongest possible pension bill in terms of disclosure, vesting, funding, fiduciary responsibilities and enforcement. We are concerned that the bills in both the United States Senate (S. 4) and in the House of Representatives (H.R. 2 and H.R. 462) do not go far enough, and must be strengthened.

Some of our areas of concern follow:

(1) FIDUCIARY RESPONSIBILITIES

The word "trustee" has, in the law and tradition of the English-speaking peoples, a very special meaning. It means a person of extraordinary sensitivities, managing, caring for, and preserving the assets, and, in many instances, the lives ofother human beings for the benefit of those others. The standard to which a trustee is held is the highest. The most fundamental duty of a trustee is of undivided loyalty to the beneficiaries, and, as it was put in the *Blankenship* case:

> ". . . You can't be just a little bit loyal. Once you are a trustee, you are a trustee, and you cannot consider what is good for the Union, what is good for the operators, what is good for the Bank, anybody but the trust."

And, as Judge Gesell found:

"... The congressional scheme (of § 302(c) of the Labor-Management Relations Act) was thus designed not to alter, but to reinforce 'the most fundamental duty owed by the trustee': the duty of undivided loyalty to he beneficiaries. 2 Scott on Trusts § 170 (3d ed. 1967). This is the duty to which ... trustees ... must be held."

The duties of a trustee are many and varied. But in exercising those duties and those responsibilities, they are held to long-standing legal principles establishing what a trustee should do. The legal standard is not as Sec. 111(b)1(B) of H.R. 2 or Sec. 510 of S. 4 state—"... 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; ..." Thus, we are very concerned about that standard. There should not be the slightest hint that H.R. 2 or S. 4 in any way is attempting to write new fiduciary standards for trustees. Those standards are clear and precise and already demand the highest performance. These bills and the committee reports and the legislative history, should make clear that, as Judge Gesell said about the Labor-Management Relations Act, that the pension reform bills are "designed not to alter but to reinforce those duties of trustees."

(2) VESTING

Regulations of pension funds do not have to be complicated. And they should never be permitted to take away the years of toil of men and women. Pension fund regulations do not have to be designed as if their sole purpose was to set up a series of hurdles to jump over, a series of loops to crawl through, and a series of rigid requirements that are hypothetical and idealized, but have no practical application to living, breathing men and women who work, sometimes get sick; have to move; have family problems; or otherwise get affected by the events of everyday life.

But regulations of this type are typical of most pension plans. We are familiar with other major pension plans whose requirements make the more outrageous requirements of the UMWA Welfare Fund appear liberal. For example, there is one pension plan which, because a man was sick and could not work for the three years before he retired, took away all of his retirement credits from February 4, 1921 through March 17, 1969. The letter from this fund stated:

"We regret to inform you that all of the 8,208 days of employment credit you accumulated from February 4, 1921 through March 17, 1969, has been forfeited (sic)."

Other funds' requirements are equally appalling. And since most of the people who have been denied do not have access to adequate legal representation, they silently burden in their working years, then are denied the fruits of their labor, and have their retirement years stripped of their dignity. They are victims of a theft of their life expectancy and of their hard-earned dollars as much as any victim of armed robbery in a street crime. And theft in this manner is more invidious because it is more impersonal, widespread, institutionalized, and takes place behind a veneer of respectability. But it is criminal none the less.

For these reasons, vesting should begin as soon as possible. If a man works two years in an industry, contributes two years' earnings to a welfare fund, he should expect to get, when he reaches retirement age, something back for the amount of money that he put in. If a pension fund wants to require a man to work twenty years before he gets a full pension, that's fine. It is not written anywhere that everybody's pension benefits should be the same. But a worker who works five years in an industry or ten years in an industry should know that come retirement age, his work and contributions will not have been in vain. In this regard we endorse and support the positions on funding and vesting of Professor Merton I. Bernstein, Professor of Law at Ohio State University, as set forth in his testimony before the United States Senate on Friday, February 16, 1973.

We realize this is difficult in some industry-wide settings such as coal mining, steel, construction work, carpentry, and the like. The answer is the portability of pension credits. And managing the problems of portability is minor when compared with managing the problems of complete loss of pension benefits.

We therefore endorse the mandatory portability program for vested pensions set forth in H.R. 462, and urge that the discrentionary provisions of Title III of S. 4 also be made mandatory. However, we do want to point out that in Sec.

BEST COPY AVAILABLE

103(b)3 of H.R. 462 and Sec. 303(a)(3) of S. 4, the Secretary is limited to investing surplus amounts only in interest-bearing accounts in banks or savings and loan associations. First, such accounts are only insured up to $20,000 each. But more importantly, there are many other investment opportunities that are just as safe, and return more to the fund than savings accounts in banks or savings and loan associations. It would seem that the Secretary should not be forced to put all of these funds into banks or savings and loan associations. For example, Sec. 206(d) of H.R. 462 permits monies of the Pension Benefit Insurance Fund to be invested in obligations of the United States, which frequently pay more than savings accounts and banks. But Sec. 206(d) is also too narrow in limiting investment decisions.

(3) FUNDING

Funding should begin immediately on an expedited funding schedule of the shortest possible time, with a maximum of thirty years. There is no need to wait three, or five, or eight years to have every pension fund in this country begin funding. Funding should begin in the immediate next fiscal year. Actuarial firms may have to work a bit overtime. But any welfare fund that does not have an actuarial computation of what it costs to fully fund is probably violating its fiduciary responsibilities now anyway.

We also would like to make these additional points regarding funding. First, there should be a limit on the number of variances from the funding schedule which the Secretary may grant. Indeed, the Secretary should be given discretion to terminate a plan at any time that he decides that employee interests will be imperiled.

There is also a built-in conflict of interest regarding the Secretary when he acts both as the manager of the Pension Benefit Insurance Fund and has the right to give variances. Since, by terminating the plan, the assets of the Pension Benefit Insurance Fund will be used, the Secretary would always be inclined to give funds too much time and perhaps imperil beyond repair the rights of beneficiaries. We would therefore urge that the Pension Benefit Insurance Fund should have an independent administrator whose sole loyalty is to the beneficiaries and to the establishment and operation of sound plans.

(4) DISCLOSURE

The present disclosure requirements relating to welfare and retirement funds are a farce. The Securities and Exchange Commission has been in existence for some 40 years. If any corporation, or any individual, would have dared to file as its annual report the disclosure forms required by the Welfare and Pension Plans Disclosure Act of 1959, that corporation, its Board of Directors, its officers and anybody even remotely connected with that report would probably have been indicted instantly. Very simply put, the report that funds have to file presently is worthless, meaningless, inadequate, and almost not worth the paper that it is written on. The SEC during the last 40 years, through a body of regulations relating to disclosure, has developed reporting requirements for major and minor corporations giving the investing public some idea of what's going on, both from an individual point of view, as well as from a corporate point of view. Unless and until the disclosure provisions of these bills, which are a vast improvement over the 1959 provisions, begin to resemble the disclosure provisions of the Security and Exchange Commission, we will continue to have some of the same insider trading, conflict of interests, mismanagement, and all the other horrors that the *Blankenship* case conjures up.

There can be no question but that welfare and retirement funds should report as extensively as any corporation or mutual fund. After all this is really wage earners' money we are dealing with. And as such it should be safeguarded. We as union representatives are glad to enlist the government's support toward this end.

If a corporation fails to file a proper report, the officers of that corporation can be not only subject to civil responsibility, but criminal responsibility as well. Some of this country's major corporate officials have gone to jail for failure to file a report. That same threat should hang over every welfare fund trustee and manager who is dealing with the hard-earned dollars of America's working men and women.

BEST COPY AVAILABLE

(5) ENFORCEMENT

John Dewey once wrote:

"No matter how ignorant any person is, there is one thing he knows better than anybody else, and that is where the shoes pinch his own feet, and that is because it is the individual that knows his own troubles, even if he is not literate or sophisticated in other respects. The idea of democracy as opposed to any conception of aristocracy is that every individual must be consulted in such a way, actively not passively, that he himself becomes a part of the process of authority, of the process of social control; that his needs and wants have a chance to be registered where they count in determining social policy."

That is the policy that we advocate in enforcement.

We believe that it is vitally important that there be a government to enforce the provisions of the law, be it a part of the Department of Labor, Department of Justice, or a separate pension fund agency, but we believe it of even more importance that the man whose shoe is being pinched—whose pension has been denied—have the right to go into Court. Thus, it must be clear from this bill that the next time a Willie Ray Blankenship stands up, it will be easy for him to get into Federal or State Court. That is why we believe H.R. 2 Sec. 106(e)8 and S. 4 Sec. 602 should be changed to permit not only the Secretary but a participant or beneficianry to enjoin any act or practice which appears to violate any provision of this title, or to ask for the removal of a trustee. We also do not understand why there is any need for Sec. 106(f) (2) of H.R. 2. There is no reason why a trustee should not know that if he plays fast and loose with working men's money he can be personally liable for losses that occur. Indeed, that is the law in any event, and, again, these bills should not raise any questions that the standards for liability of a trustee are in any way being diminished.

(6) WIDOWS AND WOMEN BENEFICIARIES

As noted, it was the wife of a retired coal miner whose letter triggered the *Blankenship* case. If she is still alive when her husband dies, our UMW Welfare Fund now does not contain adequate provisions to care for her or her dependents. President Miller has pledged that one of his top priorities is to make adequate provisions for widows. However, the UMW Welfare Fund is not unique, and, providing for lump-sum widows benefits, it is indeed more generous than most.

In addition, if the rules and regulations of welfare funds make it almost impossible for most working men to qualify for pensions, it is many times more difficult for a woman. Her pattern of employment just does not fit the typical requirements of a welfare fund. Thus, there should be special attention given to working women, and the widows of working men.

We thank you for the opportunity to present these views.

STATEMENT OF JOHN P. THOMPSON, CHAIRMAN OF THE BOARD, SOUTHLAND CORP.

Mr. Chairman and Members of the Subcommittee, my name is John P. Thompson. I am Chairman of the Board of The Southland Corporation; I have been Chief Executive Officer for 12 years. Southland is better known as 7-Eleven Stores; it also operates dairies under various names, Embassy, Velda Farms, Wanzer's, Adohr, Spreckels, Harbisons, Oak Farms, Cabell's, and so forth. I ask that my written statement and the attachments to it be admitted in evidence as a part of this hearing.

We appreciate the opportunity to appear before the Subcommittee to express Southland's position on S. 4 and the other bills in this area. These matters are of great importance to employers, employees, and the public generally, and to Southland and its employees in particular.

We believe that much of S. 4 is good and will accomplish the Subcommittee's objectives, but certain aspects of the fiduciary provisions are of great concern to us. Before discussing them, I want to describe Southland's plan.

Southland's business basically is ice, 7-Eleven stores, and dairies; these require long hours and tough, heavy work. After considering various types of employee benefit plans, over 25 years ago The Southland Corporation adopted a profit sharing plan patterned closely after the highly regarded and successful Sears, Roebuck plan. Such a plan permits employees to share in the fruits of their long hours and hard work, which a fixed dollar pension does not. In addition, it affords employees access to their funds during employment; it is a hedge against inflation; and it provides far greater financial security at retirement. Over the years our plan has proved successful in accomplishing its intended purposes.

Southland contributes 10% of its pretax profits to the plan; participation is voluntary; participants contribute 5% of their compensation, but no participant may contribute more than $1,000 per year. Before a participant joins, the trust investment program is fully disclosed. Each year he receives a statement of his own account and an audited statement describing the trust's assets in detail. These are copies of the brochure and the 1972 report. Employee contributions and fund earnings thereon are always fully vested; company contributions and fund earnings thereon vest 30% after three years and 10% per year thereafter. A participant may withdraw the vested portion of his account at any time. If he withdraws completely, he may rejoin after a waiting period.

Over 8,000 Southland employees participate in profit sharing; this is over 85% of the eligible employees. The principal reason for ineligibility is time; employees have not completed the required one year's employment.

In 1972, the 8,000 participants contributed $2,900,000 and the company contributed $4,165,882.76. In comparison, the company paid $3,500,000 in dividends to its shareholders.

The plan has been fabulously successful. Many participants have retired at 65 with a withdrawal plan designed to deplete their accounts in 10 to 20 years—and discovered at the end of 10 years that they had more in their accounts than when they retired. Some retired with more take-home pay than when they worked.

These are statements on the profit sharing accounts of eight employees for the last five years.* You will note that the seven lower echelon employees all have bigger balances than I. Six of the employees are approaching retirement age. If they elect to withdraw their balances over 20 years, as most participants do, their annual draws will compare favorably with their current salaries—five of the six will have more income after retirement than currently.

This has resulted from the plan's investment program. Company contributions, employee contributions, and the trust's income have been invested primarily in Southland common stock, which is listed on the New York Stock Exchange, and real estate (mostly 7-Eleven stores leased to Southland). The trust never has and never will loan any money to Southland or any of its officers. The Southland stock provides an opportunity for the employees to share in the growth of the company; the real estate provides a steady source of income at a relatively high yield and participation in the appreciation in land values—as well as good downside protection in case of stock market declines. This chart shows the plan's investment performance in recent years.* Since December 31, 1972, the price of Southland stock, like many other stocks, has declined sharply; but the real estate has held up or even increased in value.

At December 31, 1972, the trust's balance sheet showed $37,896,866.22 in land and buildings leased to Southland, $16,717,829.75 worth of Southland stock, and $2,620,806.14 in cash, and other securities, making total assets of $57,284,002.11; there were no liabilities. The real estate consists of over 600 7-Eleven stores scattered through 32 states; these were purchased from and leased back to Southland. Contemporaneous transactions with independent third persons demonstrated the fairness of each sale-leaseback; Southland gave profit sharing lower prices on sales and paid higher rent than in the third party transactions. Southland has 50 employees who do nothing except select sites for 7-Eleven stores. They recommend the cream of the crop for sale and leaseback to profit sharing; that is, those properties most likely to enhance in value and to pay percentage rentals in excess of the minimum base rent.

Legislation is pending in both Houses of Congress which would prohibit the trust from buying stores from Southland or leasing stores to it. The leading bills in the Senate and House are S. 4 and H.R. 2, respectively.

Section 15(b)(2) of the Welfare and Pension Plans Disclosure Act, as amended by Sec. 510 of S. 4, is of great concern to us. These provisions begin on page 79, line 8 of S. 4. They are as follows:

> (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;

*This was made a part of the official files of the Subcommittee.

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

The term "party in interest" includes an employer whose employees participate in a profit sharing plan of which the fund is a part.

S. 4 would not merely prohibit sale-leasebacks in the future; it also would require the trust either to terminate the leases to Southland (by mutual consent) or divest itself of all stores presently leased to Southland. Since the stores owned by profit sharing are among the best, the company would not be willing to terminate the leases. Thus, profit sharing would have to divest itself of over 600 stores; more than Southland sells and leases back in 8 years; and S. 4 would prohibit the trust from selling these stores to the most logical buyer—Southland.

The hearings conducted by the Senate and House Labor Committees disclosed abuses in the pension plan area, primarily delayed vesting and underfunding; neither of these problems exists in profit sharing plans. There has been almost no testimony dealing with sale-leasebacks. Instead, the testimony focused on problems like Studebaker, where many workers failed to get the pensions they anticipated because the plant was closed.

S. 4 would prohibit a profit sharing plan from buying real estate from the employer at a fair price and leasing it back at a fair rental, even though the real estate would provide a stable income with less fluctuation in value than the employer's and other stocks. Nevertheless, Sec. 15(c)(4)(A) of the WPPDA, as amended by Sec. 510 of S. 4, would permit a profit sharing plan to invest 100% of its assets in the employer's stock, thus putting the plan's assets even more at the risk of the employer's business. This provision begins on page 81 at line 15. Since profit sharing plans have always been used as incentive devices, this clearly is appropriate—if it is what an employer wants to do for its employees. On the other hand, employers should not be forced into this position by a combination of Federal law and economics.

If enacted unchanged, S. 4 would force profit sharing plans which have been leasing property to the employers to dispose of this real estate. Southland, the profit sharing trustees, and many of the participants are extremely concerned about this; none of us want to tamper with success.

H.R. 2 approaches the problem in a superior way, similar to that taken in Sec. 503(b) of the Internal Revenue Code. Sec. 111(b)(2) provides, in part, that "a fiduciary shall not—

* * * * * * *

(D) permit the transfer of any property of the fund to or its use by any person known to be a party in interest for less than adequate consideration, or

"(E) permit the acquisition of any property from or services by any person known to be a party in interest for more than adequate consideration."

Sec. 106(a) makes intentional violation of these provisions a criminal offense. Sec. 106(e) provides that civil actions may be brought by any participant or beneficiary to recover benefits, etc., or by the Secretary of Labor to enjoin violations. Sec. 106(g) gives jurisdiction to the State and Federal courts. Sec. 104 and Sec. 105 require complete disclosure of all fund transactions.

Thus, these and other provisions of H.R. 2 provide adequate protection to the participants in and beneficiaries of profit sharing plans, without the absolute prohibitions in S. 4.

If S. 4 were changed in this respect along the lines of H.R. 2 and Sec. 503(b) of the Internal Revenue Code, it would be a better bill; and we would support it This could be done by amending the provisions beginning on page 79, line 8 of S. 4 to read as follows (additions underlined):

(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 *for less than an adequate consideration in money or money's worth;*

(B) rent or purchase on behalf of the fund any property known to be owned by a party in interest of the fund *for more than adequate consideration in money or money's worth;*

* * * * * * *

(F) loan money or other assets of the fund to any party in interest of the fund *without the receipt of adequate security and a reasonable rate of interest;*

(G) furnish goods, services, or facilities of the fund to any party in interest of the fund *for less than an adequate consideration in money or money's worth;*

(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 *for less than an adequate consideration in money or money's worth;*

This memorandum discusses the legislation in greater technical detail.

We appreciate your giving us your consideration. This is a very vital matter to our company and the 8,000 members of profit sharing. We would appreciate an opportunity to work closely with your staff in helping to draft legislation which would cure the abuses in this area without stopping beneficial practices.

I would be happy to answer any questions.

Thank you.

The Southland Corporation

Memorandum on Certain Aspects of the 1973 Welfare and Pension Fund Legislation

Some of the bills currently pending before Congress would impose an absolute bar against the use of profit-sharing plan funds to buy, sell, or lease property to or from the employer. We have examined this proposal in light of the history and function of profit-sharing plans and the Congressional purpose designed to be accomplished by the proposal.

A careful study of the proposal and its history establishes that, even granting the need for extensive corrective legislation in the general area of retirement funds, that need does not extend to a prohibition against certain transactions between a profit-sharing plan and the employer. Rather, the contemplated prohibition conflicts with the basic concept of profit-sharing plans and would thwart rather than help accomplish the apparent Congressional purpose of providing greater protection and benefits for the individual employee.

History

Congressional interest in welfare and pension fund legislation is not new. Proposals have been introduced from time to time since 1965, when the President's Committee on Corporate Pension Funds released its report on the inequities and abuses within the private pension plan system. Extensive hearings have been held from that time until the present on bills that were, in large measure, the forerunners of the present legislation and which discussed many of the same problems. Some of the provisions of the present bills were taken verbatim from the earlier legislation. Other areas have been modified slightly to conform to suggestions or to counter criticisms that were expressed in earlier Congressional hearings.

The similarity among these bills is not surprising, as the same group of sponsors has been pushing this legislation for the last two Congresses. Dominant figures in the House are Messrs. Carl Perkins, Chairman of the House Committee on Education and Labor, and John Dent, Chairman of the General Subcommittee on Labor of the Committee of Education and Labor in the House. The Senate leaders have been Senators Harrison Williams and Jacob Javits, the Chairman and ranking minority member of the Committee on Labor and Public Welfare.

The Senate Subcommittee on Labor sponsored a study on the subject of pension plan abuses and released the preliminary results on April 5, 1971. The Senate committee also held preliminary hearings on S. 2 (July 27 through July 30, 1971, and in mid-October) which have served primarily to disclose specific inequities and abuses within the pension plan field.

On March 19, 1968, the first day of hearings before the House Subcommittee on Labor on the then pending bills (H.R. 5741 and H.R. 6498), the Acting Chairman spelled out the major objectives of the legislation. Mr. Daniels stated that the major changes effected by the new bill:

". . . would be the addition of a tightly defined set of rules outlining fiduciary standards and restricting certain activities on the part of plan trustees. It shall be the primary task of our hearings to assess the need for such legislation and to make sure that these measures, if adopted, will provide the best possible answer to whatever problems we discover to exist.

"In addition, we anticipate some testimony relating to welfare and pension plans such as vesting, funding, portability, reinsurance, . . ."

As it developed, however, the major areas of controversy in the pending legislation (and this was true in connection with prior bills as well) involve provisions relating to areas other than the standard of fiduciary duty. The seemingly endless procession of hearings and studies has concentrated on additional disclosure and audits, vesting, portability, funding, and reinsurance (insurance against plan termination).

While there has been some testimony relating to the fiduciary standards required under the various bills, the analysis has been largely superficial; and there has been little real controversy.

The current emphasis on fiduciary responsibility is of recent origin and appears to stem from the extensive hearings and other evidence relating to other matters. Nonetheless, the subject is clearly of current interest and is apt to continue to be so.

A clear understanding of the proposals requires first an analysis of the differences between pension plan sand profit-sharing plans.

DIFFERENCES BETWEEN PROFIT-SHARING PLANS AND PENSION PLANS

The concept of a private pension plan is like that of social security; everyone contributes, but only those who live to retirement age and satisfy the vesting requirements of the plan actually collect. In large measure, the pensions of those who "survive" are subsidized by those who do not; indeed the plan is computed on an actuarial basis to reflect these contingencies. It follows therefore that the fewer the people whose interests "vest," the higher the pension payments for those people. This is another way of expressing the conflict between early vesting and high payments upon retirement.

A profit-sharing plan operates under totally different assumptions; the basic concept calls for every member employee to share in the profits of the corporation. Obviously, therefore, the fortunes of the profit-sharing plans are tied directly to those of the corporation. And historically, just as the plan was funded out of corporate profits, accumulated funds of profit-sharing plans were reinvested in the corporation.

Put another way, although the purpose of a profit-sharing plan may well be in part to provide income to its participants when they reach retirement, its method is to offer employees an opportunity to share in the ownership and profits of the corporation.

These basic differences, although only briefly stated, furnish the background required for an accurate evaluation of the key features of the various pending bills.

1. *Vesting.*—As noted, in a pension plan vesting is a significant issue; and the larger the number who become vested, the smaller each retiree's share of the pension plan assets. This conflict has led to widespread abuses in vesting provisions. Often, a long-time employee will be denied benefits because of some strict vesting requirement which he has not met. The recent hearings before the Senate Subcommittee on Labor were geared to disclosing these failures in employee expectations.

Yet, the restrictive vesting provisions which lay the foundation for this abuse are inevitable. They are required first to hold down the actuarial cost of providing sufficient funds to meet the pension plan's obligation to pay adequate pensions to the survivors. At the same time, since this fundamental fact of life regarding pension plans is considered in making the actuarial computations in the first instance, these same restrictive vesting provisions are required to assure the accuracy and the soundness of those computations.

The very nature of a profit-sharing plan, on the other hand, has the effect of eliminating any inducement to defer vesting in such a plan. Indeed, quite the contrary is true. Since the original funds for a profit-sharing plan come only from corporate profits, once a contribution out of those profits has been made to the plan, that amount really belongs to those persons who are members of the plan at the time of the contribution. Thus, these interests might well be considered vested at the outset. Since that may be somewhat of an oversimplification, suffice it to say for purposes of this analysis that all the emphasis in the case of a profit-sharing plan is toward early vesting and not long-deferred vesting as in the case of a pension plan.

This fundamental difference is evident in still another way. Under a pension plan, its profits and forfeitures are, in effect, to be used to reduce the employer's contributions (see, e.g., Sec. 401(a)(8) of the Internal Revenue Code), so that the plan itself is not greatly affected by such matters. In a profit-sharing plan, however, those same profits and forfeitures are not required to reduce the employer's contribution; they really represent additions to the fund available for eventual distribution to the plan participants. Consequently, in a deferred profit-sharing plan, the intent and expectation of both management and workers are to increase profits through investment of the plan funds usually, at least historically, back into the corporation. Because of this difference in approach, vesting is not generally a significant problem in profit-sharing plans. Every employee who has worked for a reasonable period is expected to collect upon death or termination his share of the profit-sharing fund.

It is not surprising therefore that there has been no showing in the hearings to date of significant abuses of vesting provisions among profit-sharing plans.

2. *Funding.*—There have been allegations and a great deal of testimony to the effect that some funds are inadequate to meet accrued (vested) pension benefits. In the event the plan terminates, or the employer becomes bankrupt or insolvent, many employees may have to forfeit their anticipated pension benefits. A case in point is the closing of the Studebaker facilities in 1962. Studebaker's pension fund was insufficient to meet its obligations. Thousands of workers either received no benefits whatsoever, or only drastically reduced pension payments.

In a profit-sharing plan, the participants have no right to any specified payments upon retirement; they are entitled instead to their share of the accumulated benefits in the fund. Almost by definition, therefore, a profit-sharing plan can be said to be fully funded at all times. Since the disclosure provisions in the pending bills require specific detailing of these fund assets, the employee under a profit-sharing plan has the advantage of being able to ascertain the plan assets and to base his expectations accordingly. There is, therefore, not the same need for Congressional concern about funding and reinsurance in connection with the profit-sharing scheme. This is fully demonstrated by Senator Javits' statement in the April 27–30, 1970, hearings before the Joint Economic Committee in introducing his proposed 1970 legislation (see also Congressional Record, May 14, 1970):

"Profit-sharing plans, which I have long sought to encourage as a valuable inducement to labor-management cooperation in the interest of stability and higher productivity, present many significant differences from pension plans, even when profit-sharing involves payment of benefits on retirement. This was clearly brought out in recent hearings on private pension plans held by the Joint Economic Committee. These differences in operation necessitate differences in treatment, although in both cases the goal should be to insure fulfillment of the legitimate expectations of the participants.

"The bill I am introducing today seeks to reflect these important differences. It defines profit-sharing retirement plans separately from ordinary pension plans, and reflects the fact, for example, that true profit-sharing retirement plans are automatically fully funded because benefits are entirely dependent upon the employer's profits."

The implication of the full funding feature inherent in profit-sharing plans can be even more dramatically demonstrated. Normally, when a pension trust is created, the trust obligates itself for pension benefits for all participants, including older workers who are near retirement age. Assuming they meet all other requirements, many of these older employees become vested within a very short time after the creation of the trust. As a result, the pension plan begins life with a substantial obligation which can not realistically be adequately funded for many years. During this period, the fund is exposed to the possibility of being unable to meet its obligations due to poor plan performance or an unexpectedly high demand for pension benefits. This obviously is aggravated in those instances where the business goes bankrupt and its pension plan suffers the same fate.

The inevitable result, of course, is severe frustration of the expectations of plan participants. Congress has therefore been impelled toward a stricter regulatory scheme to protect against the abuses and risks inherent in such an overextension of obligations.

A profit-sharing plan, however, does not share these problems. Under the typical profit-sharing plan, the participant is entitled only to his share of the profit-sharing fund. In the initial years the fund in all probability will be small, and the employee will have only a small interest. As the fund grows, the value of the employee's share grows with it. At no time does the fund incur liabilities or obligations beyond its actual resources. Accordingly, the impetus for regulatory legislation is substantially less compelling in the area of profit-sharing plans.

3. *Portability.*—Since profit-sharing benefits are, by their very nature, tied to a company's profits, they are not transferable to other companies.

Furthermore, assuming the vesting provisions of the presently pending legislation were enacted, there would be no need for portability provisions in the case of profit-sharing plans. If an interest is vested, and the plan is funded (as all deferred profit-sharing plans of course are), then the employee has a vested right upon termination of employment to receive his share of the fund; and the fund is in existence. Corporate reorganization or move to new employment do not effect the participant in a profit-sharing plan; he gets his share directly from the old plan. It is only the pension plan which creates the problem of portability.

4. *Fiduciary Duty.*—It is in this area that the basic tenet of profit-sharing plans becomes most important and that the current legislative proposals could cause the most harm to the real Congressional purpose. Although of course certain fiduciary standards are desirable, the proposals of Section 14(b)(2) of S. 4 represent a serious—and unnecessary—overkill which will inevitably damage legitimate and properly administered profit-sharing plans. H.R. 2 takes a better approach, but it needs some clarifying amendments.

It appears all too clear that the fundamental tie between a profit-sharing plan and the profits of the corporate employer has not been considered in S. 4. Bluntly put, it serves no legitimate purpose—and indeed makes no economic sense—arbitrarily and flatly to require that this relationship be almost completely severed. Indeed the preservation of the one area (purchase of the employer's stock) where the relationship is allowed to continue adds still greater support for the contention that the proposals of the bill goes much too far.

In effect, the report of the President's Committee in 1965 reached a similar conclusion:

"Whatever the type of investments made by retirement funds, such investments should be made honestly, conscientiously, and prudently . . . On the basis of present evidence, the Committee does not propose the substitution of a new set of statutory standards for the recognized standards of fiducial responsibility, although there appears to be a need for strengthening statutory provisions for assuring compliance with these standards." (IV of the Introduction)

5. *The Role of State Law.*—Granted the need for fiduciary standards, the required controls have been imposed and enforced by the various states, and indeed a large body of state law is now in existence. It expounds the state trust fund doctrine which is in effect a variation of the prudent man rule. Experience has disclosed two basic problems with state trust fund doctrine:

a. The trust may exist only as an agreement between the employer and an investment company or a bank or similar institution. It is not entirely clear therefore that an employee will be looked upon by the state courts as a beneficiary of that trust.

b. Often the stronger provisions of a state's trust law can be avoided by incorporating exculpatory clauses into the trust agreement.

Additional standards are imposed by the Internal Revenue Code as a price of continued availability of the tax benefits allowed to certain types of plans. (Generally speaking, these sanctions amount to still another prudent man test that will be discussed later in this memorandum.) But there are limitations on the ability of the Internal Revenue Service to enforce these sanctions in a meaningful way. In the first instance, the only sanction under the Code is for the Internal Revenue Service to deny continued tax-exempt status to the plan. This may be as harmful to the employees as it is to the Company. Secondly, the Service has no authority to prosecute for recovery of misappropriated trust-fund assets. Thirdly, sanctions are not available against the fiduciaries who engage in prohibited transactions unless they fail to report income derived from those transactions. Thus, the present provisions under the Internal Revenue Code, while laudable in concept, are inadequate to assure fiduciary responsibility.

Against this background it is apparent some areas of potential abuse continue to exist. How best to fill the gap?

It would surely be counterproductive for new legislation to eliminate the large body of already existing state law which regulates pension and profit-sharing funds. This point was forcefully brought home by the testimony of Robert D. Hasse, Commissioner of Insurance of the State of Wisconsin, in his statement to the House General Subcommittee on Labor, printed at page 885 et seq. of the hearings on H.R. 5741 in 1968. Mr. Hasse's statement emphasized the fact that local government is better adapted to regulate these plans.

6. *The New Proposals.*—The additional safeguards admittedly needed are in our judgment provided by those provisions of S. 4 and H.R. 2 which:

a. Require every covered agreement to be in the form of a trust agreement.

b. Establish a federal prudent man test of fiduciary duty.

c. Prohibit exculpatory clauses which would relieve the trustee of any duty, obligation, or responsibility under the proposed statute.

d. Provide adequate disclosure of all dealings of the trust and adequate opportunity for the discovery of any fiduciary breach of trust.

e. Provide suitable enforcement and recovery provisions in the event a breach of trust occurs, including personal liability on the part of the breaching trustee.

With these protections, it is submitted, state law is completely adequate to protect employee interests. Even if under a particular state law a participant's rights were not adequately protected, he would now have access to the Federal courts and the benefit of the "prudent man" test laid out in the legislation.

In these circumstances, it would appear that little more is required to eliminate the possibility of abuse and increase the protection desired for the individual employee.

What then is the function of the substantive additional provisions of S. 4 which prohibit certain transactions?

Sec. 15(b)(2) of the Welfare and Pension Plans Disclosure Act ("WPPDA"), as amended by Sec. 510 of S. 4, would prohibit certain transactions between a profit-sharing plan and "a party in interest." The latter is defined in WPPDA Sec. 3(18), as amended by Sec. 502(f) of S. 4, as follows:

"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 of any of the above-described persons."

With this all-encompassing definition of "the other party," the profit-sharing plan "shall not" among other things (1) "rent or sell property of the fund" to a party in interest [Sec. 15(b)(2)(A)], (2) "rent or purchase on behalf of the fund any property known to be property of" a party in interest [Sec. 15(b)(2)(B)], (3) "loan money or other assets of the fund" to a party in interest [Sec. 15(b)(2)(F)], (4) "furnish goods, services, or facilities of the fund" to a party in interest [Sec. 15(b)(2)(G)], or (5) "permit the transfer of any assets or property of the fund to, or its use by or for the benefit" of a party in interest [Sec. 15(b)(2)(H)].

To repeat what is both the obvious and the essential crux of the matter, these are flat and absolute provisions, all with the inevitable purpose and effect of isolating the profit-sharing plan from the employer—the exact opposite of the original concept of profit-sharing plans.

Careful study of S. 4 and the legislative history of its various predecessors and legislative activity in related areas discloses no warrant for this type of provision. Although there has been considerable testimony regarding self-dealing and its abuses, these have been thoroughly covered in other appropriate contexts. Thus, in the Tax Reform Act of 1969, after extensive study and hearings, Congress adopted a set of stringent rules for what the Internal Revenue Code defines as "private foundations." Although a detailed analysis of that subject is beyond the scope of this memorandum, it is relevant to note that even for that type of organization—the basic nature of which is, as indicated by its name, wholly foreign to that of a profit-sharing plan—there are few flat prohibitions. Rather, there are exceptions which in large measure constitute the prudent man test of the current proposals.

Although Sec. 4041(d)(1)(C) prohibits "furnishing of goods, services, or facilities" between a private foundation and a "disqualified person" (synonymous for purposes of this memorandum with "a party in interest"), the same section excludes those situations where such furnishing by the private foundation "is made on a basis no more favorable than that on which such goods, services, or facilities are made available to the general public." Although "lending of money" is a prohibited transaction, the disqualified person may do so at no interest if the funds are used for the foundation's exempt purposes.

Admittedly, there are certain flat prohibitions; but, to repeat, these are with regard to transactions between a private foundation (an organizaion having no public or general origin or support or historical obligation to any one but the private founder) on the one hand and that founder and certain other persons who in effect bear certain relationships to that founder. Furthermore, the sweeping legislation stemmed from what Congress considered to be extensive evidence of widespread abuse in precisely such situations.

Perhaps most significant of all is the fact that in the same piece of legislation the Tax Reform Act of 1969, Congress looked at non-private foundations—public organizations similar, at least in generic terms, to profit-sharing plans—and decided to impose certain limitations and restrictions, but carefully refrained from making any such sweeping changes.

Presumably, it may be argued that experience warrants equating pension plans to private foundations, at least for purposes of determining the nature and extent of rules and regulations regarding investments and other areas of fiduciary responsibility. But, even if that be true, the same does not extend to profit-sharing plans.

The earlier discussion establishes the fundamental differences between the two types of plans; those differences are substantive and conceptual. They clearly warrant different treatment in that very area which reflects the one most significant difference—the relationship with the corporate employer.

The Internal Revenue Code makes significant distinctions between pensions and profit-sharing plans. It permits a qualified profit-sharing plan—but not a pension plan—to allow an employee to elect, under appropriate circumstances, to participate in the trust forming a part of such plan, or accept his share in cash. Also, a profit-sharing plan—but not a pension plan—may, under appropriate circumstances, permit participants, prior to any severance of employment or termination of the plan, to withdraw all or part of the funds accumulated on their behalf which consist of employer contributions or increments in the fund. The Internal Revenue Code also allows a profit-sharing plan to permit the beneficiaries to make the investment decisions on their vested interest in the profit-sharing fund. Under Rev. Rul. 65-178, Part 5(r), 1965-2 Cum. Bull. 125, a beneficiary can elect to handle his own investment decisions for his share of the profit-sharing fund.

All of this seems clearly to reflect Congressional understanding of the functions of a profit-sharing plan to hedge against inflation, provide investment profits, and give the employee a share of the business profits. Yet S. 4 would eliminate many of these alternatives for all types of plans, thereby ignoring the numerous and fundamental differences between a pension plan or a profit-sharing plan, differences recognized under state law and under the Internal Revenue Code, differences in origin, fact, purpose, and concept.

At the same time, however, S. 4 would recognize these differences by drawing one distinction between the two types of plans. It is a distinction which is explainable only in terms of the fundamental tie that exists only between a profit-sharing plan and the employer and not between a pension plan and the employer.

WPPDA Sec. 15(c)(4)(A), as amended by Sec. 510 of S. 4, deals with the use of plan funds to purchase "any security which has been issued by" the employer. The proposal would allow pension funds to invest no more than 10 percent of the fair market value of the assets of the fund in any such security. However, that limitation would not apply to profit-sharing, stock bonus, thrift and savings, or other similar plans. A profit-sharing plan could invest 100 percent of its assets in the employer's stock, so long as the fiduciary standards of the bill were met. Obviously the draftsmen, recognizing the distinction between profit-sharing and pension funds, determined to give effect to the historical concept of the profit-sharing plan while at the same time protecting the participants in that plan.

The same recognition and determination must extend to other types of dealing between a profit-sharing plan and the employer. If not, S. 4 would produce incongruous results. The effect of Sec. 15(c)(4)(A) is to allow a profit-sharing fund to invest all of its assets in the stock of the parent company with no control or even a voice—other than that of a minority stockholder—in the policy or operations or any aspect of the employer's business. No matter how speculative that investment may be, no matter how limited or erratic the market for selling the stock, there is no limit on the investment.

Yet, Sec. 15(b)(2) prohibits the plan from investing any amount in a business transaction with the employer—regardless of the fairness and reasonableness of the transaction, regardless of the fact that the profit-sharing plan may have adequate security and other protection.

The anomaly is easily dramatized by pointing out that the effect of the bill would be to bar a profit-sharing plan from buying a building and selling or leasing it to the employer at fair and reasonable prices with the property itself as security, but the bill would allow that same profit-sharing plan to provide the identical sum of money to the employer by buying its stock. The employer could use that money to purchase the identical piece of property.

The point is worth repeating. The bill would say that a sale of property to the employer at fair market value is prohibited; that a lease in which the fund is secured by its outright ownership of the land is prohibited; that a loan, at the prevailing interest rate and adequately secured, is prohibited. Yet, a fund could purchase the employer's stock and thereby fund these same transactions, but with no real security passing to the fund. It violates the very reason for the bill to allow stock investments but to disallow normal, businesslike, properly secured transactions which involve no substantial risk to the plan.

The fiduciary safeguards provision (Section 404 of Title IV) of Senator Javits' Pension and Employee Benefit Act of 1967 (S. 2688, Congressional Record, February 28, 1967) states:

"No person who is an officer or employee of an employer or organization of employers or a labor organization, which is a party to any employee's benefit fund, shall receive or accept, directly or indirectly, whether through a corporation or other entity owned or controlled in any substantial degree by such person or otherwise, any payment, loan, pledge, hypothecation, assignment, or other transfer out of the assets of such fund (other than benefits to which such person is entitled as an employee), . . . Nothing herein contained shall prohibit the purchase by a profit-sharing retirement plan or other profit-sharing plan, in the ordinary course of business, of the securities or indebtedness of any corporation or other business entity employing directly or through a subsidiary or parent entity a substantial number of the beneficiaries of such fund."

This section would prevent any personal self-dealings between the fund and its fiduciaries. It recognizes, however, the fundamental distinctions between the pension and profit-sharing systems and allows loans and stock purchases between the profit-sharing fund and the employer.

It does not appear that it would violate the traditional concepts of fiduciary responsibility to allow profit-sharing plans to engage in arms' length transactions with the employer corporation whose profits are the very life blood of the plan. As long as the terms are reasonable and fair consideration is received, the basic purpose of profit-sharing plans requires Congress to encourage—not prohibit—such transactions. To the concern that it might be difficult to police the bona fides of transactions between "related parties," the answer is already contained in current law and in other portions of S. 4—the requirement for extensive disclosure, the imposition of the prudent man test, the elimination of the availability of exculpatory clauses for trustees, and the proposals for stringent penalties at all levels.

It was presumably for similar reasons that the President's Committee's 1965 report considered the question of fiduciary standards and specifically rejected the concept of stringent federal regulations.

"The Committee recognizes the need for additional measures for the protection of the interests of the employees but doubts whether a major problem is the lack of 'appropriate standards of prudence.' The chief problem, rather, is one of enforcing existing standards of fiduciary obligations as trustees—in behalf of the interests of employees and their beneficiaries. The general standards of conduct for any trustee have been long established by law and custom. These include the degree of prudence that must be exercised in investing the funds of others." (at page 73)

In these circumstances, it would appear that Congress should be willing to add appropriate standards of bona fides and arm-length dealing to what the bills now propose as absolute prohibitions.

H.R. 2 approaches the problem in a superior way, similar to that taken in Sec. 503(b) of the Internal Revenue Code. Sec. 111(b)(2) provides, in part, that "a fiduciary shall not—

*   *   *   *   *   *   *

> "(D) permit the transfer of any property of the fund to or its use by any person known to be a party in interest for less than adequate consideration, or
>
> "(E) permit the acquisition of any property from or services by any person known to be a party in interest for more than adequate consideration."

Sec. 106(a) makes intentional violation of these provisions a criminal offense. Sec. 106(e) provides that civil actions may be brought by any participant or beneficiary to recover benefits, etc., or by the Secretary of Labor to enjoin violations. Sec. 106(g) gives jurisdiction to the State and Federal courts. Sec. 104 and Sec. 105 require complete disclosure of all fund transactions.

Thus, these and other provisions of H.R. 2 provide adequate protection to the participants in and beneficiaries of profit sharing plans, without the absolute prohibitions in S. 4.

If S. 4 were changed in this respect along the lines of H.R. 2 and Sec. 503(b) of the Internal Revenue Code, it would be a better bill; and we would support it. This could be done by amending the provisions beginning on page 79, line 3 of S. 4 to read as follows (additions in italic):

(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 for less than an adequate consideration in money or money's worth;
>
> (B) rent or purchase on behalf of the fund any property known to be owned by a party in interest of the fund for more than adequate consideration in money or money's worth;

*   *   *   *   *   *   *

> (F) loan money or other assets of the fund to any party in interest of the fund without the receipt of adequate security and a reasonable rate of interest;
>
> (G) furnish goods, services, or facilities of the fund to any party in interest of the fund for less than an adequate consideration in money or money's worth;
>
> (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 for less than an adequate consideration in money or money's worth;

CONCLUSION

Congressional interest in various types of retirement and profit-sharing plans has provided a steady stream of legislative proposals. These purport to cover all phases of the operations of such funds, vesting, funding, investment policy, etc.

The current proposals has followed the pattern of past suggestions, but with increased emphasis on fiduciary standards. Commendable though this is, S. 4 appears to go too far in terms of the nature and extent of the proposed "prohibited transactions" and in the failure to maintain the distinction between different types of plans. The basic tenet of profit-sharing plans, as opposed to pension plans, is the tie, which exists only in the former, between the profits of the employer and their contribution to the profit-sharing plan.

Because there appears to have been no evidence of any abuse in this area, the failure to provide separate treatment for profit-sharing plans reflects what is likely an unintended lack of appreciation of the differences between the various types of plans. In any event, accomplishment of the Congressional desire to protect employees does not require, and indeed will be thwarted by, absolute prohibition of certain types of transactions by profit-sharing plans just because the other party to the transaction is the employer. On the contrary, the Congressional purpose requires encouragement of that relationship just so long as appropriate information is required to be disclosed to the enforcement authorities; just so long as the prudent man test is made specifically applicable to these transactions, and just so long as the penalties are sufficiently strict and are energetically enforced. If S. 4 were amended along the lines of H.R. 2 and Sec. 508(b) of the Internal Revenue Code as discussed above, it would meet this need.

OREGON SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS,
Portland, Oreg., May 7, 1973.

Hon. ROBERT W. PACKWOOD,
New Senate Office Building,
Washington, D.C.

DEAR SIR: On behalf of the Board of Directors and Members of the Oregon Society of Certified Public Accountants, I am writing to urge you to actively support the increase in the limitation on deductible contributions by self-employed persons to retirement plans, as proposed in Section 4 of Senate Bill 1631.

We believe the proposed legislation should be enacted for the following reasons:

1. Congress should eliminate the distinction between retirement benefits allowed to self-employed persons and to corporate employees.
2. There should be no distinction of benefits allowed between employees of self-employed persons and employees of corporate organizations.
3. The increased limits proposed are certainly necessary considering the inflation which has occurred since 1962 when the present Keogh provisions were first enacted.
4. The increased ability of self-employed people and their employees to provide for their own retirement will lessen their dependence on increased government funding of old age programs.

We will particulary appreciate your efforts to make these views known to the Senate Finance Committee in its deliberations on Senate Bill 1631.

Yours very truly,

ROBERT F. ISLER.

STATEMENT OF UNIROYAL, INC. SUBMITTED N. H. FLETCHER, ASSISTANT TREASURER

Much attention has been given by the Congress to the subject of pension legislation. Initially, there was widespread doubt about the wisdom of adopting many of the particular proposals. We have now reached a point, however, where there is broad agreement in industry and throughout the country that it is desirable to adopt certain of the proposals for private pension plans.

In respect to the particular interests of UNIROYAL, Inc., we do not have major objection to legislation in the areas of vesting, funding, disclosure or fiduciary standards. We do, however, strongly object to the proposed legislation contained in S-4 regarding:

(1) plan termination insurance, and
(2) portability.

PLAN TERMINATION INSURANCE

Several of the various bills now before the Congress, which relate to the regulation of private pension plans, provide for "plan termination insurance" or "reinsurance". The purpose is to establish a new Government fund from which benefits would be paid to employees who lose their vested pensions under private plans which have been terminated, often because the employer goes out of business. In these cases there may be insufficient assets in the trust fund to discharge all liabilities for vested pension benefits, particularly if the plan has been recently adopted or substantially improved.

The fund would be established and maintained by a premium charged to employers of 2/10 of 1% of unfunded vested liabilities.

THE PROBLEM

There can be no doubt that a problem exists. While the dimensions of the problem were unknown until recently, the "Study of Pension Plan Terminations, 1972" published by the Department of the Treasury and the Department of Labor as an Interim Report furnishes some hard evidence. It shows that of the more than 30 million employees covered by private pension plans, only 8,100 persons lost vested benefits with a present value of approximately $10,000,000. On an annual basis this is less than $20,000,000 per year. Thus, in the aggregate, plan terminations are not a major problem; to the affected individual, however, it is a personal disaster.

OBJECTIONS TO PROPOSED PLAN TERMINATION INSURANCE

While the problem may be real, the proposed solution is one aspect of the proposed legislation which rightly has aroused considerable opposition. There are several valid objections to the way the cost will be distributed:

1. It is inequitable. The burden will fall on those companies which have recently adopted or made substantial improvements in their plans, regardless of their ability to meet their obligations.
2. The determination is based on a number of estimated figures whose accuracy cannot be determined; e.g. will a private plan fund earn 0%, 5% or 10% over the next 60 years? This is all important to calculating the unfunded vested liability figure.
3. The cost method bears no relation to the risk involved, as normally the case with insurance premiums. Even the soundest companies may pay heavily because they recently improved benefits.
4. Most importantly, the premium will positively discourage the adoption of new plans or improvement of existing plans. The 30,000,000 persons not now covered will have much less prospect of ever obtaining coverage.

If, in spite of all disadvantages, an insurance program is imposed, a preferable way of determining the premium is to base the amount as a percentage of annual pension cost. This method is more direct and in proportion to the benefit scale assumed. At least, it will be based on assumptions which are the best estimates for the current year only.

PROPOSED SOCIAL SECURITY GUARANTY IN LIEU OF PLAN TERMINATION INSURANCE

There is a way to meet the problem of the few who might lose benefits from plan terminations without any of the objections set forth above. This is simply to furnish a guaranty for certain vested pension benefits under the Social Security system and as an integral part thereof.

An analogy can be drawn with certain financing plans followed by agencies of the Government in which they assist by loaning a portion of the funds required and offering guaranties for another major portion (The Export-Import Bank and Overseas Private Investment Corporations are examples of agencies following this practice).

The safeguards which limit payments to no more than $500 monthly, to benefits from plans in existence 8 years or more, and others proposed are essential. It is also suggested that the following be added:

1. The guaranteed benefit, when added to all other Social Security benefits, cannot exceed 80% of final pay over the prior 5 years.
2. The guaranteed benefit cannot exceed 1.5% of average pay in 5 years for each year of service, which pay must be reasonable.

No doubt there are other safeguards which should be included.

There are numerous advantages to this proposal:

1. Private pension plans would be encouraged, not discouraged; the versatility and flexibility of private plans are essential in order to meet the wide geographic, industry and compensation differences which exist throughout the nation.
2. No inequity falls on anyone since even those employers and employees not now covered have received a valuable right to a guaranty which will offer an inducement to adopt modest pension plans as a supplement to the Social Security benefits.

The existence of the guaranty will encourage employees, particularly to seek private pension coverage as part of their compensation.

3. The $20,000,000 cost is insignificant in relation to the more than $60,000,000,000 raised in Social Security taxes.
4. By reinforcing the private pension arm of the retirement income system, there is less need for higher direct Social Security benefits and taxes.

BEST COPY AVAILABLE

PORTABILITY

While we strongly urge the committee to reject the proposals relating to Plan Termination Insurance (or if some coverage is considered essential, to adopt a Social Security guaranty as described above) we consider the Portability proposal highly detrimental to the security of most active employees, retired employees covered under private pension plans.

First, it is unnecessary if the other proposals are adopted. More importantly, it offers a positive inducement for many active employees to leave their present employer and seek employment elsewhere, taking the value of their vested benefits with them.

Nearly all newly established plans plus older plans which have recently made substantial improvements in benefits will, for a time, have substantial unfunded vested liabilities. These liabilities will be amortized over a reasonable period of time—a maximum of 40 years under Opinion #8.

However, if a number of active employees start a "run" on the assets of a trust fund, the security of the remaining, probably older, employees will inevitably suffer. Particularly, the retired group, who can take no protective action by leaving themselves, will find their position endangered. This is the group usually furnished the greatest security.

Without being unduly alarmist, it is conceivable that an accelerating number of terminations could develop which would destroy an operating organization and the pension benefits of a large proportion of its most loyal active employees and particularly, its retired employees. We must strongly urge that the Portability provisions be discarded.

STATEMENT OF R. W. LAXSON, HONEYWELL INC.

Most of the more than 50,000 employees of Honeywell in the United States are members of company pension plans. The balance are covered by multi-employer trade union plans. Annual cost to Honeywell is presently about $20 million. Accumulated funds in the hands of plan trustees to finance future pension payments now exceed $175 million.

Honeywell favors the adoption of reasonable federal minimum standards for several aspects of pension plan operation. We believe the rapidly expanding private pension system is too important to permit its accomplishments to be marred by marginal provisions and practices by a few, but within reason employers must retain a fair degree of flexibility to meet individual needs. Also, being a multi-state manufacturer, we are cognizant of the need for one set of standards nation-wide rather than defaulting to a group of conflicting regulations by individual states. Our comments on specific aspects are as follows:

VESTING

The underlying purpose in the origination of company pension plans was to encourage better employees to remain with a company through their working lives and to provide, in conjunction with social security and personal savings, an adequate income at normal retirement date. A vesting provision is included to protect older long service employees who may leave the employ of the company for a variety of reasons prior to retirement date. Pension plans and their vesting provisions were not intended to provide benefits for younger people who may work for several different companies a few months or a few years on their way to finding their longer term occupation.

We believe a vesting provision which takes into account both age and period of service serves the purposes better than one based on period of service alone. Therefore we prefer a standard along the lines of the "Rule of 50" (50% vesting when age plus years of service equals 50 with additional 10% vesting each subsequent year of service until 100% is reached), as proposed in S. 1631.

As mater of information, the adoption of this provision in Honeywell plans will add well over $1 million to annual pension costs. The vesting provision in S. 4 (30% after 8 years' service increasing 10% per year to 100% after 15 years), which we believe will increase costs approximately to the same extent as the "Rule of 50", would be somewhat less desirable in our opinion. No provision more liberal than these two should be considered.

The above comments refer primarily to non-contributory plans. An identical vesting provision in a contributory plan would be proportionately less costly to

BEST COPY AVAILABLE

an employer since a terminating employee must ordinarily leave his own contributions in the plan in order to retain vested benefits—and many terminating employees elect not to do so.

FUNDING

The provision in S. 4 requiring all unfunded liabilities to be amortized over a thirty year period represents a stringent "minimum" requirement and should be recognized as such. Honeywell is now funding its plans on a 30-year basis and therefore concurs with this requirement. However, in addition S. 4 calls for correcting any experience deficiencies which may develop within a five year period. We believe flexibility should be retained by the company to fund such deficiencies (or surpluses) on any reasonable basis consistent with the thirty year over-all requirement.

There are other proposals (S. 1631 and H.R. 2) which tie funding requirements to percentages of vested benefits. These could result in wide variations in funding required from one year to the next and would be less well understood and probably less conservative than gearing contributions to total unfunded liabilities.

PORTABILITY AND TERMINATION INSURANCE

We believe strongly that if adequate vesting and funding provisions are in effect the vast majority of problems and inequities which have been illustrated in various hearings will be eliminated, and that portability and insurance provisions, if enacted, would ultimately retard growth and weaken the private pension system.

As to portability, the transfer of a vested benefit applicable to a terminating employee, first to a government fund and then perhaps to the fund of a new employer (each with different investment practices and earnings assumptions) would be an unnecessary and costly process that would lead to much confusion and misunderstanding. There is no problem from a Honeywell standpoint in maintaining records on employees terminating with vested benefits and beginning monthly payments when the individual reaches age 65. S. 4 provides for portability on a voluntary basis only, but even so we believe the section should be eliminated entirely.

Termination insurance seems to be a process whereby the stronger companies would underwrite a portion of the pension costs of weaker ones. This could slow down or limit improvements in plans where added costs can be economically absorbed, and conversely can encourage unsound improvements by marginal companies because of the insurance feature.

Honeywell, just a year ago, amended a plan covering 40% of its U.S. employees, increasing benefits from $5.00 per month for each year of service to $8.50. This increase applied to all prior service so that Honeywell's unfunded liability immediately jumped by almost $40 million, which we will pay for over a 30 year period. If at the same time we had had in effect the proposed vesting minimums, our fund assets at that time would have been slightly less than 65% of vested liability and under the terms of S. 4 we would have been subject to a .4% annual insurance payment, amounting to about $125,000. The provision in S. 4, in differentiating between the .2% and .4% rate, specifically discriminates against an existing plan which improves its benefits. A new plan qualifies for the .2% rate if annual contributions equal 4% of vested liability; an existing plan cannot.

In the context of an insurance premium such a payment makes little sense to us and it would certainly affect to some extent the timing or amount of plan improvements. In addition, on an over-all basis, we believe the joint Treasury-Labor study released in February 1973 does not indicate a sufficient problem to warrant such an innovation.

We would recommend, however, a requirement that a company acquiring another going concern make equitable provision for carrying over pension liabilities to employees of the acquired operation. In every Honeywell acquisition or disposal, we have made certain (with one minor exception now being corrected' the pension rights of employees transferred were properly protected.

JURISDICTION

The Treasury Department Internal Revenue Service has long performed the function of reviewing new pension plans and revisions of plans to assure compliance with standards presently in existence and has audited annual company contributions in relation to the minimums and maximums set by law.

It seems logical that the knowledge and expertise presently existing in that department should continue to be used to monitor compliance with new standards on vesting and funding—and that such new standards be made part of the Internal Revenue Code. Reviews of actuarial assumptions and calculations should also remain a part of the Treasury function. We can see no reason to set up an essentially duplicate effort in the Labor Department and subject employers to two different jurisdictions with its attendant complications and confusion.

The Department of Labor, on the other hand, can monitor the adequacy of communications with employees on plan matters. We believe all covered employees should receive full information on details of the plan as it affects him or her, and periodically a non-technical, understandable summary of the status of the total pension fund.

The Department of Labor should also monitor compliance with fiduciary standards. It is recognized there is a minmum of problem in this regard with plans administered by bank trustees and insurance companies and that most concern is with certain multi-employer plans and those administered by individual trustees.

GENERAL

An important element which cannot be overemphasized is that the ultimate soundness of the private pension system is dependent on continued profitability of industry. Each company must generate sufficient earnings to be able to set aside funds over a period of years to cover pension liabilities. These funds when received by trustees are invested in a wide range of corporate securities, so that employees at that point are looking to continued earnings of all industry to underwrite the rapidly growing flow of pension payments.

FRIMET, GOREN & BELLAMY, P. C.,
Southfield, Mich., May 29, 1973.

TOM VAIL,
Chief Counsel, Senate Finance Committee,
Dirksen Senate Office Building, Washington, D.C.

DEAR MR. VAIL: Your telegram indicated that the Senate Finance Committee would appreciate comments before June 1, 1973, relative to deferred compensation and pension/profit sharing plans. I hope that the Committee will not elect to treat small business corporations, including professional corporations, differently from other corporations in the amounts that may be set aside for retirement and the conditions and restrictions regulating the same.

I say this because if anyone needs pension planning and deferred compensation assistance, it is certainly small corporations. Persons employed by larger corporations have considerably more security of tenure and hence an illness will not preclude them from receiving benefits. Conversely, small corporations often depend on one, or a few, people, whose absence from the corporation can create serious financial hardship. The assistance of deferred compensation through pension and profit sharing plans is one way to protect such persons. For some reason some people may feel otherwise, and the small corporation has become a whipping boy in this whole area. I think this trend is regretable and can only lead to more hardship for small business with its ultimate contraction as a part of the economic fabric of this country. This is certainly not what Justice Brandeis had in mind.

I hope, therefore, that in the deliberations of the Committee and in its ultimate action, that whatever is done will be applied equally to large and small alike; to the small merchant as well as to the professional person, and equally to the executive of the larger corporations. The best traditions dictate that this is the appropriate and fair approach.

Many thanks for the opportunity to write you on my thoughts and feelings in this matter.

Very truly yours,

GILBERT M. FRIMET.

STATEMENT BY HOWARD YOUNG[1]

This statement is submitted in response to the Subcommittee's invitation for written comments in connection with its hearings of May 21–23, 1973.

Without discounting the importance of other matters included in various proposed bills, this statement focuses on the issues of vesting (with some comments on the related issue of portability) and plan termination insurance (with some comments on the related issue of funding).

This statement is organized as follows:

The importance of *requiring* vesting and termination insurance, as opposed to *encouraging* such provisions through tax rules.

The inadequacies of proposals based on benefits to be accrued in the future.

Comments specifically related to vesting and portability.

Comments specifically related to termination insurance and funding.

Concluding comments.

THE IMPORTANCE OF REQUIRING VESTING AND TERMINATION INSURANCE AS OPPOSED TO ENCOURAGING SUCH PROVISIONS THROUGH TAX RULES

There has been considerable controversy as to whether any new requirements should be administered by the Department of the Treasury, Department of Labor, or some other agency. While there are several considerations involved, a major question is whether the new requirements would be conditions for "qualification" under the tax law, or whether they would be requirements imposed on all plans (subject to specified exceptions) as is now done under the Welfare and Pension Plans Disclosure Act. The Senate Committee on Labor and Public Welfare has concluded that new requirements concerning vesting and termination insurance are needed (I agree with that conclusion); in order to effectively implement that conclusion, such requirements should be a condition of the plan's legality rather than one for favorable tax treatment.

Even though the incentive for favorable tax treatment might be an effective one for most situations, there are cases in which it is reasonable to assume that incentive would be insufficient. The problem would be particularly acute with respect to termination insurance. If an employer with an existing pension plan (which presumably was covered by plan termination insurance) experienced a year with no taxable income, payment of the insurance premium might be omitted (just as plan contributions are now "skipped" in some such situations), since no tax deduction is available that year. Since the non-payment of one, or several, insurance premiums could result in loss of termination insurance protection, employees would have no real assurance that their benefits are secure. The provisions of insurance protection must not be a function of whether or not the employer has sufficient tax incentive to pay the current premium; it must be continuous coverage which is in effect as long as the plan functions. Undoubtedly, there is less chance of intermittent application of vesting requirements even if only based on tax qualification. Nevertheless, the conclusion that vesting should be required is based on considerations of the employees' equitable interest in plan benefits; thus that interest should not be dependent on the employer's choice whether or not to satisfy tax qualification rules, just as the fiduciary and disclosure rules concerning a pension plan are required—whether or not the employer chooses to satisfy tax qualification requirements—the vesting standard enacted should be a mandatory plan provision.

It should be recognized that the matter of vesting and termination insurance requirements is of a different nature than the more basic question of whether or not to establish a pension plan. The latter is a voluntary act on the part of the employer—or the result of mutual agreement between parties in collective bargaining—and may be encouraged (even though not required) by tax incentives. To use this as an argument (as some have done) that all provisions should have a simliar degree of volutary choice ignores the widely accepted principle that certain minimum standards of performance are applicable to agreements, even though the agreements were entered into voluntarily. For example: while an employer may have a choice whether or not to install a particular machine, if he decides to use the machine it must meet certain safety standards. Similarly: while the adoption of a group life insurance program may be voluntary, any such program must satisfy certain requirements (e.g. provision of a conversion

[1] Mr. Young is an independent, self-employed actuary (details concerning his professional qualifications and activities are submitted in support of this statement); this is a personal statement by Mr. Young, and is not presented on behalf of any client or other party.

option to terminating employees). Numerous other illustrations could be cited—the Disclosure Act is, of course, the most relevant one—the point is tuat vesting and termination insurance are minimum quality standards which should be required; in the absence of meeting such standards the plan should not be permitted to operate.

THE INADEQUACIES OF PROPOSALS BASED ON BENEFITS TO BE ACCRUED IN THE FUTURE

There is a fundamental difference of approach, among the proposals under consideration, with respect to benefits accrued prior to the effective date of any new legislation. For example: under S1631 vesting requirements would not apply to benefits accrued during plan years beginning before 1975 (subject to certain exceptions); S4 and S1179 impose some vesting requirements with respect to such benefits. Similarly, a point of contention is whether termination insurance should apply to benefits already accrued.

While there is theoretical merit to proposals which would apply only to future benefit accruals, it is obvious that such an arrangement would give little protection, if any, to those employees who have the greatest immediate need for the reforms involved. If "justice delayed is justice denied", then it should be clear that pension reform which applies only to future benfits would—for a very large number of employees—be no reform at all.

It is also important to recognize the effect of extending this "legislate for future service only" concept to the question of basic benefit accruals, as some have proposed. The Administration's proposal (as incorporated in S1631) illustrates this in the proposed tax deductibility of employee contributions. The Fact Sheet accompanying the President's message of April 11, 1973 contained the following example:

Age when $1,500 contributions begin:	*Annual pension beginning at age 65 (assuming an average life span)* [1]
40	$7,500
45	5,200
50	3,375
55	1,950
60	900

[1] Pensions are straight-life pension for males payable in monthly installments. A 5-percent interest rate is assumed.

At first glance, it would appear that significant results can be achieved even if benefit accruals are based only on future service (that is implicit in the concept of determining benefits based on specified contributions to be saved in the future). However, that conclusion changes if reasonable assumptions are made concerning the employee's earnings level.

The example above assumes that interest will be earned annually at a 5% rate. A widely accepted "rule of thumb" is that interest will approximately equal 3% plus the inflation rate; thus a consistent assumption would be a 2% inflation rate. A consistent wage rate assumption would be the assumed inflation rate (2%) plus the productivity rate (assume 2½%), or 4½%.

Now consider several alternatives as to the employee's earnings at the start of the savings program: (1) $7,500 annually, this is the lowest rate for which $1,500 savings would be deductible; (2) $15,000 annually, the amount required so that the $1,500 savings rate does not exceed 10% of earnings (a "high" savings goal for most people); and (3) $30,000 annually, arbitrarily used as probably more realistic if assumed savings for retirement are $1,500.

The table below shows the ratio of annual annuity (as estimated in the President's Fact sheet) to the final pre-retirement salary, using these assumptions.

Age contribution begins	Annual pension [1]	If initial salary is—		If initial salary is $15,000		If initial salary is $30,000	
		Final salary [2]	Pension as percent	Final salary [2]	Pension as percent	Final salary [2]	Pension as percent
40	$7,500	$21,570	35	$43,140	17	$86,280	9
45	5,200	17,309	30	34,619	15	69,237	8
50	3,375	13,889	24	27,779	12	55,557	6
55	1,950	11,146	17	22,292	9	44,583	4
60	900	8,944	10	17,888	5	35,775	3

[1] See preceding table for assumptions.

[2] Assumes 4½ percent annual pay increase.

Thus aside from any question as to whether the tax deductibility of employee contributions is a desirable allocation of tax resources, it should be clear that such a provision must not be relied upon to "solve" the problem of pension security. Similarly, proposals which merely improve the status of benefits to be earned in the future will not do the job.

What is needed is: (1) adequate Social Security to provide every employee with a satisfactory base pension (it seems odd that concern is expressed about the level of OASDI because FICA taxes are equal to a total for employee and employer of approximately 12% of pay, up to the maximum, but the Administration proposes a tax deduction plan in which employees are presumed to save up to 20% of pay subject to the maximum), and (2) legislative arrangements which will assist the private pension system in effectively implementing the tools available to it, including the provision for, and periodic updating of, benefits for "past service".

COMMENTS SPECIFICALLY RELATED TO VESTING AND PORTABILITY

Since the three major bills before the Senate (S. 4, S. 1179, and S. 1631) each provide for significant vesting requirements, I assume there is adequate consensus on the appropriateness of assuring employees protection against loss of benefits if they terminate employment prior to retirement. However, further consideration needs to be given to the issues of an appropriate vesting standard, the effective date, the impact of employee contributions, portability, central record keeping, and erosion of benefit values.

Three major alternative vesting standards are under consideration: graduated vesting based on service as in S. 4 and S. 1179, zero-to-fill vesting based on service as in House Bill H.R. 2, and the Rule of 50 as in S. 1631. Depending on the circumstances of an individual employee, any of the three approaches could provide the best or the worst result. Thus no one rule can be characterized as "best". However, the Rule of 50 is significantly different from the others in that it would allow extended periods of service prior to age 40 to be forfeited, particularly since S. 1631 allows all service before age 30 to be ignored. Since none of the alternatives suggested is clearly superior to all the others, and since it is recognized in most proposals that some variances may be desirable, the following concept is suggested, require that vesting occur as of the time when the employee's accrued benefit equals some specified portion (e.g. 10%) of his then current pay rate.[3] This proposal is based on the concept that vesting will not be required if the loss of benefit is relatively small (e.g. less than 10% of pay) regardless of the age or service of the employee; also that in plans where the basic benefit is low compared to pay, vesting would occur later and thus divert less money from the amounts available for basic benefits.

Most of the legislative proposals provide for a "transition" or "adaptation" period with respect to the implementation of the vesting requirements; presumably this is intended to soften the cost impact on the plan. Of course, this also has the undesirable effect of not providing protection to employees who terminate prior to the effective date. It is important to recognize that the funding provisions could permit this tempering of cost impact even with more rapid implementation of the vesting requirements. For example, new vesting requirements could apply to any employee who terminates after a specified date, but the funding requirements could permit that any costs due solely to the new vesting requirements be deferred for a specified period. At that latter date, the accrued vesting cost would become a "past service" cost and would be amortized over a fairly long time period. I am not suggesting specific legislation on this, but merely pointing out that the impact of the vesting requirements does not have to be deferred because of cost impact; of course, new vesting requirements will have very little short term effect on actual benefit payments.

When a plan requires employee contributions, vesting is frequently "conditional"; that is, if a terminating employee—who otherwise satisfies the vesting requirements—withdraws his contributions, he loses all benefits. Experience indicates that in such situations the vast majority of employees withdraw their contributions, even through they lose substantial employer financed benefits. Permitting this situation to continue will undercut the effectiveness of any manda-

[3] Where a plan benefit is defined as a fixed amount per year of service, or otherwise not directly related to pay, it should be permissible to use average pay rates to define when the specified percentage is achieved.

tory vesting requirement. This would be further compounded under S1631 since an avowed goal of the new tax deductibility is to encourage employee contributions for retirement. Vesting should not be dependent on the employee's choice with respect to withdrawal of his own contributions.

Portability is a concept closely related to vesting, although it involves many other features. The administration of a portability program would involve procedures and rules much more complicated than all the other items under consideration. As a single illustration: procedures would be needed to effectively equate the value of benefits under any plan with those under any other plan. Subject to the comments below, I believe that adequate vesting, funding and termination insurance provisions will provide those aspects of portability which are most desirable; so that a separate portability program is unnecessary. (In fact, it seems to me that portability was originally suggested as an alternative to vesting, funding and termination insurance requirements.) In addition, if in the future it appears that a portability program would in fact be desirable, it will be possible to apply it to benefits already vested so that no real loss should occur as the result of deferring action on portability.

One desirable aspect of portability is the consolidation of record keeping which would occur. This would reduce the probability that an individual would lose benefits because of forgetting them or otherwise. This goal can easily be achieved by requiring that information on vested benefits be included in the individual's Social Security record. Then, when he applies for Social Security, he will be reminded of his benefit accruals; that reminder should include information on the procedure for applying for those benefits. No funds would be transmitted; no elaborate procedures are involved; only a notification statement from the plan to the Social Security Administration.

Another aspect of portability is the possibility of protection against erosion of vested benefits due to increases in the cost and standard of living. Of course, this is a problem which is also applicable to benefits under certain plans whether or not the participant terminates before retirement. Many employers cannot be expected to bear the risk of protecting plan participants against increases in the cost and standard of living. The only available alternative—the variable annuity—may, or may not, do the job for any individual; thus, it puts the risk on the individual. Further work is needed on this problem. For many years, it has been suggested that the government issue bonds the value of which would increase to provide cost and standard of living protection. If such investments were available, a pension plan could be expected to include this protection in its provisions. In any event, the problem of benefit erosion should be met directly, rather than through an intermediary mechanism with other difficulties such as a portability program.

COMMENTS SPECIFICALLY RELATED TO TERMINATION INSURANCE AND FUNDING

With the possible exception of the proposed legislation on fiduciary responsibility—concerning which there seems to be little controversy—the most important pension reform issue before the Congress is that of termination insurance. This is so because other matters—such as vesting or funding—can be improved by the employer, or the parties to the collective bargaining agreement covering the pension plan. However, there is no generally available mechanism to meet the problem of inadequate assets in the event of plan termination.

Extensive testimony has been presented to Congress specifying the types of situations in which plan terminations have occurred and employees have lost significant benefit accruals. There is no need to repeat or summarize that testimony. Perhaps the need for termination insurance can best be characterized by the following two quotations:

On December 8, 1971, President Nixon is reported to have stated: ". . . . even one worker whose retirement security is destroyed by the termination of a plan is one too many".

In its statement of February 15, 1973 to the Senate Subcommittee on Labor, the American Life Insurance Association expressed various reservations about the proposal for termination insurance, but also stated: "Complete protection of these rights—which we concede is an admirable objective—can probably be obtained only though some sort of plan termination protection program."

To one who has advocated such a program since the first proposal by Senator Hartke in 1964, it has been very interesting to observe the basis for objection expressed by those in opposition.

In the early years, the primary argument was that such a program was not feasible. For various reasons, including refinements that have been made in the legislative proposals,[3] this type of opposition has diminished; there now appears to be a reasonable consensus (although admittedly there are significant reservations) that such a program can function effectively if enacted along the lines proposed in S. 4.

Currently the primary opposition arguments seem to be that the magnitude of benefit losses is insufficient to justify the establishment of a termination insurance program. While there may not be general support for the President's reference to "one worker" as an adequate test of need for the program, the Treasury-Labor Departments' February 1973 interim report of the "Study of Pension Plan Terminations, 1972" shows that terminations reported during the first seven months of 1972 involved a loss of benefits to 8,400 individuals; the present value of benefits lost was $20 million. The average loss per individual was $2,400.

Is $20 million a significant amount? For comparison consider the current major scandal involving Equity Funding; coincidentally, the estimate of possible loss by the reinsurers has been reported as $20 million.

Is a loss of $2,400 significant to an individual employee? That will, of course, depend on each individual's status; any comparison with other financial data is artificial and reflects the biases of the comparer. Nevertheless, a single illustration that the amount is not trivial, it is interesting to note that the average payment to life insurance beneficiaries in the United States was $2,685 in 1971.[4]

The above data does not "prove" that there is sufficient need for legislation establishing a termination insurance program. The problem is not statistical; rather it is a matter of reinforcing the confidence which employees have in the pension system, and making sure the system works. I suggest that there has been sufficient qualitative and quantitative evidence accumulated to support the case for such a program. Further deferral of establishment of such a program will result in loss of benefits by additional plan participants.

Funding is closely related to termination insurance, because they are both intended to enhance the security of benefit expectations, and because it is reasonable to assume that improved funding requirements will assist the functioning of the termination insurance program. There appears to be fairly widespread consensus on the desirability of additional funding reqiurements. Therefore, my comment on this subject is only to emphasize the interrelationship of two points made above:

(1) Use of future service benefits only will generally be unsatisfactory, because that will not provide adequate benefits. Therefore, additional unfunded past service liabilities will continually be created under many plans.

(2) Any reasonable funding requirement will not provide full assurance that benefits will be secure in the event of plan termination.

Improved funding requirements are desirable; a termination insurance program is essential.

CONCLUDING COMMENTS

In summary, the major points of this statement are:

Mandatory requirements for vesting, termination insurance and funding are needed; a portability program is not needed. (This statement does not discuss other issues such as fiduciary responsibility or disclosure.)

Vesting and termination insurance provisions should apply whether or not the plan meets the "qualification" rules for favorable tax treatment.

Vesting and termination insurance requirements should apply to benefits accrued before and after the effective date of legislation.

Encouraging, through tax deductions, individual savings for retirement will not significantly hel pmost employees. We need adequate Social Security benefits, and legislation to assist private pension plans to function effectively.

A minimum vesting standard based on the amount accrued benefit (in relation to pay), rather than age or service, is suggested.

The vesting requirement should be implemented quickly; and desired "cushioning" of the cost effect can be achieved in the funding requirements.

Vesting should not be subject to loss due to withdrawal of employee contributions.

[3] Senator Hartke pointed out that his proposals were intended to serve as a basis for study, rather than as a completely defined program.

[4] Life Insurance Fact Book, 1972.

Vesting benefits should be recorded on the individual's Social Security record.

The government should issue securities which will reflect increases in the cost and standard of living, or develop other means to prevent erosion of benefit values.

Termination insurance is essential; a program along the lines proposed in S4 should be established now.

A separate memorandum is being submitted to your staff with some "technical comments" on the issues of vesting, funding and termination insurance. If any additional details are desired with respect to any portion of this statement, I will be happy to discuss those with the Subcommittee or its staff.

HOWARD YOUNG, F.S.A., ACTUARY

PROFESSIONAL DATA

Self-employed, independent actuary
Member, American Academy of Actuaries
Fellow, Society of Actuaries
Fellow, Canadian Institute of Actuaries
Member, Mathematical Association of America
Member, American Pension Conference
Member, American Risk and Insurance Association
B.S. Mathematics, City College of New York
M.A. Economics, University of Michigan
Phi Beta Kappa

Experience: Metropolitan Life Insurance Company, New York, from 1952–1960 doing various actuarial functions in individual life and health and accident insurance policies, with the exception of two years from 1953–55 which were spent as an Army Infantry Officer with duty in Korea.

Joined the staff of the United Auto Workers in 1960 as Actuarial Consultant; became Director of the Information Systems Department in 1968. (Supplementary information is attached.)

Joined the staff of League Life Insurance Company in 1971. (Supplementary information is attached.)

Appointment at various times (most recently 1972) as a lecturer in insurance and actuarial subjects at the University of Michigan.

PUBLICATIONS

Second Annual Pension Trust Conference, Graduate School of Business Administration, New York University: "The Unions' Attitude Concerning Pension Investments"—1961.

National Foundation of Health, Welfare & Pension Plans, Inc.: "The Effect of Technological and Population Mix Changes on 1964 Pension Bargaining by the UAW"—1964.

Social Security Conference, Canadian Labour Congress: "Negotiations arising out of the Canada Pension Plan and other Pension Legislation"—March, 1965.

Society of Actuaries: "A Government Guarantee Fund for Private Pensions"—1965.

Congressional Record: "Reinsurance for Private Pension Plans"—September, 1965.

American Risk & Insurance Association: "Panel Discussion on the Future of Private Pensions"—August, 1966.

Pension & Welfare News: "The National Industrial Group Pension Plan"—September, 1966.

Various portions of "Early Retirement, the Decision and the Experience", Barfield & Morgan, Institute for Social Research, the University of Michigan, 1969.

Appendix C of "Guaranty Fund for Private Pension Obligations," McGill, Pension Research Council, 1970.

Miscellaneous Discussions: Transactions, Society of Actuaries; Journal of Risk and Insurance.

Article on Pension Termination Insurance for "Pensions" magazine, Fall, 1972.

COMMITTEES AND BOARDS

Member, Pension Research Council (Wharton School).

Member of Advisory Council on Employee Welfare and Pension Benefit Plans (U.S. Department of Labor) 1964–1968.

Consultant to Advisory Council on Social Security Financing, Actuarial Subcommittee (U.S. Department of Health, Education, and Welfare—(1964).

Consultant to the U.S. Department of Labor on pension reinsurance programs (1971).

STATEMENT BY ROBERT J. BUCKLEY, PRESIDENT, ALLEGHENY LUDLUM INDUSTRIES, INC., BEFORE THE EASTERN DIVISION MANAGEMENT CLUB, WYMAN GORDON COMPANY, WORCESTER, MASS.

THE CURIOUS CASE OF THE BUSTED BUCK (OR, WILL THE REAL SHYLOCK HOLMES PLEASE STAND UP?)

Many people have forgotten that a manufacturing corporation in the United States has been assigned a given function by our society: the responsibility for the production of the material abundances by which that society improves its condition.

Translated into plain English, this means our job is to *produce wealth.* And the single *measurement* of how much wealth we produce is, of course, *money.*

And the tragedy of our time is what has been done to the *value of money.*

Speaking plainly—you and I should be much angrier than we are that the *wealth we produce* is measured in terms of a *devalued* and *weakened dollar.* And because we seek economic equilibrium by requiring more of those cheapened pieces of paper in exchange for the wealth we create—*We* are blamed for inflation!

And everybody is up in arms about inflation.

People are running around in Wall Street, State Street, and Montgomery Street—the principal financial centers of our nation—and all around Washington pointing the finger at each other.

And the real Shylock Holmes, who is responsible for the debasement of the dollar, just won't stand up!

Maybe it's just that most of us don't understand the problem.

Like the story of the three young ladies applying for posts with the United Nations. "What would you do if you were alone on a desert island and a platoon of 40 strange Marines landed?" each was asked. "I would naturally call for the British Navy," said the English girl. "I would call the CIA and the CIC," said the American girl. "I see the opportunity—but don't understand the problem!" said the French girl.

Listen to the government economists, the Federal apologists, and the financial busybodies and you may find yourself nodding in Pavlovian response when they say: "Devaluation really means that our exports will cost less—and give us a greater opportunity to sell abroad."

Hardly anybody—least of all anybody in Government—admits that the curious case of the busted buck is as puzzling to *them*, as it is to *us.*

How many times before have we heard this sad story?

In May of 1961, just 12 years ago but almost a million light-years in economic terms, Dr. Arthur Burns, then Chairman of the Council of Economic Advisers, said at the annual meeting of the American Iron and Steel Institute:

"There is widespread hope both inside and outside government that inflation will be halted. If, in spite of this widespread concern, Government officials, trade union leaders, and businessmen should continue in the ways to which they have become accustomed, they will do so only because they have not yet grasped the truth that a *dollar in which people have full confidence is as vital to our national security as are planes and missiles. There is still time to learn and practice this truth.*"

And who was Chairman of the Federal Reserve Board when, in 1972 and 1973, not *one* but *two* large devaluations of the dollar were taken? Dr. Arthur Burns!!

Apparently, not even a professor learns.

For under Dr. Burns, the Fed has undertaken monetary policy which has been disastrous to the value of the dollar—and has fed the inflationary flames.

He is at one and the same time *powerful* in deciding the flow of funds into the American banking system but *impotent* as a major factor in sustaining the *value* of those funds—both at home and abroad.

On April 26 of this year, Dr. Burns said: "The true and basic function of reserve requirements (a strong arm of the Fed) is *not to provide liquidity* but to permit the Federal Reserve to *control the supply of money and credit so that monetary policy can effectively promote our national economic objectives.*"

Only if we assume a complete misunderstanding or perversion of "national economic objectives" can we agree that the Fed's activities in recent years have "promoted" the welfare of the American dollar.

What have been our "national economic objectives?"

I submit that two principal objectives have been embodied in the following: (and have had a devastating effect on our economic life and the value of the American dollar)

(1) The policies contained in such programs as the Marshall Plan, which developed into massive reconstruction of West Europe and East Asia, including Japan, and which produced a global security network based on American pledges to fight, if necessary, to keep the peace.

These policies and actions brought about not only the tremendous new competitive forces that we now see in the European Common Market and Japan—but forced us into Korea and Vietnam.

(2) The Employment Act of 1946—in which Congress declared it to be the *responsibility of the Federal Government to* "promote maximum employment, production, and purchasing power."

It has accomplished *none* of its objectives. A *stimulative* fiscal policy to take up the *slack* in the economy and a *restrictive* fiscal policy to *cool* an overheating economy were *presumed* as the principal Federal weapons to implement the Act. The fact is that such an economy is always on, or close to, the threshold of inflation—and money manipulation. The fact is that, since the enactment of that statute, *budget deficits have greatly outnumbered surpluses.* And experience has proved that failure to attend properly to governmental priorities leads to excessive fiscal stimulus and this, in turn, is *more apt to produce inflation than jobs!*

Gentlemen, we *had* it! Or should I say: we've been *had?*

The Act presumed further that *Government* would act prudently both in fiscal and monetary policies; that *trade unions* would keep their wage demands from exceeding improvements in general productivity; that *Congress* would refrain from passing laws that raised wages and prices; that *business firms* and *unions* would join in efforts to remove restrictive labor practices and featherbedding; that the *Government* would sensibly reform the tax system—to stimulate effort, productive investment, and greater efficiency; and that a careful balance of trade and balance of payments policy would be pursued.

You know, and I know, that none—absolutely none—of these things happened!

In truth—the opposite occurred.

Under the heavy pressures of politics—and I use the word in its broadest sense, both on a domestic and world scope—America kept escaping the hard economic facts of life and sipping the heady brew of inflation. Perfectly human way to act. Like the limerick that says:

There once was a Bishop of Treet
Who decided to be indiscreet,
But after one round
To his horror he found
You repeat and repeat and repeat!

And the record shows that this is *exactly* what we in America did.

We are now in the *seventh* period of serious price inflation since World War one—and that's just 50 years.

The inflation of 1919–20 ended with the most shocking depression in America's history—the psychological effects of which are still widely felt here. Business recovery and inflation in 1936–37 was followed by a sharp recession. Following the 1946–48 inflation, after price controls of World War II were ended and prices jumped 45 per cent, an 11-month recession came. The 1950–51 Korean War business recovery saw price inflation of 16 per cent, until controls were imposed in January, 1951. Yet recession began in August, 1953, when the war ended. The 1955–57 inflation saw prices go up 7 per cent—and another 11-month recession followed. The 1966–69 inflation saw prices climb at an annual rate of 7 per cent—and a 12-month recession followed, the so-called "Nixon Recession" when Dr. Burns and the Fed performed so nobly they almost stopped America in its tracks.

That recession was accompanied by the greatest deficits in the history of the United States and the greatest increases in Federal budgets. Simultaneously, our balance of payments and balance of trade went completely off the charts—with a 2.5 billion deficit in 1971 and more than 6 billion in 1972.

Now—we are in Inflation #7, and I don't have to tell you what is happening to prices. Has anybody learned a lesson—after 50 years—or are we heading for another recession, starting sometime in 1974?

And aren't we, the producers of wealth, just a little weary of being both the victim of this boom-and-bust—and being accused as its progenitor? I am!

I am getting tired of the numbers—and, besides that, they worry me. Inflation (which means the busted buck will get more busted) is now in a virulent state in our country. Wholesale prices in March, 1973, climbed at a yearly rate of almost 30 per cent!! This is the largest reported increase for a single month in more than 20 years. Industrial commodity prices accompanied farm prices in this climb—with industrial commodities at their highest level since the Korean War.

And the busted buck comes back to haunt us as a factor in 1973 inflation—since price increases seem to have been most pronounced among major internationally traded commodities. That's because such imports cost more, as the result of the second devaluaiton of the dollar!

Talk about the dog chasing its tail!

It looks like there will be a slackening of economic expansion in the months ahead—with real growth (minus inflation) down to some 4 per cent in early 1974, compared with 8 per cent currently. If our legislative elders and executive juniors in the Federal government succeed in holding down Federal spending—the 1974 Federal budget could be reduced. 20–20 rear vision tells us that fiscal policy should have become less expansive around the middle of last year—but in a Presidential election year, would the people and the politicians have stood for it? I doubt it.

Obviously the persistence of the phoney "full employment budget" deficits clearly and undeniably have played a key role in the recent inflationary binge. And the immediate outlook is grim. For the near term, the next three to five years, we are unlikely to see an inflation rate of less than 3 per cent per year. This means further erosion of the value of the dollar—and the need for Government to continue economic controls of some kind.

The kick in the pocketbook will continue.

The curious case of the busted buck won't be solved—but Shylock Holmes will be more clearly identified.

I say this because not only have the *two principal "economic policies of the post World War II period failed the American people*—but also because much in our economic future is tied to the fact that the *American supremacy in international finance is finished.* Kaput!! The monetary and trading system that provided the basis for the postwar era has collapsed. We had been living in the belief that we were so large and so powerful that our economy was invulnerable. Now in 1973 we know different! We know now that no monetary apparatus, however sophisticated, is able to counteract the effect of basic distortions in the patterns of trade among the great nations of the world. I do no have to give this audience details of those distortions—the result of expending our surplus and extending our credits, under the Marshall Plan policy, until both were exhausted.

Now we are in a new world of business—

New here; and new overseas.

The United States is now a different economy—with some 52 percent of its working population engaged in so-called "service industries." But there is *one fact* that has escaped many:

The real wealth producing sectors in the American republic are now "manufacturing industry" and "agricultural industry"—a new phenonmenon on the face of this earth.

Other nations sought to achieve "agricultural industry" via "collective farms"—where people are herded onto farm property that belongs to the State.

In the United States—we truly "industrialized" the farm, to the point where unheard of productivity has resulted and where products of the farm now take their place in international trade as principal factors in our balance of payments. This has grown to the point where a recent issue of U.S. News and World Report carried a Page One headline saying "Will America Farms Save America's Balance of Trade?"

This changed economy, plus numerous changing social values, are making ours a different society.

Just as the new Common Market in Europe, with nine members, is a different society—outnumbering the United States in population, exceeding us in steelmaking capacity, in auto manufacture, and with a worldwide export of $130 billion a year!

And just as Japan is new and different—the free world's third biggest economy, with $24 billion a year in exports, the world's second largest steel industry, the world's third largest auto industry, and the world's largest shipbuilding industry. And growing fast!

Preferential trade agreements which the EEC is making with developing nations and with the nations of the European Free Trade Association will have a definite *negative influence* on the ability of the United States to compete, not only in most European markets but in the Third World as well. Dollar devaluation or no dollar devaluation!

It is going to be very interesting to see how America's negotiators in the world trade talks starting in September will fare with their counter-proposal calling for *elimination of all tariffs* on *industrial products* among industral nations. I hope we will not prove unrealistic in the hard world or world trade, now among equals; nor naive, as we have been in the past.

For we no longer deal from great strength—but from comparative weakness.

The mark, the yen, the franc (Swiss and French) are the strong, hard currencies in today's world.

And while output per man hour in the total private economy in the U.S. advanced at an annual rate of 4.7 percent in the first quarter of 1973—we still are behind Japan, where it went up 11 per cent; and in the Common Market, where it went up 8 per cent.

We are currently in a state of relative economic euphoria in the United States. Business is a lot better; profits have improved; more people have jobs.

But there is a latent uneasiness—to be found everywhere you go.

It rests on the Curious Case of the Busted Buck. The dollar is worth *less*—and that's why all of us have to pay *more*. Fancy names, like inflation and recession, may come and go. But the ordinary citizen, and the ordinary manager, knows in his gut that you can't take more OUT of the dollar than you put INTO it!

When you pay a plumber $25 for five dollars' worth of work; when you pay $6,000 for a $3,000 auto; when you pay $10 for a $4 steak—when, in short, as Bob Anderson of Rockwell recently told the Detroit Economic Club, we "let low productivity force the imposition of a $10 price on a $7 product"—you haven't solved the Curious Case of the Busted Buck.

No longer the sole dominating economic power in the world, America faces a time of global interdependence, shared economic leadership, and sweeping economic change. It is now archaic, to a certain degree, to speak of "our domestic economy"—for economic conditions here no longer will exist independent of, and in isolation from, events around the world: in Europe, Japan, the Arab Nations, China, and Russia.

Internally, we must quickly and solidly mend the busted buck. Externally, we can show again the productivity, technological advance, and competitiveness that formerly made us great.

As for the Real Shylock Holmes—have you looked in the mirror lately?

STATEMENT BY THE MICHIGAN CREDIT UNION LEAGUE

The MCUL is a statewide association, affiliated with Credit Union National Association, and representing approximately 1,000 credit unions. Over two million people in Michigan are credit union members. Many of these are employees who would be affected by pension legislation.

The goals of strengthening the operation of pension plans and assuring payment of benefits would be beneficial to credit union members, and MCUL support the legislation to accomplish that.

However, a matter of particular concern to credit unions are those portions of any legislation which would define eligible depositories for various purposes. For example, the "Portability" title of S4 provides for certain funds to be deposited in banks or savings and loan associations. We request that credit unions also be included as such eligible depositories; as you probably know, there is a program of federal insurance for credit unions which is comparable to those for banks and savings and loan associations.

Therefore, we request that any references to eligible depositories include language necessary to permit credit unions to act as such depositories.

Statement of the Communications Workers of America, Submitted by Joseph A. Beirne, President

The Communications Workers of America, which represents more than 550,000 people in collective bargaining, endorses the passage of meaningful legislation that will strengthen our nation's private pension plan system.

Since pension plans began in the United States almost a century ago, in the 1870's, millions of workers have been forced to forfeit for reasons beyond their own control the money that was deducted from their payroll checks for the avowed purpose of benefiting them during their later years. Even today, in the 1970's, because of inadequate federal standards, employees must play a variation of the game of Russian roulette to collect their deferred wages—and that is exactly what a pension is—when the companies they work for are shut down, sold, go bankrupt or the pension money is mismanaged as has happened in thousands of instances.

When this occurs workers lose out on a dream that they have quietly nurtured, the dream of living their "golden years" in comfort free from the pangs of financial misery. Instead they are faced with a nightmare of despair which can lead to severe depression and even suicide.

The need for effective pension legislation is especially pressing now as both the total number of workers involved in pension plans and the assets of pension programs are accelerating at an unprecedented rate. Currently, there are almost 35,000 pension plans in operation in the United States and 34 million workers participating in them. It is projected that by the beginning of the next decade 42 million American working people will be entrusting part of their earned income to pension plans in the hope of security during their later years.

Since 1940, the assets of private pension plans have skyrocketed from $2.4 billion to more than $135 billion today and by 1980 assets should be in excess of $200 billion. This last figure would be almost 100 times the assets of America's pension plans in 1940, a phenomenal increase.

Thus, it is clear that the money in pension plans is there but the tragedy is that the intended beneficiary, the American worker, is not receiving what he paid for. In fact, recent statistics have shown only one out of every ten employees who enroll in a pension program receive pension benefits.

A government official accurately summed up the plight of prospective pensioneers when he stated:

"If you remain in good health and stay with the same company until you are 65 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."

Currently, one out of every 14 plans qualified by the Internal Revenue Service terminates. In 1971, 3,300 plans folded affecting more than 125,000 workers. During the first seven months of 1972 alone, 683 pension plans failed affecting 20,700 pension participants. The saddest part of this story is that the participants hit the hardest by these closeouts are those between the ages of 40 and 60 and they have considerably less chance than younger workers of finding new jobs with pension coverage.

Concerning our own union, almost all of the 550,000 people that the Communications Workers of America represent in collective bargaining work for the Bell System. The Bell System Pension Plan has been in effect since 1913 but it was only five years ago, in 1968, more than a half century after the Plan's inception, that Bell included any vesting rights to pension equity for terminating employees.

A terminating Bell employee is now entitled to his pension equity if he has achieved 15 years of service on the job and is at least 40 years old at the time of termination. The Bell System offers no partial vesting schedule but takes an "all or nothing" approach, anachronistic in concept and inequitable in approach. Under the Bell System arrangement, a worker could diligently perform his job

BEST COPY AVAILABLE

for 14½ years and wind up with absolutely nothing in terms of vesting although if he had worked for six months more, he would suddenly be 100% vested.

There is one startling statistic concerning the operation of the Bell System Pension Plan that we would like to call to your attention. This deals with the inordinately poor earnings record of the Fund. In 1971, the Bell System earned only 3.08 percent on its pension holdings on approximately $10 billion. There are triple A bonds, of the highest security, that pay almost three times this. Moreover, in 1969, the Fund earned 2.9 percent on $8 billion. Thus, practically anyone who puts his savings in a federally insured bank in the United States receives a higher rate of interest on his savings than that secured on workers' pension money by the administrators of the Bell System Pension Plan.

As to the various pension reform proposals before Congress, we support S. 4, the Williams-Javits bill. This legislation could be strengthened by certain modifications but it addresses itself to the existing problems of private pension plans with a sense of clarity and purpose that outstrips its rivals.

We advocate coverage beginning immediately from the time of employment for all workers as this would bestow on a worker potential benefits from the start of his employment and would end the practice of cancelling the pension equity of those who terminate their employment with a firm after a few years of service.

Concerning vesting, we favor a system of immediate partial vesting under which vesting credits would accrue to participants in pension plans commencing with their first year of service after enactment at a rate of 10 percent a year, so that after 10 years an employee would be 100 percent vested. Thus, under this arrangement, a worker would be fully vested after a decade.

We believe that this approach and also the vesting formula spelled out in S. 4, 80% vesting after 8 years and then 10% vesting a year for seven additional years, are both superior to the "rule of 50" advocated by the Administration.

The "rule of 50" is far more lenient on employers than S. 4. Under this proposal, a worker would be 50% vested when the combination of his age and years of service totalled 50. He would then earn 10 percent a year for five more years to receive full vesting.

The "rule of 50" is particularly detrimental to the hiring of older employees. It would provide a direct threat to the elderly as it puts the full burden of pension support on the last employer so that the incentive would be greater than ever before for companies to avoid hiring the elderly.

Another aspect of pension reform that is badly needed is retroactivity. This involves recognizing work done by an employee prior to enactment of any future pension legislation. S. 4 deals directly with this problem by allowing workers who are at least 45 years of age to receive vesting credit for their service with their present employer prior to enactment of the law.

Portability is another needed feature of any effective pension legislation. When a worker transfers to a new employer he often loses his entire pension. Just as an employee carries his social security credits with him from position to position, he should also be permitted to take his vested pension credits from one company to another when changing jobs.

S. 4 has taken a significant step forward by proposing a voluntary portability fund that would be administered by the Secretary of Labor. The portability provisions are especially timely as now more and more workers are changing jobs and moving throughout the United States as transportation improvements continue to "shrink" distances and we become a more mobile and transient society.

Indeed, one of the chief drawbacks of the Administration's proposal is that it provides no portability provisions for workers who change jobs or relocate to another place in the United States.

To make pension programs more secure, S. 4, authorizes the setting-up of a Pension Plan Termination Insurance Program similar in concept to the way in which the government protects the public's bank savings through the Federal Deposit Insurance Corporation. The insurance program contemplated by S. 4 would protect participants against the loss of vested benefits arising from pension plan termination if the plan in which a worker participates fell short of money.

Perhaps the chief failing of the Administration's proposal is the complete lack of termination insurance for pension plans. This omission ignores the horrors such as the Studebaker plant closing ten years ago when many workers got nothing because their pension fund was mismanaged and uninsured. It also

BEST COPY AVAILABLE

ignores other tragic plant closings where a worker received no pension money at all after laboring industriously for many years.

S. 4 recognizes the need to make sure that employers are responsible in funding their portion of workers' pensions. The legislation recognizes that the money in a pension fund is not "company" money but is money set aside for the future benefit of the employees for whom the fund was established.

In summary, we believe that the strongest features of the Williams-Javits bill are its vesting, retroactivity, portability and insurance features whereas we believe that the weakest portions of the Administration's proposal are the lack of portability and pension termination insurance.

Again, we stress that an immediate partial vesting schedule taking place over a ten-year period would be the best possible way to handle the vesting question, rather than the "rule of 50" formula which would place an onerous burden on older workers.

We are encouraged that so many Members of Congress realize that pensions are not gifts to workers but rather are compensation largely deducted from paychecks which would have gone into the employees' wallets through the years if they had not belonged to a pension plan.

Enactment of legislation along the lines of S. 4 would provide new hope for the American worker and would afford millions of employees with the opportunity to enjoy their retirement period free from the duress of financial hardship.

Statement of Paul H. Jackson

My name is Paul H. Jackson. I am a Member of the American Academy of Actuaries, a Fellow of the Canadian Institute of Actuaries, and I am employed as a Consulting Actuary with The Wyatt Company, Washington, D.C. This statement is based on my own personal experience with private pension plans in the United States and Canada, as a practicing consulting actuary. Since I have not canvassed my clients, or even the other actuaries within my company, this statement should not be considered to represent their positions. For this reason, I have restricted my comments to several practical matters of a technical nature. A brief summary of these points, together with my conclusions, would run as follows:

1. A single vesting provision should not be incorporated in any law. Since full 10 year vesting, graded vesting after 8 years, and after 5 years, and vesting by Rule of 50 have been proposed by different parties, each believing them to be reasonable, all of them should be included as alternative options for a particular plan. This would provide the greatest flexibility for private programs to meet the specific needs of plan sponsors and covered employees.

2. Any vested benefits required by law should not be based on the normal or early retirement provision of the particular pension plan but rather should be a monthly benefit payable for life commencing at age 65, the normal retirement age under the U.S. Social Security program. To do otherwise would be to unfairly penalize employers and employees in those industries where older workers cannot be safely or profitably employed.

3. Minimum funding and vesting standards should not be applied at this time to area-wide or industry-wide multi-employer pension plans. In many cases these plans call for specified contributions and specified benefits based on a particular level of funding that has been agreed upon as being reasonable by the negotiating parties. Because the negotiated income to the plan remains fixed, any requirement to improve the degree of funding would have the immediate result of either lowering the current benefits or forcing the actuary to employ unreasonable assumptions on a temporary basis.

4. The requirement of 5-year amortization of experience deficiency contained in the Williams-Javits bill (S. 4) is unreasonable in that it would impose substantial short-term variations on a funding pattern that is adopted for the long-term. Any final legislation should require only 30- or 40-year amortization of unfunded liabilities, whatever their source.

5. Reinsurance of pension liabilities should not be included in any legislation. All reinsurance mechanisms suggested thus far would improperly exclude from benefits the many individuals who have already testified as to loss of benefits while the government would collect large sums of money almost all of which would have to be invested. If the government is to be involved in any pensioner

welfare program, it should be set up on a basis where the taxes that are collected are immediately disbursed as benefits to all aged persons who can demonstrate that they have been unfairly treated in the past through the operation of private pension plans, regardless of the date of plan termination. Preferably the necessary financing would come from general revenues and not from a tax imposed only on newly established defined benefit pension plans.

Conclusion.—The future will be sufficiently unstable and the possibility of inflation so real that the pension promises of employers, even unbacked by assets in a formal fund, may prove more valuable to workers in assuring adequate benefits than any of the other available alternatives. Private pension plans should therefore be encouraged.

VESTING PROVISION

The sponsors of proposed pension legislation have not agreed upon a single "best" vesting provision. The Williams-Javits bill calls for 30% vesting of the accrued benefit after 8 years of service grading up to 100% after 15 years; the Dent bill calls for 100% vesting at 10 years; the Administration proposal is to have 50% vesting in the accrued benefit when age plus service total 50, grading up up from 10% to 100% vesting 5 years later; the Bentsen bill would require 25% vesting at 5 years grading up to 100% at 20. Any one of these provisions might be shown to be reasonable for a given plan. Certainly the sponsors of these varied legislative proposals have given careful thought to the design of their requirement. Each tends to serve a different purpose. The Rule-of-50 is intended to restrict vested benefits to the older workers who are least able to make up any loss in pension rights at termination; the graded vesting in the Williams-Javits and Bentsen bills is intended to minimize the differential between the employee terminating just before and just after meeting the vesting requirements and possibly to prevent unfair discharge just prior to vesting; the Dent proposal is a more practical requirement that would be met by many existing pattern plans such as Auto, Aluminum, Rubber, Oil, etc.

At the present time pension programs are designed to meet specific circumstances of a particular group of employees in a particular industry, and the range in choice of vesting provision has, up to this point, been completely unlimited. This suggests that, as one form of compromise, it might be best to put all four of the above vesting requirements in a pension bill and permit the individual plan to test out under any of them. This would serve to reduce the present unrestricted choice down to a choice of four provisions for minimal vesting. The vesting provision should not, however, apply to those multi-employer plans of sufficient scope that full portability can be assumed to be operative already. It should be kept in mind that the vesting provision in any pension legislation is intended to set forth a limit beyond which plans should not be permitted to go from a standpoint of general public policy. Such a limit should not be confused with the legislative approach in Social Security and the Civil Service retirement system where a reasonable set of benefits for a given plan would be involved. Actually, each of the four previously mentioned vesting provisions would appear to be a reasonable provision for some plans so that setting all four of them out as alternatives in the final legislation might provide a more reasonable approach to a socially justifiable limit.

BENEFIT TO BE VESTED

Most of the proposed pension legislation refers to the vesting of a benefit to commence at normal retirement age. It would be my recommendation that the legislated minimum should be defined as a pension payable for life commencing at age 65. It could even be argued that the pension should not commence until employment ceases in those cases where Social Security is not paid at 65 because of the earnings test. Very serious problems would result if some of the incidental features in pension plans such as early retirement provisions, disability pensions, death benefits and the like were to be vested. Early retirement, for example, is a matter which varies widely by industry, depending on the particular job requirements. Generally, however, the added cost involved in early retirement under a pension plan can be justified, from the stock holders standpoint, by the concomitant payroll savings. Then too, if vested benefits commence before 65, there is discrimination in favor of the quitter and against the continuing employee. If in a particular industry normal retirement takes place at 55, for example, the employee terminating at 35 and entering a different industry can then start to receive his vested benefit at age 55 while continuing to work in that different industry, whereas the employees who continue in service must sever their current employment relationship before they can get their early retirement benefit.

Disability pensions are another troublesome area and appear to be practical only where careful controls exist. Considerable abuse can result with a disability pension and so it has been customary to restrict it to situations where the pension represents a partial replacement of lost wages. To extend disability pensions to individuals who have left the labor market would present unmanageable problems with the absence of an "ability to work" test. So far as death benefits are concerned, many pension programs provide no specific death benefits, widows' pensions, or subsidized joint and survivor options because the employee group may be covered by a group life insurance program with very generous benefits. In other cases, minimal group life insurance benefits are provided along with considerable death benefits under the pension plan. It is difficult to see why some death benefits should be vested and others should not. Based upon the above reasoning, I have concluded that the benefit to be vested should not include special early retirement features, disability or death benefit provisions and should start at age 65—the normal retirement age under the Social Security program.

MULTI-EMPLOYER PLANS

Where industry-wide plans have been bargained it has been customary for the level of both contributions and benefits to be negotiated. If legislated funding requirements are imposed upon such plans, the legislation will not, in and of itself, add to the contribution income—that must be bargained for at some future date. In order to keep the program in balance, therefore, it would be necessary to decrease pension benefits. For the vast majority of multi-employer plans covering entire industries either in large areas or country wide, there is no compelling reason for requiring full funding since entire industries do not collapse overnight, merge, or move elsewhere. Funding on a going-concern basis on some level cost pattern such as normal cost plus interest on unfunded past service is therefore a perfectly adequate funding pattern for a multi-employer plan. To go beyond such a level long-range cost would be to inject a serious element of distortion in the equity among various generations of workers. Current workers would be forced to give up earnings which are used in the aggregate to finance their own current service benefits, their own past service benefits and the past service benefits of the older workers as well. Upon the completion of the funding, some future generation of workers would be in a position where the same level of contributions would provide considerably greater benefits.

In many multi-employer situations, employment records are not available at a central source and the estimates of the pension accruals under the fairly complex provisions relating to credited service can be most difficult. Thus, the funding calculations for multi-employer plans tend to be far less exact than in the case with single-employer plans. Accordingly, it would be my recommendation to permit multi-employer plans to continue to operate within the framework of the present rules and regulations relating to the funding of qualified pension plans.

5-YEAR AMORTIZATION OF EXPERIENCE DEFICIENCIES

The Williams-Javits bill in the Section on funding would require the separate development of "experience deficiencies" and any such deficiency would have to be funded over a 5-year period. To begin with, it should be noted that a short fall in assets will have exactly the same effect on the benefit security of the covered employees, whether it is due to an experience deficiency, a failure to contribute, or any other reason. Accordingly, it can be stated as a matter of principle that this 5-year amortization requirement is not desirable per se. In fact, the requirement has been copied from the regulations implementing the Ontario Pension Benefits Act. This requirement was adopted by Ontario in 1966 because it was believed that such harsh treatment of experience deficiencies would encourage actuaries to use more conservative assumptions. As it turns out, this is simply not the case. As an actuary practicing in Canada and certifying under Ontario regulations since 1966, I can state categorically (and back the statement up with mathematical demonstrations if need be) that the 5-year deficiency rule actually encourages the actuary to adopt the weakest possible assumptions. It is true that more conservative actuarial assumptions would tend to lower the deficiencies, but the deficiencies cannot be eliminated entirely and the use of more conservative assumptions would simultaneously impose far heavier normal cost requirements on sponsoring employers to a degree that far overshadows their effectiveness in reducing deficiencies. As a further proof of this point, the province of Ontario is currently quite concerned with the fact that some actuaries are using unreasonable assumptions so that even though the 5-year amortization of experience deficiencies has been in their regulations from the very beginning, they still have the problem. In other words, this mechanical solution to a real-world problem simply has not worked.

There are many situations where the experience deficiencies that arise simply could not have been anticipated in the actuarial assumptions. A sharp drop in the fair market value of the securities in the fund, an across-the-board salary increase made necessary by inflation, or a surge of early retirements following plan amendment are but a few illustrations. To demonstrate the complexity of this matter, consider the many situations where actuaries employ aggregate rates of withdrawal from service that depend only on the ages of the employees (a commonly used actuarial procedure). These aggregate tables imply a certain "mix" by length of service at each age. If an employer should experience a down turn in his business and simply go through several years of not hiring new employees, employment terminations among the remaining group may fall well below that of the aggregate table even though that table is a perfectly reasonable long-range expectation for the future. Certainly it would not seem reasonable to force an increase in pension cost on an employer at the very time when his future outlook is the bleakest. The alternative is to employ more complex actuarial procedures utilizing select and ultimate service tables, at a considerable increase in the cost of valuation.

Where the general market value of assets falls sharply, such as in business recessions, pension programs should not be forced to amortize the drop in the fair market value of the entire accumulated fund over a 5-year period as would seem to be called for by S. 4. Five-year amortization means that the contribution for the next year would be increased by perhaps 22% or 23% of the drop in asset value and for well-funded plans, the accumulated assets may be 10 to 20 times the size of the current contribution. This requirement is so extreme that it would encourage the use of exotic formulas for asset values in order to avoid these sharp changes in contribution requirements but such formulas would develop more stable contributions only by the device of producing asset values that are likely to be far in excess of the fair market value of the securities held by the fund after the market has dropped. In any case, since the requirement of 5-year amortization of deficiency is not desirable in and of itself, since it does not influence actuaries to use more conservative assumptions and since it does impose unreasonable short-term variations on funding of a long-term pension obligation, it should be deleted from any final legislation.

REINSURANCE

Most provisions for pension reinsurance follow a general pattern that might be described as follows: the event to be insured against is considered to be the total prospective loss in benefit resulting from the termination of a pension plan. The excess of the single sum value of all future benefits over the fair market value of the assets on hand under the terminating plan thus determines the amount of loss in the individual case. First off, the annual claim cost will then be the aggregate total of these single sum values for the relative handful of pension plans that terminate in a given year. This annual claim cost will vary widely from one year to the next, depending on general business conditions. Accordingly, no stable statistical basis for the development of fair "premiums" would be possible. Second, the assets in the terminating plan will generally be applied to continue the payment of benefits to people already retired and then to provide the benefits for those eligible for retirement, so that the supplementary amount needed that would be drawn from the proposed reinsurance fund would not be required for the actual payment of benefits for many many years. This raises the question of whether the government can invest such funds on as profitable a long-term basis as private investment counsel. Finally, because these proposed reinsurance programs start out prospectively by recognizing only those losses resulting from plan terminations that take place after the effective date of the law, the programs would do nothing for those older individuals who are in need today because they are not receiving a private pension benefit due to the prior termination of a pension program.

It seems clear on any logical assessment of the above facts that the proper role for government in this matter is not one of collecting large amounts of money which must be invested for many years but rather is one of meeting current needs directly. All government programs must be measured by the standard of social adequacy, and since they rely on taxing power, they need not sedulously adhere to the concept of individual equity that is so necessary in the design of privately financed programs. If at the outset the government were to take on the obligation of paying people who are then over age 65 a benefit equal to that which they lost under their private plans (with some overall dollar maximum such as the maximum Social Security primary benefit available in the year of their retirement), then the program would meet today's needs, would be socially adequate, and would avoid the investment problem. Furthermore, the cost pattern for such a program would be quite stable and predictable from year to year because it would consist of the cash payments to a known group of pensioners at the start of each year, increased only by the "losers" under already terminated pension plans who attain age 65 in the given year. This pay-as-you-go cash outlay is demonstratably stable and predictable. In short, after talking about the poor Studebaker workers for a decade, perhaps we should *do* something for them other than merely use them as a cause celebre to justify some legislation that will only help others.

Thus, on actuarial grounds as well as the general principle of social adequacy, I recommend the adoption of a federal pensioners welfare program that would collect sufficient funds in taxes of one form or another to pay benefits today to those older workers who are currently suffering a loss of private pension benefits without regard to the particular date of plan termination. And, in implementing this program, the approach should be to review each individual case on its merits and make things right.

FINANCING MECHANISM FOR REINSURANCE

The Williams-Javits bill in its reinsurance provision would collect a tax (or reinsurance premium) at a specified percentage rate of the unfunded vested liabilities of a given plan. The value of such unfunded vested liabilities will depend on the actuarial assumptions and this would seem to place the determination of the amount of the reinsurance premium in the hands of the party insured! The less conservative the actuarial assumptions, the lower the reinsurance premium tax. This would seem then to call for federal review and approval of the actuarial assumptions used for each case and an assessment of whether or not they are appropriate. Furthermore, this method of developing a tax is quite complex and would be costly to administer. In reality it is a pseudo scientific method for the assessing of premiums whose administrative costs might well outstrip the revenue raised while at the same time it would add only a spurious accuracy to the process of taxation.

If the fair market value of the assets in a fund should drop sharply, such as after a general market decline, the reinsurance tax would rise considerably and at just the wrong time of the business cycle, since the moneys taken from the fund in tax would have otherwise purchased the maximum number of shares in the depressed securities then available. This again raises a question of asset valuation.

There are some clear alternatives that would be far more practical such as collecting the necessary funds at an average dollar charge per employee covered or as a percentage of contributions or as a percentage of the investment income of all qualified plans. The collection of the reinsurance tax from the funds themselves, however, violates a principle so fundamental in pension planning as to cause both management and labor to object. Management generally opposes federal regulation of actuarial assumptions, permissible benefits and investments. Unions view pension programs as arrangements under which their working members defer an increase in current wages in order to have that money placed in a pension fund under circumstances where all of the money in the fund will go to those of their group who retire because the assets must be used solely for the benefit of the covered employees. A reinsurance tax on these private funds would set a precedent in a very fundamental way because the assets in the fund could no longer be considered inviolate since a portion of the fund (modest enough at the start) can be siphoned off for other purposes such as for the payment of benefits to individuals in totally unrelated groups. Like the tax imposed by the various states on insurance premiums, this taxing of pension funds must come to be viewed as a mechanism for raising revenue that is highly atractive in the sense that the revenue can be increased well beyond the level needed to support the insured benefits without any individual or corporate taxpayer feeling the pinch directly.

For the above reasons, I have concluded that any pensioner welfare benefits as recommended in the previous section should be supported out of general revenues. It would also appear possible, because of the small aggregate benefits involved, to fit them into some other seemingly unrelated program such as unemployment compensation. In any case, all of the money placed in a pension fund should be preserved for the benefit of the individuals who were in the group which has foregone ~~the~~ wage increases in order to develop the funds. There should be no tax on qualified funds.

GENERAL COMMENTARY

The Williams-Javits bill and some of the other proposals would make it impossible for an employer without a pension plan to pay, out of pocket, an adequate pension to a single old employee who is retiring currently without first establishing a plan that covers everyone from age 25 on, provides vested rights, is funded at some minimum level, and pays a reinsurance premium on the initial large unfunded vested liabilities. The cost of such a program at the outset is clearly so much higher than it has been in the past, that the end result can only be lower benefits for the older people. The supporters of pension legislation base all their logical arguments on the apparently reasonable assumption that the pension benefits that exist at a given level today will not be reduced by reason of their legislation. There is an implication that the regulations will improve benefit security, all other things being equal. The principal of ceteris paribus, however, is simply not applicable over the long run. The regulations will result in future benefit improvements on a less frequent basis and in smaller amounts. Thus, what is involved is a lower level of benefits that is financed on a safer basis. If too sharp a change in funding requirements is imposed on private pension plans, the end result will be to encourage employers to freeze those plans in the status quo and move in other employee benefit directions.

Where the promise of a pension is going to involve an employer in financing problems, taxes, and in a possible government claim against his entire net assets in case of plan termination, this surely must operate as a terrible deterrent to the adoption of a pension plan. Rather than pension promises being made (which in occasional unfortunate circumstances admittedly have been broken), we will end up with a climate in which employers will be encouraged to make no promise whatever. Profit sharing programs, money purchase pension plans and savings and thrift plans do not involve all of these drawbacks so that employers could be expected to shift future service credits over to such arrangements to avoid the taxes, funding complexities, etc. A study of the past will indicate, however, that money purchase plans have not worked satisfactorily in the pension area because we have not had a stable enough economic environment.

The major problem facing pension plans today is not the occasional loss of benefit at plan termination but rather the annual catastrophic loss of pension purchasing power through the ravages of uncontrolled inflation. Where employers have responded to the loss of benefits due to inflation, by providing greater current pensions under their plans, they have at the same time added considerable past service liabilities which, under proposed legislation, would be subject to reinsurance premium tax and, at plan termination, to assessment against the stockholders' interests. There are some well meaning critics of the private pension system who have pointed to money purchase programs that are fully vested in each individual as representing the ideal solution here. If we could be sure that the world in which we live would be so stable that the price of gold will be $35 an ounce in the year 2000, as it was in the years 1935 and 1965, then their suggestions might have some merit. However, the supplementation of any such arrangements by defined benefit pension plans that can be tailored to meet the real needs of those retiring each year would seem to be even more desirable in the unstable future than in the past.

While it is true that some private pension plans have not paid benefits to some of the younger workers who considered themselves entitled thereto, there have been no instances that I have read about where it has been clearly shown that the actual assets in those pension funds have been paid to individuals who were not deserving of or entitled to benefits. There will be no increase in market value of the assets up to the level of full pension expectation for everyone simply because of the passage of comprehensive pension legislation. By insisting on greater prospective benefit rights for younger workers to be paid decades in the future under private pension plans, the legislators must accept the responsibility for depriving the older workers today and tomorrow of badly needed retirement income. It is for this reason that sharp changes in the operating rules and legal requirements for these plans should not be made.

The private pension system is by and large, a good one, as the 5 million senior citizens now collecting benefits should confirm. There is an element of social adequacy inherent in these plans that should not be sacrificed on the selfish principle that each worker must get back no less than the cents per hour cost times the hours that he worked. The possibility of forfeiture, or of contributing to the well being of others, may, in fact, be the only rational argument for not taxing employees on the current contribution and investment income. Too great an emphasis on individual equity may reduce these programs to an inflexible collection of individual bank accounts at the very time in our nation's history that we appear to be in the greatest need of flexibility and compassion.

STATEMENT BY A. ROBERT STEVENSON, ASSISTANT SECRETARY, S. S. KRESGE COMPANY, AND CHAIRMAN, EMPLOYEE BENEFITS COMMITTEE, AMERICAN RETAIL FEDERATION

This statement on private pension legislation is submitted by the American Retail Federation, which, through its 31 national and 50 state retail association affiliates, represents over one million retail establishments throughout the country.

We appreciate the opportunity to comment on pension reform legislation because of the great importance of the proposals in the various bills introduced. Our purpose is to present the retail industry's viewpoint on the issues involved in order to assist this Committee and the Senate to arrive at a practical and appropriate decision on these important subjects.

We would also like to express our gratitude for your thoughtful action last year in assuming jurisdiction over all but the reporting and fiduciary responsibility sections of proposed pension and profit sharing legislation and your committee's insistence upon a more objective discussion of the pension issues. Pension and profit-sharing legislation has been within the tax writing committees of Congress for the past forty-two years and properly belongs there. Also, any proposed pension and profit-sharing legislation without the expertise of the Internal Revenue Service would be more costly to enforce and far less effective in obtaining compliance generally.

Retailing is a labor intensive highly competitive industry which employs a significant percentage of the country's working population (over ten and a half million workers—about 12.5% of the total workforce). At the same time, retailing operates on a profit margin lower than that of other industries. For these reasons, such pension reform legislation as may be enacted will have a more significant impact on the retail industry than on more capital intensive industries.

Many retailers would like to have the option to adopt pension plans at a reasonable cost without a lot of red tape. Additional regulation, with its inherent expense would deter retailers from adopting such pension plans. Furthermore, additional costs imposed only on the companies which now have pension plans, further widens the competitive disadvantage between those companies and companies which have no pension plans.

1978 and the near future does not seem to be an appropriate time in which to load additional cost on an American industry striving to provide full employment and remain world-competitive. It must be kept in mind that increased pension and profit-sharing cost is not the only cost facing employers. Increases in other forms of social legislation demand their place in the order of priority: For example, increases in Social Security which were recently enacted along with proposed increases in the minimum wage both impact very heavily on the labor intensive retail industry. This is especially true with the further possibility of a proposed national health care system. Thus, it would seem that the least expensive form of pension and profit sharing legislation is all that should be considered at this time.

GROWTH OF PRIVATE PENSION PLANS

The growth of private voluntary pension plans has a good record. It has been estimated that $150 billion in assets are he'd in trust in private pension plans, for retirees—present and future. Approximately $10 billion a year is being contributed to private pension plans, and about 50% of all employees are covered by private pensions. Five million people are receiving pensions amounting to more than $8 billion a year, and 50,000 new plans are being added each year. About 70% of all plans have vesting provisions and the figure nears 85% or 90% among employer-administered plans. It is estimated that 65% of the employees covered are expected to qualify for benefits under their present plan and another 10.0% are young enough to qualify for a pension in subsequent employment. This, we think, is a good record for a voluntary and diverse private pension system.

As the above would indicate, most of the current literature on private pensions deals with the universal, the general, and the aggregate. The problem is that, having done so, there is an unjustifiable tendency toward not seeing the trees for the forest. Thus there is a danger of having legislation based on averages and generalities rather than with the understanding of the effects of such legislation upon specific industries. It must be understood that pension plans are not a huge private industry but rather a series of *individual programs* tailored on the basis of voluntary individual choice. Each company has special problems and no single set of benefits will fit the requirements of each and every group.

WHAT PENSIONS ARE AND ARE NOT

Most articles on pensions rely on some sort of analogy: thus, pensions are a collective form of personal savings; pensions are deferred wages; pensions are a type of transfer payment; or pensions are a means of maintaining a young and active staff. Actually, pensions are pensions. A pension plan is a useful and fairly flexible tool that provides management with alternatives that are not available in bank accounts or annuity contracts, thrift plans, or other personnel benefit devices. A pension plan is not a desirable tool to give a little bit to a lot of people—like a flat pay raise—but it is an excellent means of providing adequate retirement benefits to employees. A pension plan is a program, a plan, not a promise; and prospective pension benefits are to be earned over the course of employment.

It must be recognized that private pension plans are not another layer of social insurance. Private pensions are not compulsory and there is no benefit if there is no plan. The matter of tax treatment presently allowed does not amount to a subsidy but more relates to a tax timing. Also, as to the argument that early vesting will increase labor mobility, a recent Department of Labor study showed that seniority was a more important factor in labor mobility than vesting requirements of a pension plan.

One of the surest ways to kill the spread of private pension plans to employees who do not now have such benefits, and to stop the voluntary improvement of existing plans, is by legislation which is not practical and appropriate. Controls that now exist are substantial, and such agencies as the Department of Labor, the Securities and Exchange Commission, and the Internal Revenue Service are already required to check on such plans.

In spite of the fact that various business spokesmen favor legislation proposals which would not require changes in their own particular plans, the future of private pension and profit sharing plans requires getting the actuarial facts and evaluating the overall benefits, current and future, for whichever legislative or regulatory action is being advocated. Each industry and indeed each company, have special problems. The financial impact of these proposals would not be the same for the different types of plans and different employers involved. Not all companies have the same profitability. The same coat cannot fit everyone. As pension plans are currently constituted, they provide flexibility and alternatives.

Unlike the larger retailers, many retailers do not have pension plans. Developing a pension plan is an evolutionary process; most companies cannot afford to start off with a Cadillac. This is especially true in the retail industry. Retailing is a very competitive business and is one of the large gap areas as to pensions. If about half of the nation's workforce is not covered by pension plans, a sizable percentage of that half not covered is in retailing. Since so many smaller retailers have no plan at all and, thus, no cost or additional regulation, with its inherent expense and red tape, legislative standards would deter retailers from adopting pension plans.

LEGISLATIVE STANDARDS BEING CONSIDERED

Vesting

To be opposed to vesting legislation is not currently popular, and one runs the risk of public criticism by even raising a question as to the desirability of vesting requirements via legislation. The effect, however, of government compulsion and standardization as to vesting would retard rather than encourage the development of new plans, and would tend to deprive both employer and employee of freedom of choice in developing the kind of pension plans they want. It would be erroneous to treat vesting as a right to deferred compensation.

Pension reformers must be made to realize that by legislating early vesting, you are trading off against larger pension benefits, disability, and widow's benefits, and the granting of further increases to already retired employees, or any number of other things in the pension area. Out of the pension area, you are trading off against other fringe benefits such as larger wage increases, shorter hours, and longer vacation time. Minimum vesting standards therefore, must not be considered in a vacuum, but rather must be examined in context with the items mentioned above, as such federal standards would ultimately affect other interrelated and socially beneficial priorities.

It is interesting to note from the statistics previously cited as to the number of plans with vesting provisions now in existence, and the projection of the number of employees that will qualify for such benefits; that estimate is very high, without government intervention.

Most companies and employees feel that the primary purpose of their pension plan is to protect long-term employees at or near retirement age and to provide adequate pension benefits for them rather than vesting pension rights to the credit of the younger, shorter term employees. In effect, legislating minimum vesting requirements would be dictating to retailing and its employees, that voluntary pension obligations must be spent to provide a smaller benefit for a great number of employees and thus scatter its shot instead of providing a meaningful benefit for those employees who stay with the company for a significant number of years.

Assuming legislation is needed in setting limits on pension plans, which the American Retail Federation seriously questions, there should be a searching for the limit of social patience far below that which has thus far been proposed. The object of a vesting standard, if one is needed, should be to protect against loss of accrued benefits for long service workers.

Legislative proposals have suggested various vesting requirements. HR-2 contemplates vesting upon 10 years of participation in the particular plan; the Administration Bill calls for 50% vesting when age and service equal 50 points, increasing 10% per year to full vesting with 60 points; and the Williams-Javitts bill requires 30% vesting after eight years of plan participation, increasing 10% per year to 100% vesting after 15 years. These approaches may have similar impact on costs of a "typical" pension plan, but few plans are "typical," rather, one or the other of these vesting proposals would cost a particular plan more or less than a different type of vesting schedule.

One retailer has commented that funding cost of the Vesting provisions in HR-2 could increase their cost by as much as 1.0% of covered payroll. (Grubbs Study Report to Senate Labor Subcommittee). Even at 0.5% of payroll, this employer's additional cost would be $1,200,000 requiring approximately 50 million dollars additional sales to produce the additional cost in pre-tax dollars.

Certainly any enacted vesting formula should be purely plan-participation related and not include any age factor. Any vesting schedule containing an age factor (for example, the Administration Bill), would be extremely costly to the retailing industry which historically hires older workers in large numbers. The inclusion of an age factor would create a pressure which might well lead to discrimination against the hiring of older employees. No single vesting rule, however, has so much merit that it should be imposed upon the structure of all plans regardless of their current vesting provision. A single inflexible and, for some, inappropriate and costly standard would be detrimental to encouraging new plans and increasing benefits in existing plans.

We suggest a reasonable approach to the matter of vesting requirements would be to permit the use of one of several vesting schedules. Some plans condition eligibility for benefits on attainment of particular ages; others require certain length of service; and others specify both. Some plans vest gradually while others fully vest upon completion of certain requirements. Each plan should be able to adopt a reasonable vesting provision in a form that corresponds closely to the type of provisions it already has for qualification for benefits. Thus, instead of forcing one form of vesting on all plans, legislation might incorporate alternative standards, permitting a plan to qualify by meeting any one of them.

Another aspect to be considered in the matter of vesting is what benefits should vest. We suggest that vested credit should be the accrued normal retirement pension benefit, and should not include disability and non-retirement benefits.

Committee action on vesting on present information would be premature. The first step must be to accurately determine the cost of a minimum vesting standard and its varying impact on different industries and companies.

Eligibility

In the retail industry, an eligibility standard of less than 5 years service would cause costly administrative problems and increased record-keeping costs for a very high turnover group of employees. When credited service and vesting refer to hire date, rather than the date of plan participation, the enrollment date is not important from an employee's point of view. Fairness to career employees also justifies a widely included eligibility restriction that those hired after age 55 will not qualify.

Funding

Before legislating away the flexibility which has, up to now, encouraged the growth of private pension plans, the effect of legislation or regulation on the formulation of new plans, and on the voluntary increases in benefits by employers, should be weighed. Even if the various proposed funding requirements do not directly affect existing pension plans, fluctuations in market values of pension fund assets could make adherence to a funding schedule costly. In fact, plans might avoid equity investments with the likelihood of short-term temporary market declines even though long-term prospects were superior, if a plan were required to rigidly adhere to a funding schedule. In addition, if there is a substantial influx of new plan participants in any pension plan, it may be more desirable to have a retirement program that is not fully funded. If the government were to impose certain vesting and funding requirements, such requirements might well become very restrictive. We must be wary of mandatory actuarial assumptions which might well accompany any funding requirements.

We feel a new funding standard is not necessary to pension plan participants. There are already standards for funding private pension plans. The Internal Revenue Service has a minimum funding provision which requires payment of current service costs plus interest on unfunded prior service costs as of the date of plan establishment or amendment. The Accounting Principals Board has established a higher minimum if the plan's vested liability is not covered by the value of assets, based on a 40 year amortization of prior service costs or an annual decrease in unfunded vested liabilities of 5%. There is no need for an additional legislative funding standard, especially when the actual amount of contributions involved will be very small under most proposals.

As to the funding standard found in S-4 it should be noted that it is not related to the issue of sufficiency of assets compared to vested liabilities; instead, it is concerned with the entire funding process for all liabilities for all benefits. Because the standard is not clearly defined in the Bill, interpretation by the administering authority would be necessary. While we assume it is not the intention of S-4 to regulate actuarial methods, such regulation might be considered necessary by the administering authority, including actuarial assumptions such as interest rate, turnover prior to retirement, and compensation increase scale, in accomplishing uniform application of the funding standard. Thus, undesirable technical complexities and increased regulation are bound to follow an enactment of this provision.

PORTABILITY

A portability program does not add anything to an employee's benefit and would merely provide an expensive way of implementing such benefits. What difference does it make if an employee retires and has vested benefits from 2 or 8 different companies, so long as he gets them? What is gained by creating a government agency to give an employee one check instead of his getting three? *Also, there are insolvable problems in transferring credits which are not 100% funded.*

Apart from the complexity of administering a portability program the transfer of fully funded vested benefits, even though actuarially reduced, can have an undesirable impact on pension plans since each plan has its own actuarial assumption. There is no uniformity in the various factors used to determine the value of a vested benefit. As a result there may be differences either in the present value of given benefits or in benefits on retirement from a given amount of assets transferred. This could lead to the government establishing uniform inflexible standards to all plans.

Another problem has to do with the fact that portability could result in short term employees syphoning off assets to the detriment of long service employees particularly where the pension plan were not fully funded. For example, when a terminated employee takes with him 100% of his vested benefit the funding of benefits and the remaining employees could be placed in jeopardy.

In any case, we believe that a mandatory portability program would jeopardize the pension system as we know it today. We oppose establishment of a portability program.

RE-INSURANCE

99.98% of 23 million covered employees' vested benefits were unreduced by plan terminations, according to the 1072 government study. This indicates a minute fraction of pension benefit defaults, yet it is proposed that termination insurance be established which would treat voluntary private pension plans as though they were a form of social insurance.

Adequate disclosure to employees of the portion of their benefits which are vested and funded (or note if the amount reported is not both vested and funded) would reduce, if not eliminate surprise as to decreased benefits in the event of plan termination. As to the fraction of pension plan participants who do not realize full vested benefits due to plan terminations, in the great majority of such cases the pension "promises" of the company was kept: benefits accrued and were funded as agreed. The employees, however, were not aware that only a portion of their prospective benefit was both earned out and funded.

We oppose reinsurance because it would result in an assessment against sound and continuing plans to pay for the losses of poorly administered or terminated plans. Further, the subject to be "insured" does not exist. Actually, the word insurance or re-insurance is a misnomer, describing what is actually a tax on unfunded liabilities.

The expense of "re-insurance" would divert employer funds from providing employee benefits, and it would also have the effect of deterring conscientious employers from amending plans retroactively increasing benefits, thereby increasing unfunded past service liabilities. We feel a re-insurance program would also encourage speculative investment and irresponsible benefit increases for unsound plans which might collect against the "insurance," i.e., tax bank.

The operation of a system of re-insurance would necessitate greater regulation, and therefore decreased flexibility, of pension plan administration and actuarial methods and assumptions.

As a matter of fact the existence of an insurance pool to guarantee pension benefits could also lead to pressure and an increase in benefit levels beyond the company's or collectively-bargained trust's capability to pay for them. On the theory that the insurance pool would make up any deficiency, it might also encourage administrators to engage in speculative investments since, if successful, contributions to the plan could be reduced or minimized. In the event of failure, the insurance pool would bail out the speculators.

Ultimately the Federal Government would be compelled to establish ground rules on the types of investments made, assumptions used and evaluation of plan assets, in order to protect the insurance pool. We believe that a Federal re-insurance provision would lead to complete regulation and takeover of a private pension system.

Retailing is very strongly opposed to any sort of re-insurance as being of questionable propriety and workability.

DISCLOSURE AND REPORTING

There are two aspects to disclosure: Communication to employees and registration, disclosure and/or reporting to a governmental agency.

Meaningful communication to employees is important and is presently required under the Welfare and Pension Plan Disclosure Act as recently amended. Most, if not all, retail companies which now have pension plans keep plan participants apprised of any changes in the plan and distribute, usually on an annual basis, a statement setting forth the amount each participant will receive for credited service to date. Such communication to the participant is designed to be as easily understood as possible as to individual benefits. For this reason, ARF believes that it is unnecessary to have such communications patterned by government guidelines. ARF is also circumspect as to the matter of certifying employee benefits. To require the sending, on an annual basis, of minute investment details which, in the majority of companies, are available to the employee on request, would both be costly to the employer and of little use to the employee—such requirements should therefore be avoided.

ARF is opposed to Additional Proposed Registration, Disclosure and/or Reporting Requirements to the extent the same would be cumbersome and would require the keeping of additional records both for the employer and for the insurer. Disclosure should be adequate and meaningful, but not unnecessarily detailed and burdensome. (Currently, the principal users of information on retirement plans found at the Department of Labor are those who sell investments, stocks and bonds to fund trustees.) In addition, many thousands of dollars would be spent by a lot of employers for very little protection for pension plan participants. Cases of irresponsible fiduciary management turned up so far, under current disclosure laws, are few in number and deal more with welfare plans than pension plans.

FIDUCIARY RESPONSIBILITY

ARF believes that the imposition of stricter fiduciary responsibility requirements would probably not go beyond the strict standards now observed by most trustees. Although we do feel that this matter is sufficiently regulated under the Internal Revenue Code and the Welfare and Pension Plan Disclosure Act, we would have no strong objection to reasonable legislation in this regard.

LEGISLATION AND ADMINISTRATION OF PENSION PROFIT SHARING PLANS

In our opening remarks, we said that minimum standards on pension or profit sharing plans, if enacted, should be administered by the Treasury Department, specifically by the Internal Revenue Service (IRS). Again, we would like to emphasize this extremely crucial point. Except for the disclosure provisions which are administered by the Labor Department under the Welfare and Pension Plan Disclosure Act, it is the IRS that has the economic expertise to enforce the proposed standards on such a complicated issue as private pension and profit sharing plans. The IRS is attuned to the task of administering pension standards as they already have the ability and expertise in the financial, economic and actuarial occupations so necessary to the intelligent administration of such a highly specialized field.

For this very reason, the Federation also believes that it should be the Finance Committee in the Senate and the Ways & Means Committee in the House that ultimately examine the need for such pension standards. It is these Committees which should, first, see if any legislation in this area is needed, and, second, should have the oversight powers if such legislation should be enacted.

CONCLUSION

To date, most proposed pension legislation is based on horror stories affecting a very small percentage of covered workers. Thousands of private pension and profit-sharing plans can be legislated out of business and millions of employees deprived of benefits unless great care is given to the consequence of legislation or regulation justified as needed to protect a very small minority of employees.

Pension plans are a part of a total compensation package, including other non-wage benefits, and should be capable of administration by the employer as may be suitable in that context.

If there is a demonstrated need for additional legislation, a set of priorities should be established after sufficient study. While reasonable and meaningful disclosure and fiduciary standards are less involved, proposals on vesting, funding portability and reinsurance are more complex and costly.

Destructive public policy can snuff out private pension plans. There is much more that is strong and right with private pension than there is weakness. Solution through standardization appears to be founded on the premise that flexibility is a source of weakness in a private pension system. As we have seen, however, this very flexibility is in fact the source of the strength of the private pension system. The overwhelming majority of pension plans are well run, well designed and well thought of by the covered worker. Forcing private pension plans into such proposed vesting, funding and insurance patterns would be harmful to most employees, as well as their employers. Also, uniformity would have a stifling affect on the growth of private pension plans. In addition, if further regulation is to come, it should come on the same basis for all, without discrimination. A Congress that is avowedly interested in guaranteeing some benefits at retirement, seems rather to be pushing present and future employer retirement programs in the direction of plans that do not fix benefits. Thus, inappropriate and impractical legislation would be self-defeating.

Finally, although the Federation believes there is no need for minimum pension standards legislation at this time, we would like to reemphasize that it should be placed in the hands of IRS and not the Labor Department. Furthermore, the oversight jurisdiction over pension and profit sharing standards should be under the purview of the Finance Committees and not the Labor Committees.

UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION,
Washington, D.C., May 31, 1973.

Hon. GAYLORD NELSON,
Chairman, Subcommittee on Private Pension Plans, Senate Finance Committee, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR NELSON: This letter is prompted by a concern that inadequate consideration has been given to the effect of the provisions of S. 4 and similar legislation requiring accelerated liquidation of so-called "experience deficiencies" or actuarial deficits. These provisions in many cases would require unnecessarily burdensome and unreasonably fluctuating special annual payments to pension funds by employers.

The likely effect of such special annual contribution requirements would be to encourage unwarranted actuarial assumptions and to discourage improvements in plan benefits and structure. We are told that, even in Ontario where similar provisions were enacted some years ago under much more favorable circumstances, these adverse effects are beginning to appear.

Thus, USITA, which is the national representative of the Independent (non-Bell) telephone companies in the United States, urges that no pension reform bill containing such accelerated liquidation provisions be reported without redrafting to eliminate these adverse effects.

The locus of the special payments problem is in Section 210(b)(3) of S. 4, which requires liquidation of experience deficiencies by special annual payments over a term not exceeding five years. An "experience deficiency" is defined in Section 3(22) as "any actuarial deficit, determined at the time of a review of the plan."

We are apprehensive that the term "experience deficiency" might be construed to embrace:

(1) Fluctuations in market value of the fund assets.

(2) Increases in funding requirements due to automatic increases in pension benefits tied to increases in wages of employees.

(3) Extraordinary increases in funding requirements due to sudden shifts in employee retention, early retirement, mortality, seniority, etc.

First, the inclusion of raw or unnormalized market fluctuations in the experience deficiency category is unsound, since market value gives only a short-term estimate of the real value of the fund assets. Indeed, it is not clear from the text that such a result is required, since only actuarial deficits are included, and any proper actuarial determination of principal appreciation would presumably reflect changes in market value more gradually. (See Senate Report No. 93-127 to accompany S. 4 at page 16, Apr. 18, 1973.)

BEST COPY AVAILABLE

If an inclusory interpretation were established, however, downward market fluctuations would result in heavy special payments in years when the employer was least able to pay and, under current IRS regulations, would preclude payments in good times when the employer was best able to pay. The fear of heavy special payments in poor years would inhibit employers from improving pension benefits and structure in good years and would preclude as a practical matter such improvements during market downturns. The impact of fluctuations would be particularly burdensome on the well-funded plans with a heavy percentage of common stock investments.

Second, the requirement of five-year liquidation of experience deficiencies resulting from automatic increases in pensions due to general increases in the wages of active employees is equally unsound. Such a result would discriminate against plan provisions providing for automatic pension increases in favor of nonautomatic increases in pensions, which would be considered plan amendments and hence subject to a thirty-year funding schedule [Sec. 210(b)(2)(B)]. The impact on plans measuring benefits by the five-high-years would be particularly unfair and burdensome, since the employer would be required to fund tomorrow's inflation with today's dollars. The impact would also be particularly unfair and burdensome in industries such as the telephone industry, where triennial wage negotiations are common. Severe upward fluctuations in pension payments would result from the bargaining cycle.

Third, changes due to sudden shifts in employee population characteristics, such as retention rate, early retirement, seniority, etc., could produce rather extreme fluctuations in pension plan payments. These, again, would be unnecessarily burdensome under a five-year liquidation schedule.

In sum, special annual payments required to liquidate deficiencies originating in any one of these categories alone could be unfair, burdensome, and counterproductive, due to their extraordinary amount and unpredictableness. In any given year, however, the sum of the special annual payments attributable to the three categories could fluctuate upward or downward in amount wildly and unpredictably. Certainly the magnitude of the potential fluctuation, coupled with its unpredictability, would be unfair and would tend to constrain management's latitude in setting the upper limits for pension benefits. The element of unpredictability is particularly undesirable for public utilities, whose rates are regulated by Federal and/or state regulatory bodies.

For the foregoing reasons, USITA strongly urges that any compulsory funding legislation not attempt to convert portions of long-term advance funding into short-term obligations. Specifically, any "experience deficiency" provision should either exclude factors productive of extreme fluctuations in pension plan contributions or provide for a longer liquidation period. As to the latter approach, methods consistent with the recommendations in Opinion 8 of the Accounting Principles Board of the American Institute of Certified Public Accountants should be permitted. Opinion 8 would permit such special adjustments to be covered by "the routine application" of an acceptable funding method or alternatively spread over a suitable term such as the weighted average future active employees' lifetime.

It is requested that this letter be placed in the record.

Respectfully yours,

THOMAS HOWARTH,
Director of Government Relations.

AMERICAN SOCIETY FOR PERSONNEL ADMINISTRATION,
Berea, Ohio, May 29, 1973.

Mr. TOM VAIL,
Chief Counsel, Senate Finance Committee.
New Senate Office Building, Washington, D.C.

DEAR MR. VAIL: On behalf of the American Society for Personnel Administration, representing 11,000 professional employee and labor relations personnel, we submit this letter and the attached paper, "Meeting The Challenge of Providing Adequate Retirement Income For The American People", as our testimony on proposed reforms of the private pension system. We respectfully request that this testimony be entered into the records of hearings held recently by the Senate Finance Committee on this subject. Our testimony before other congressional committee hearings on private pension reform is a matter of record.

BEST COPY AVAILABLE

The single major point that we wish to make to the members of the Senate Finance Committee is as follows:

The problem of securing an adequate retirement income for the American people is not going to be solved by reforms of *only* the private pension system. Many improvements are needed in this sector and we are confident they will be forthcoming and are generally supportive of their enactment into legislation.

But the providing of, and securing of, adequate retirement income is made up of: (1) private pension plans, (2) social security, (3) municipal and other governmental retirement plans, (4) the resources of private individuals, and (5) railroad retirement systems.

It is certainly legitimate to ask: Why are there not proposed reforms to deal with the inequities and inadequacies of the other sources of retirement income? All of these sources of income work together to provide income to the American people in retirement. And they should all be examined in depth, and reformed if necessary to do a proper job in fulfilling their role.

The fact that social security is a government sponsored pension plan, and that other governmentally sponsored retirement plans are outside of tax considerations, should not stand as a basis for exempting those systems from the same restrictive demands and controls placed upon private pension plans. What is equitable for participants in private pension plans should be equitable for participants of social security and other government sponsored plans. There is no logical basis for a double standard applied to private pension plans.

We request that legislation passed to reform the private pension system require of Congress that it undertake to investigate the social security system and other governmentally sponsored retirement income systems, and to enact reforms of those retirement systems as well.

Sincerely,

ERNEST J. E. GRIFFES,
Chairman, Subcommittee on Retirement Income Systems, National Committee on Compensation and Benefits.

MEETING THE CHALLENGE OF PROVIDING ADEQUATE RETIREMENT INCOME FOR THE AMERICAN PEOPLE

(A Presentation by Ernest J. E. Griffes on behalf of the American Society for Personnel Administration Member)

TABLE OF CONTENTS

Preface.
Perspective.
Orientation.
Fundamental Principles:
  Dual Pension System.
  Governmental Controls.
Maturing of the Private Pension System.
Positions on Specific Proposed Legislation:
  Vesting and Portability.
  Funding and Termination Insurance.
  Communication and Disclosure.
  Governmental Pension Department.
  Fiduciary Standards and Investment Limitations.
Additional Considerations.
Summation and Conclusion.

PREFACE

The purpose of this preface is to provide a concise summary of the content of this paper.

The 10,000 members of the American Society for Personnel Administration believe that the system for providing human dignity in retirement through adequate retirement income must be viewed as a unified whole, with Social Security, public retirement plans, private retirement plans, and the financial resources of individuals each serving an important role in meeting the needs of our retirees.

We believe that it is in the best interest of the people of America to maintain the dual system of providing retirement income through Social Security as a base with private pension plans as an income supplement, and that every encouragement must be offered to individuals to provide a measure of their retirement income security from their own resources.

We believe that personnel administrators are in a crucial and unique position in the private pension debate because they operate in the realm of practicality at the base level, the people level, and in employee benefits the buck stops in the personnel administrators office. Everything that is good or bad about a private pension plan focuses on the point at which an employee is told about the benefits he will receive.

We do not agree with the contention that it is the intent of most employers to deprive employees of retirement income security or to structure pension plans in such a manner as to benefit only a chosen few.

It appears to us that the logical vehicle for additional regulation is the present process of qualification of a private pension plan with the Internal Revenue Service. Another over-burdened government bureaucracy will only impede the delivery of benefits.

We believe the basic structure of the private pension institution to be sound and capable of delivering the benefits it promises, and that what is needed is significant legislation to encourage faster funding and broader coverage for American workers.

We believe that there must be a minimum level of visiting required and that this negates the need for a portability system that would appear to us to be impractical and even unworkable. But care must be taken to avoid the minimum becoming an accepted standard.

We believe that the answer to benefit security is in faster funding of benefits through encouragement to contribute more resources, and that termination insurance would discourage growth of private pension plans, and possibly operate to the disadvantage of plan participants during periods of economic depression.

We believe that a requirement to communicate plan benefits in simplistic language is unrealistic without extensive guidelines on what simplistic language is and protection for employers from liabilities arising out of the use of such language. But plan participants are entitled to be told the full and complete story about their benefits and the handling of their pension funds.

We believe that the Social Security system and public retirement systems also contain substantial weaknesses and deserve to be subjected to the same intense study and review that is being applied to the private pension system.

The 10,000 members of the American Society for Personnel Administration commit themselves to observe a code of ethical practices, two tenets of which are:

"I will respect the dignity of the individual as one of the essential elements of success in any enterprise."

"I will demonstrate and promote a spirit of cooperative effort between owners, managers, employees, and the general public, directly or indirectly connected with the enterprise."

When the human machine wears out, the continuing reward for a lifetime of work takes the form of a retirement income providing dignity and independence in the "Golden Years". That is what the private pension institution is all about—dignity for human beings.

The raging controversy over private pension legislation is characterized by elaborate and detailed technical studies, conducted by brilliant men, but arriving at opposite conclusions. Harsh accusations by intelligent men against other intelligent men have hardened positions and frozen attitudes.

And yet the goal of all parties on all sides is the same—to provide security and dignity in retirement for human beings who have contributed a working lifetime to society.

The time for promoting a spirit of cooperative effort is at hand.

ORIENTATION

Personnel administrators are by nature people orientated.

Our basic approach to any subject is to ask, "What impact will this action have on the people—what is the meaning of this action in terms of human life experience?"

We are not unmindful of economic implications—for we understand that economic factors—especially the profit motive and the free enterprise concept—are a part of the foundations of our society.

It is the economic factors that make possible a standard of living for our people unmatched in the history of mankind. But people make the free enterprise system work—and the rewards of the system should be shared with them to the maximum possible extent.

Personnel officers occupy a unique position in the pension benefit controversy. They are personally involved in the design and administration of pension plans at the base level—the people level. They are most often responsible for communicating the benefits of the plan and for the administration of the plan—including all the face-to-face feedback when problems arise in benefit eligibility. The net total of all the positives and negatives in a private pension plan come to focus at the point of telling an employee he will or will not receive a benefit and what the benefit will be. In employee benefits, the buck stops in the personnel administrators office.

To these purposes—human dignity in retirement and a cooperative spirit in solving the problems of providing the means to achieve that dignity—the members of the American Society for Personnel Administration rededicate themselves in offering the concensus of their opinion with respect to improving the systems for providing retirement income in the United States.

FUNDAMENTAL PRINCIPLES

Dual Pension System

We believe that it is in the best interest of the people of America to maintain the dual system of providing retirement income—that is social security as a retirement income base, supplemented by the resources of private industry in providing additional benefits to the maximum extent possible through private pension plans.

But the social security system must remain a base benefit and not be permitted to expand without limit to the point where economic resources are less available to provide private pension benefits.

We, therefore, believe that every effort should be made to restrain the spiral of ever increasing social security costs that bear heaviest on the middle income employee under the present system. Continually increasing the wage base is a cruel deception on working men and women—a mirage that appears to offer great future security but in fact is a welfare plan shifting the income of some to support others.

We believe that the financing of the social security system would be more appropriate to the nature of social security benefits if it were spread in some manner across the resources of the nation as a whole rather than falling so heavily on an arbitrarily selected segment of our workers. Furthermore, the payment of benefits should recognize all other sources of retirement income so that those who have the need for income receive adequate income, and those who have adequate retirement income from other sources do not drain social security resources for unneeded income.

The private pension system thus should be offered every encouragement and inducement to fulfill its proper role as a democratic institution established in the tradition of free men negotiating their relationships and the contracts controlling those relationships.

GOVERNMENTAL CONTROLS

It is in the best tradition of Democratic ideals that people be permitted maximum freedom from governmental restraint to work out the relationship between employee and employer. Legislation that has as its ultimate effect restraint of action by either party can only be justified on the basis of protecting the interest of one party as against the other. This justification of necessity assumes it is the intent of one party to deprive the other of some privilege or right to which the injured party is entitled.

We do not agree with the contention that it is the intent of most employers to deprive employees of retirement income security or to structure pension plans in such a manner as to benefit only a chosen few. The vast complexity of regulations now existing under the Treasury Department and the Internal Revenue Service is adequate to prevent this *if those regulations and rulings are enforced.*

The present process of qualifying a pension plan is the logical vehicle for any additional regulations that are deemed necessary. Another governmental control unit with an equally vast array of regulations, equally understaffed and unable to properly enforce its regulations, is an expensive duplication of effort and only serves again to demonstrate the folly of the premise that all problems can be solved by creating another governmental agency.

THE PRIVATE PENSION INSTITUTION IS MATURE

Although the inception of the private pension concept dates into the 1800's in the United States, the real birth of private pensions occurred in the early 1940's. Thus the private pension institution is relatively young. Considering the long period of time necessary for pension plans to mature, only plans established in the 1940's and early 50's have had an opportunity to approach maturity. Yet the greatest growth ever in private pension plans is just now taking place.

The maturing process of the private pension institution suggests that what is needed now is some guidance and direcction to smooth out the problem areas and encouragement to mature toward fulfillment of the useful and important role for which it is designed. *We believe the basic structure of the private pension institution to be sound and capable of delivering the benefits it promises.* Legislation that cuts deeply into the present system and changes its nature seems unnecessary and would likely have the effect of discouraging the continued growth of private pension plans. This would mean only that fewer people would have the opportunity to participate in this allocation of private resources. We believe that such a result is contrary to the interests of the American society and economy.

We do believe, however, that my legislation that is passed must be significant enough to result in real improvement, and must not be a simple whitewash to satisfy the demand of the public for some sort of action. To gloss over the very real problems of benefit security with ineffective legislation will only serve to weaken the private pension institution.

POSITIONS ON SPECIFIC PROPOSED LEGISLATION

Vesting and Portability

There must be a minimum level of vesting—for it's wrong in every sense that an employee who has provided his service for many years should be deprived of any benefit upon termination resulting from circumstances beyond his control.

And yet the maximum vesting of 100% immediately is unrealistic because the cost would force benefit levels at actual retirement to a much lower level. We assume that there is a limit to the resources an employer can allocate for pension benefits and, therefore, choices must be made between which benefits are to be provided. Since it is the basic objective of a pension plan to provide an adequate retirement income, the goal must be maximizing the retirement benefits and vesting benefits within a given resource allocation for these benefits.

We believe that as a requirement for qualification of a pension plan, full vesting in the earned benefit should occur not later than age 55, with five years service, with partial vesting occurring prior to that age and commencing not later than age 40.

The specific approach to achieve this minimum need not be legislated, for there are any number of methods that could achieve this goal and there is no need to impose legislation that unnecessarily limits the imagination of the people involved in each case to meet the requirement in the best manner possible under their own circumstances.

Certainly we have learned the lesson that imposing a minimum standard often leads to that standard becoming the accepted level. Many plans now provide more liberal vesting than this minimum—and care should be taken not to allow the standard to restrict the initiative of individual employers to do better than the minimum.

Furthermore, we believe that there should be a guarantee under the social security system that every contributor should always be 100% vested in his own contributions so that under no circumstances could a participant, or his beneficiaries, receive less in benefits than the contributions he had paid in with interest.

We believe that a vesting minimum should be set, but enacted as a Treasury Department or Internal Revenue Service requirement for qualification, and not legislated by an act of Congress.

There are certain industries with special turnover problems, such as the aerospace and some defense industries, that should have a lower minimum requirement because of those unique industry problems.

We believe that vesting and portability are related. If adequate vesting occurs with benefits being payable at retirement then portability is not necessary. The proposals for portability of benefits contemplate a governmental clearing agency as the mechanism for the holding of funds and payment of benefits.

It is our position that the mechanism of portability, if it could be organized at all, would be an unnecessary and costly process. As personnel officers we would almost surely bear responsibility for the administration of the process and it appears to us to be unworkable. We believe that the mantenance of adequate records to assure payment of deferred vesting benefits can be handled within present established administrative procedures at a reasonable cost.

For these reasons we believe a system of portability of benefits is unworkable and unnecessary, and would be an intrusion into the private pension institution that would impede, rather than improve, the delivery of pension benefits to recipients.

FUNDING AND TERMINATION INSURANCE

The problem of lost benefits when a pension plan terminates has been perhaps the principal source of severe criticism of the private pension institution. The inadequacy of funds to provide benefits in such circumstances is a tragic occurrence and any solution to prevent such situations deserves the full support of every facet of government, industry and society.

The fact that such unfortunate occurrences represent only a very small percentage of the total plans in operation, and affect an even smaller percentage of the total of all participants in private pension plans, does not minimize the tragedy to those affected.

We believe that a requirement for funding of past service over a period of not more than 40 years would contribute to securing benefits without creating a burden on the contributing employers.

We also believe that the maximum restriction on contributions that permits only a 10% of Past Service cost deduction per year should be liberalized. There are employers who would contribute more, and the larger the contribution, the more secure are the benefits of the participants. This action would contribute significantly to a solution of the problem in plan terminations.

Plan termination insurance of unfunded Past Service liabilities or vested benefit liabilities does not appear to us as the answer to securing benefits.

The cost would fall most heavily on young plans with large liabilities for past service. This would act to discourage plan development. Alternatively, the cost would be factored into contributions and benefits would be lower. Or, plans would be in past service liabilities to be insured and also depriving employees of benefits for past service. If the termination insurance is applied to vested benefits only, the effect would still be the same. Lower benefits would result in lower liabilities for vested benefits.

Equally as important is the potential for some employers to use this as an escape from the liability for pension benefits. In difficult times, the easy way out would be to terminate the plan and let the insurance fund pay the benefits. An economic downturn could quickly bankrupt the insurance fund and the participants would again be the losers--perhaps on a much greater scale than has been experienced to date.

In summation, *we believe the answer to securing benefits in plan termination is to encourage faster funding so that more funds are available to provide those benefits.*

The vehicle for accomplishing this would again logically be the present requirements for qualification of a plan.

We also believe that the present limitation on deductible contributions to HR-10 plans for the self employed should be increased. The entrepreneur is the foundation of our economic system. It is the striving for dignity that drives a man to bear the risk of a business undertaking. He should be encouraged to provide for himself and his employees. There is no rationale for telling him that if he worked for someone else instead of for himself, he could be entitled to the privileges of greater retirement income.

COMMUNICATION AND DISCLOSURE

The very basis of understanding between people is open and complete communication. We become suspect of the source of information when we have reason to believe that communication is designed to be misleading or deceptive.

The charges made against the communication of information about pension benefits stems from two factors of the present system:

1. The complex technical and legal aspects of the pension contract have lead to wariness in communication of plan provisions. It is a difficult task to translate legal jargon into simplistic language and yet retain the legal protections that are a part of the contract. There have been many occurrences in which employers have been required to meet a liability arising from communication material that was not accepted as an obligation under the terms of the plan.

2. The magnitude of the investment employers make in pension benefits for employees, encourages the tendency to present the plan in the most positive terms possible so that a return in positive employee attitudes can be realized on the investment. This leads to over simplification and an advertising sales approach. When, as is so often the case, the communication material is prepared by persons not thoroughly cognizant of the technical and legal nature of plan provisions, the result can easily become a document subject to criticism as incomplete and misleading.

We believe that people prefer to be told the full story and are entitled to be provided full information. This alone would raise the level of performance in securing pension benefits because it would discourage the kinds of actions that result in losing benefits.

Full disclosure of all information regarding the plan and benefit security is a logical and reasonable requirement for deductibility of contributions to a retirement plan. The money belongs to the employees and they are entitled to be advised of what is being done with that money.

The proposed requirement to emphasize negative aspects of the plan and to use simplistic language in communications is, however, totally unrealistic, and could only be suggested by one who has never faced the task of preparing such material or presenting it face to face to employees. It is comparable to legislating a requirement that every legislator report to all his constituents the full and complete explanation of his vote on every issue and the significance of his vote, emphasizing the negative impact it might have on the lives and incomes of his constituents—in terms designed to be understood by an average constituent.

We therefore support requirements for fuller disclosure and more complete information in communication material but oppose requirements to emphasize negative aspects and the generalized requirement to use simple language, which in itself is a completely subjective judgment.

We, in fact, believe that Congress should restrain the Department of Labor from enacting this portion of the proposed regulation as published in the Federal Register on February 1, 1972, (37 F.R. 2448), unless and until the Department can also provide comprehensive guidelines as to what is not simple language that an average participant will understand, and further provide a protective mechanism for employers under circumstances in which simple language results in unintended liabilities.

It is not beyond belief to envision an employer, particularly small employers, terminating a pension plan, or being financially destroyed by a liability arising from an attempt to use simple language in explaining a pension plan to employees. Such a result certaily will not secure pension benefits for the employees involved.

DEDUCTIBILITY OF INDIVIDUAL CONTRIBUTIONS

We believe the enactment of legislation permitting tax deductions for voluntary or mandatory contributions to qualified pension plans is long overdue. The logic of encouraging individuals to save for their retirement is so basic that there appears to be every moral and social justification for this approach. Man derives the utmost in human dignity when he can provide for himself and does not have to rely upon others for assistance.

Furthermore, we believe that the required contributions to the social security system should be tax deductible to employees, just as they are deductible to the employers.

GOVERNMENTAL PENSION DEPARTMENT

Private pension plans are now subject to regulations and controls from eleven federal departments and agencies, not to mention state and local regulation where it exists.

Assuming that all of these departments and agencies could transfer their pension plan control functions to one agency, we believe the operation of the private pension institution might be improved. Short of this, and it seems unlikely that this could be accomplished, we see no value in having yet another governmental control unit with more bureaucratic mechanisms to hobble the delivery of retirement benefits to participants.

FIDUCIARY STANDARDS AND INVESTMENT LIMITATIONS

We believe that any step necessary to assure the safety of employee pension funds and the integrity of persons responsible for those funds is deserving of our support.

Requirements to assure that such persons are qualified by training, experience and personal character are logical and valid. They should meet the same criteria as others who are entrusted with public funds, such as officers of financial institutions.

However, assuming that such qualified people are appointed to such positions, we believe they should be permitted to exercise their expertise in the competitive financial marketplace to do the best job they can for the participants of the plan.

We support the principle of the "prudent man" rule in fiduciary situations and believe it works to the benefit of the plan participants. Elaborate restrictions on investments, or a requirement that investments be made to accomplish social objectives, are not in the best interest of all plan participants. We oppose the attempt to place such restrictions or fiduciaries. We believe they alone are responsible for those judgments in their circumstances and should be free to act in their capacity.

Present law provides for the problems of fraud and outright mismanagement of funds. And present qualification requirements prohibit the most common transactions that could endanger the security of the funds. Requirements for disclosure of adequate information to detect violations seem to us to be appropriate and we support such requirements.

ADDITIONAL CONSIDERATIONS

The changing nature of our work force and of the American social structure offer guidance in what the objectives of our retirement income delivery system should be.

A mobile work force suggests that vesting must be an integral part of the retirement system.

A younger and more affluent work force suggests that ways must be found to encourage individuals to participate in providing their own retirement income.

A better educated work force suggests that the level of information provided about their retirement income should be raised and that they will understand and accept this increased information.

A greater percentage of women in the work force suggests that provisions must be made to permit them to participate fully.

The shifting social attitude toward more opportunity for leisure and aesthetic pursuits, suggests that we must prepare for earlier retirement at higher income levels.

The expanding retired population and the new social awareness of the problems of the aging suggests that programs of education and preparation for retirement should be undertaken.

The increasing proportion of our work force engaged in public and governmental employment suggests that public retirement programs deserve the same review now being given to private plans, to assure that public retirement systems also function as they should.

The new awareness in our young people of their individuality and their desire to participate in the events that control their lives, suggest that they will demand a higher level of participation in the decision making process and administration of retirement income systems, both public and private.

These new factors suggest additional concepts and approaches. If social security is permitted to continually increase benefits, then the future role of private pension plans may be the provision of a level of income from age 55 to 65 equal to the social security income commencing at 65. This would encourage earlier retirement at an adequate income so that retired persons could enjoy their retirement years, and the channels of promotion would be opened for our youthful work force.

Such earlier retirement would provide a segment of our population that could be retrained to dedicate some of their time at reasonable additional income, to attacking some of our social problems that need attention. Alternatively, their training and experience, willingness and ability to give of their time, could be turned to advantage in teaching or training activities—or assistance to small faltering businesses.

Programs to prepare people for the emotional and psychological impact of retirement are sadly lacking. Programs designed to ease the transition from a lifetime of work to days of leisure deserve everyone's encouragement. This is a crucial factor in enabling our people to enter retirement and live out their retirement years with dignity.

SUMMATION AND CONCLUSION

As a basic principle, we believe that the entire system of delivering retirement income to our people must be the consideration in this great pension debate. The focus of criticism on private pension plans alone is not justified, for they have performed a great service in their relatively short lifetime, and certainly are maturing into one of the finest of our democratic institutions.

The social security system, which is also an integral part of our retirement income system, should also be subject to this review and debate. The requirements placed upon it to perform in delivering the maximum benefit for dollars contributed, should be no less than those placed upon the private pension system.

Likewise, the public and governmental retirement systems should also share in this debate, for they also are an integral part of the retirement income system, and have weaknesses and strengths that should be scrutinized carefully.

It is our consensus that every effort should be made to encourage the integrated growth and development of all of these retirement income systems, with the basic objectives always being to secure and maximize the benefits that make it possible for our people to live out their retirement years with dignity.

The cooperative spirit of us all—of the legislators, the actuaries and the consultants, the employers and the union representatives, the participants and fiduciaries—must be invigorated and energized to generate the imagination and to achieve the team work necessary for meeting this great social challenge of our time.

Statement of Caterpillar Tractor Co., Submitted by M. H. Glick, Manager, Compensation Department

I. INTRODUCTION

Caterpillar Tractor Co. is a manufacturer of earthmoving, construction anu materials handling equipment and diesel and natural gas engines. The Company's corporate headquarters are located at 100 N.E. Adams Street, Peoria, Illinois, 61602. Caterpillar employs approximately 45,000 employees in Illinois and presently is the largest private employer in the state. Nationally, Caterpillar employs approximately 54,000 persons.

To assist you in your consideration of S. 4 and other legislation regarding private pension plans, we would like to make you aware of the retirement program provided by Caterpillar because we feel it is representative of the programs provided by many larger employers. We also will make specific suggestions for changes to S. 4 which we feel would it more acceptable to many segments of our economy without diminishing the effectiveness of the bill.

II. CATERPILLAR'S PENSION PLANS AND EMPLOYEES' INVESTMENT PLAN

Pension Plans

We first established a pension plan in 1945. At its inception, that plan required employee contributions, and pension benefits were based on employees' career average of compensation. It provided vesting after completion of 20 years of service. Through the years our pension program has been expanded and many improvements made in both benefits and vesting, and employee contributions are no longer required. Today Caterpillar has several pension plans covering various groups of its employees. The provisions of some of these plans have been developed through collective bargaining. At the close of 1972, we had approximately 7,300 retirees and survivors of retirees receiving pension payments at the rate of approximately $19 million per year.

Our UAW pension plan presently provides for vesting of benefits after 10 years of credited service, regardless of age. It provides for monthly pension benefits computed at the rate of $9 and $10 per month for each year of credited service. A typical Caterpillar UAW employee retiring today at age 62 and with 30 years of credited service receives a pension for life under the UAW plan of approximately 41% of his final take-home pay. If he chooses to have his Social Security benefit commence at age 62, his monthly benefit from both sources is increased to approximately 72% of his final take-home pay. If his spouse is also eligible for Social Security benefits, the combined Company benefit and Social Security would be more than 85% of his final take-home pay. Under the UAW pension plan, there is an early retirement feature providing up to $500 per month with 30 or more years of credited service.

In administering all of our pension plans, it has always been our policy to inform employees of their benefits, rights and obligations under their pension plan. We provide each employee with an explanatory booklet describing his pension plan. This is done at the time of hire and also following any major change in the plan. (See Exhibits I and II.)*

The purpose of these booklets is to give employees a summary of their pension plan and to increase their understanding of it. While pension documents are necessarily complex, we attempt to make these booklets as understandable as possible—questions are welcomed and every effort is made to answer them. In addition, each year we inform each employee of his accrued credited service. At retirement each employee is individually counseled concerning his pension and other retirement benefits, and he is given a certificate setting forth his monthly pension amount. Each employee who leaves the Company with a vested pension also receives a certificate setting forth his right to a pension benefit at a later date. Prior to age 65, we also send such former employee a notice to remind him of his right to apply for his vested benefit.

Employees' Investment Plan

In addition to our various pension plans, Caterpillar maintains an Employees' Investment Plan which provides eligible employees an opportunity to achieve an ownership interest in the Company through the purchase of Caterpillar common stock. Participating employees may contribute, on a voluntary basis, up to 6% of their earnings, and the Company will contribute, from current or accumulated profits $1 for each $2 contributed by employees. These contributions are turned over to a bank, as trustee, to purchase shares of Caterpillar common stock. Approximately 85% of all eligible employees have chosen to participate in the Employees' Investment Plan. Participating employees, if they desire, may direct that one-half of their contributions be invested in a government securities fund holding U.S. Government obligations.

The Employees' Investment Plan provides for immediate vesting of shares purchased by employees' contributions. Vesting of Company-purchased shares occurs progressively over a period of time, except that a participating employee will be fully vested in, and entitled to receive, 100% of all Company-purchased shares if he terminates employment because of:

1. Retirement at or after age 65; or
2. Retirement at or after age 60 with 20 years of service; or
3. Total and permanent disability.

If he dies while employed by the Company, his beneficiary will be entitled to receive 100% of the shares in his account, including Company-purchased shares. We have a very extensive program of informing employees about this plan. Each employee eligible to participate is given a prospectus meeting SEC requirements when he is first eligible to join. Each year a new prospectus is also given to all members of the Plan. (See Exhibit III.)* Twice each year they are given a detailed statement of their accounts. (See Exhibit IV.)* Participants are given Proxy Statements and may vote shares held in their accounts. (See Exhibit V.)*

Funding

The Company's pension funding policy is to fund the costs of current service benefits in the year earned and to amortize unfunded past service liabilities over a 30-year period commencing with the date they are incurred. Unfunded past service liabilities are incurred each time the pension benefit levels for active

*Exhibits were made a part of the official files of the Subcommittee.

employees are raised, and each time the pension benefits payable to retirees are increased.

In funding our pension obligations, the Company is guided by the advice of a firm of independent actuarial consultants. The contributions made by the Company under the plans have been paid to ten separate trust funds held by banks. The trustees, or the investment counsel employed for any particular trust fund, have sole investment discretion. As of the end of 1972, the total of our pension fund assets amounted to approximately one-half billion dollars.

Our Employees' Investment Plan which provides benefits at retirement as well as upon the occurrence of other events is a qualified profit sharing plan. There is no unfunded liability under this Plan. The Company's funding obligation under this plan is to make its matching contributions related to the contributions made by participants in the plan. All Company contributions made on behalf of participants are invested in stock of the Company.

As of the end of 1972, a total of approximately 2.6 million shares of stock of the Company were held under this plan by the bank trustee.

III. COMMENTS WITH RESPECT TO CERTAIN PROVISIONS OF S. 4

Fiduciary Responsibility and Disclosure

To the extent that the disclosure provisions of Title V of S. 4 would encourage the dissemination of meaningful information about employees benefit plans, we support them. As a matter of fact, we already do many things which Title V would require all employers to do. We do them because we have an excellent employee benefit program, which costs more than $100 million annually, and we believe it makes good business sense to inform our employees about their employee-benefit package. Similarly, to the extent that the fiduciary responsibility provisions of Title V would encourage honesty and responsible behavior on the part of plan administrators, we support them. We are concerned, however, that some of the disclosure requirements and the fiduciary responsibility provisions go further than is either necessary or desirable. For example, Section 506(d) would require that a schedule be included in an annual report which would list (with some exceptions) "all purchases, sales, redemptions, and exchanges of securities" from a fund. The sheer bulk of information that would be required to be furnished would overwhelm and confuse employees rather than enlighten them. This would be particularly true in our situation where ten separate trust funds are involved. On the other hand, we support a requirement that "party in interest" transactions must be singled out and disclosed.

Much information required under the annual report already is being furnished by employers, either voluntarily, as a result of collective bargaining agreements or in response to other statutes. Where this is already being done, the furnishing of essentially the same information, but in another required format, would seem to be unnecessary duplication and might be confusing.

Insofar as a percentage limitation on investment in employer securities is concerned, we are pleased to note that the "Fiduciary Standards" section of Title V recognizes the special nature and purpose of plans like our Employees' Investment Plan by exempting them from the limitation. As stated above, the Employees' Investment Plan was designed to enable eligible employees to achieve an ownership interest in the Company through the purchase of its common stock. While employees may elect to have half of their own contributions invested in a government securities fund rather than Caterpillar stock, only 3/10 of 1% of employee contributions were held in that form at the end of 1972. A requirement that the investments of this plan be diversified would run contrary to the expressed desires of the employees themselves.

Vesting

In general, Title I of S. 4 requires that employees be vested in 30% of their accrued pension after eight years of service, increasing at the rate of 10% each year thereafter so that 100% vesting is attained after 15 years of service. Since vesting is but one of many different forms of benefits provided under pension plans, we believe it would be preferable to leave it to employers, employees and representatives of employees to establish their priorities as to what benefits ought to be provided from time to time. We are pleased to note, however, that Section 202(e) does authorize a waiver of the bill's vesting requirements if it is determined that a particular plan's vesting provisions provide a degree of vesting "as equitable as the vesting schedules set forth in Section 202." Insofar as the majority of our bargained pension plans are concerned, the vesting requirements of S. 4 are not a problem. However, for other employers this may prove costly and may cause a sacrifice of another benefit which the employees of that employer would prefer to have.

Special Provisions for Professional Employees

Section 221 of Title II authorizes the development of regulations concerning the pension rights or benefits of 'professional, scientific, and technical personnel and others working in associated occupations employed under Federal procurement, construction, or research contracts or grants." We understand that the intended purpose of this section is to provide protection for those personnel who, because of changes in federal procurement requirements, do not work with any single employer for a sufficient period of time to become "vested" in a pension plan. However, the language of this section is so general and vague that it could be interpreted to require all government contractors to establish special pension privileges for scientists, engineers and others working in associated occupations employed under government contracts. To require special vesting under government contracts is in basic conflict with S. 4 and the other major pension bills currently before Congress because it permits the application of an entirely different standard to a select group of employees. This would be inequitable to other employees and could be in conflict with present IRS requirements that pension plans must not discriminate, particularly in favor of management employees. Also, it overlooks the fact that many government contractors provide stable employment—and the resultant accrual of "pension rights"—for people who perform work under government contracts.

Certificates

Section 108 of the bill requires that plan administrators must "furnish or make available, whichever is the most practicable," certificates to participants who terminate service with a "vested right to an immediate or deferred pension benefit or other vested interest." As mentioned-earlier in this statement, Caterpillar already provides certificates to its employees when they retire or terminate service with a vested pension. Caterpillar supports such a requirement, but we feel that it is not necessary that a copy of each certificate be forwarded to the agency charged with administering the provisions of this bill. Instead, each plan administrator should be required to keep a copy of each certificate issued so that in the event an employee loses his certificate he may write the plan administrator and receive a new certificate in a relatively short period of time. Such a procedure would avoid the flow of unnecessary paper to Washington and the imposition of an unnecessary burden upon the agency administering this bill. In addition, we suggest that an exception to the certificate requirement be made in the case of lump sum distributions under pension or profit sharing plans where the employee is provided with a comprehensive statement of accounts and assets distributed. (See Exhibit VI.)*

Plan Termination Insurance and Portability

Proposals concerning portability and plan termination insurance, such as those contained in Title III and Title IV of S. 4, are highly controversial and need much further study. We believe that the enactment of minimum vesting and funding standards, together with the enactment of increased reporting and fiduciary standards, will eliminate any need for these proposals. We, therefore, strongly urge that they not be included in any bill which may be passed.

Preemption

Caterpillar endorses the preemption provisions of Section 609(a) which denies the overlapping regulation of private pension plans by state governments. Many pension plans cover persons employed in several states. To permit state governments to develop eligibility, vesting, fiduciary responsibility, disclosure and funding requirements which differ from federal requirements would substantially increase the costs of administering pension plans without providing any additional protection to plan participants.

Administration of New Regulatory Legislation

We strongly urge that the provisions of S. 4 dealing with fiduciary conduct, eligibility, vesting and funding of pension and profit sharing plans should be amendments to the Internal Revenue Code. These matters have traditionally been handled through the nation's tax laws. If S. 4 were to be passed in its pres-

*Exhibit was made a part of the official files of the Subcommittee.

ent form, it would be extremely difficult for plan administrators to conform with the requirements of the Internal Revenue Service in administering the present provisions of the Internal Revenue Code and the requirements of an agency in the Department of Labor administering the provisions of S. 4. It would be far more effective if these provisions were made part of the Internal Revenue Code so they could be administered by the Internal Revenue Service in conjunction with the existing Code provisions. The Service has had considerable experience in regulating pension and profit sharing plans under the present tax laws and regulations and would be best equipped to administer the provisions of any new pension bill relating to fiduciary conduct, eligibility, vesting and funding. Also, instead of authorizing individual court actions by employees and their beneficiaries, it may be more effective if any inquiries or complaints concerning pension or profit sharing plans were referred to the Internal Revenue Service, who would then have the authority to investigate them and to determine whether or not the plan in question was being operated in accordance with the plan provisions and any applicable tax laws.

IV. SUMMARY

We at Caterpillar feel that any legislation involving pension and profit sharing plans and other employee benefit plans which increases employee understanding as to precisely what their benefits are—and what they are not—is worthy of support. However, any legislation must also have as one of its objectives the encouragement and growth of private employee benefit programs. We support any effort to encourage responsible funding and administration of these programs.

STATEMENT OF THE UNITED STATES SAVINGS AND LOAN LEAGUE[1]

The United States Savings and Loan League appreciates this opportunity to comment on S. 1631, the Retirement Benefits Tax Act. We support this legislation designed to strengthen the private retirement system by establishing standards for participation in employer-sponsored pension plans. We are concerned with any legislation which would expand pension plan benefits since our members employ large numbers of personnel who are covered by various benefit plans and because savings and loan associations handle Keogh accounts and plans established by the self-employed.

We do have some basic suggestions which we believe would be helpful in developing and expanding the coverage of the private pension system.

SECTION 2—MINIMUM STANDARDS RELATING TO FUNDING, ELIGIBILITY AND VESTING

We understand Congressional concern regarding some existing private pension plan provisions which arbitrarily exclude certain employees from participation, fail to provide any pre-retirement vesting rights, and/or inadequately fund their liabilities. While the League endorses some minimum eligibility, vesting, and funding requirements to correct these inequities, we also recognize certain increased costs and other effects from adopting such standards.

Employer contributions to pension plans are but one aspect of any well-designed benefits program. The employer necessarily must consider the overall costs of his benefits package, as well as the impact on individual employees. New eligibility and vesting standards impose new costs on employers for the benefit of short-term employees and employees who may no longer be with the organization. These costs must be weighed in relation to the benefits provided for those who have worked faithfully for the employer for a longer period of years, and those still in his employ. In order to control total pension plan costs, an employer may be forced into a "trade-off" among these different categories of employees, particularly when minimum funding requirements are proposed at the same time.

[1] The United States Savings and Loan League has a membership of 4,800 savings and loan associations, representing over 95 percent of the assets of the savings and loan business. League membership includes all types of associations—Federal and state chartered, insured and uninsured, stock and mutual. The principal officers are: Richard G. Gilbert, President, Canton, Ohio; George B. Preston, Vice President, West Palm Beach, Fla.; Tom B. Scott, Jr., Legislative Chairman, Jackson, Miss.; Norman Strunk, Executive Vice President, Chicago, Ill.; and Stephen Slipher, Legislative Director, Washington, D.C. League headquarters is at 111 East Wacker Dr., Chicago, Ill. (60601); and the Washington Office is located at 1709 New York Ave., N.W., Washington, D.C.; Telephone: 785-9150.

Despite the likelihood of increased costs for employers, we feel that the proposed eligibility and vesting standards constitute a generally reasonable approach. The so called "Rule of 50" should ameliorate some unfortunate hardships for older employees; postponing the effective date for existing plans to benefits accrued for plan years beginning after January 1, 1975 should give employers a reasonable opportunity to meet the new requirements and costs.

At the same time, however, we feel that any such standard should be a minimum rather than an inflexible rule. It is certainly conceivable that in some instances the rights of employees under some plans could be served by another approach, perhaps one similar to those suggested by other proposed legislation on this topic. By the same token, we feel any minimum funding requirements adopted should give the employer adequate time to cover unfunded liabilities as well as year-to-year flexibility in so doing.

SECTION 3—DEDUCTION FOR RETIREMENT SAVINGS

Under present law, self-employed individuals are encouraged to provide for their retirement through our tax laws, but similar opportunities are not available to wage-earners.

The legislation pending before this Subcommittee would enable individuals who wish to save independently for their retirement or to supplement employer-financed pensions to deduct up to 20% of the first $7,500 of earned income ($1,500) reported on their Federal income tax return.

However, we feel that there is too great a difference between the proposed $7,500 tax deductible ceiling for self-employed plans and the $1,500 for individual retirement plans. We suggest that the individual limit be increased to $5,000 which, in turn, would provide greater benefits to individuals without discouraging owner-employees Keogh plans.

In describing the funding media (Section 3), the bill implies—but does not specifically mention—that an individual would be allowed to invest these amounts in savings accounts with financial institutions.

The League suggests that Section 3 of S. 1631 be amended to specifically identify the types of funding media that will be permissible in individual retirement savings plans.

The reason we stress the need for specific clarification is that savings and loan associations, although they were made eligible to act as trustees when the original Self-Employed Individual's Tax Retirement Act was passed in 1962, had to wait another eight years for enabling legislation. It was not until July of 1970 when the Emergency Home Finance Act was passed that Federally chartered savings and loan associations were given the power to act as trustees for Keogh accounts. This change was important not only because a new choice was open to Keogh participants; it also provided an important new source of funds for our thrift institutions—the primary financiers of residential housing.

In 1972 more than 750 savings and loan associations were acting as trustees for self-employed pensions. It is estimated that there were 10,000 Keogh accounts in savings and loan associations, and this number is expected to grow dramatically during the 1970's.

We have found that retirement savings is ideal money for home mortgages. It is long-term money and the kind of "rainy day" savings money which helps stabilize the home mortgage market. Because the principal home financing business can accept this kind of money, the retirement savings of self-employed individuals is staying in the community and thus available for home financing.

This is why we recommend that Section 3(b) be amended to remove any confusion in interpretation of the bill. We encourage the Committee to clarify section 408(a)(4) by including the following language at the end of the paragraph:

"For the purposes of this Section, money shall be deemed to be held in a trust or custodial capacity when the deposit account is opened in a bank in the name of the saver himself or in trust for the saver with the appropriate contractual safeguards as far as withdrawal is concerned."[2]

[2] We would like to bring to the attention of the Subcommittee the possible need to amend the basic statute governing the chartering and operations of Federal savings and loan associations, namely the Homeowner's Loan Act of 1933, in order to empower these associations to handle the new accounts. But if the Subcommittee would like to accomplish this change by amending sec. 408(a)(4), we suggest the addition of the following language to accomplish this purpose: "For the purpose of this section, Federal savings and loan associations are authorized to offer accounts having contractual provisions restricting withdrawals as contemplated in this section."

BEST COPY AVAILABLE

SECTION 4—CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS AND SHAREHOLDER-EMPLOYEES OF ELECTING SMALL BUSINESS CORPORATION.

The League supports the provisions applicable to self-employed individuals and shareholder employees of small corporations. This section of the bill would increase the limitations under the Keogh plan to the lesser of 15% of annual earnings, or $7,500. This provision would be a major step toward equalizing the tax treatment of self-employed persons and employees. For example, if a 55 year old doctor has an income of $50,000 and contributes $5,000 per year for ten years, he would at age 65 have a monthly income of only $576. With the maximum of $7,500 per year, he would have a monthly income of $864 per month. This $7,500 ceiling gives the self-employed a more adequate retirement pension income plan, one which is comparable to present-day corporate plans.

CONCLUSION

The League urges this Subcommittee and Congress to approve private pension legislation which would better enable individuals and the self-employed to plan resourcefully for their retirement. We believe that this legislation is based on a sound policy, namely, the Administration and Congress encouraging the growth of individual pension plans as supplements to Social Security. We feel that this bill, with certain improvements, would both strengthen private pension plans and provide increased incentive to establish pension plans for millions of Americans.

PREPARED STATEMENT, NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

The National Retired Teachers Association and the American Association of Retired Persons are affiliated, nonprofit organizations with executive offices located in Washington, D.C.

Included within our Associations' combined membership of over five million, four hundred older persons are many whose private pension expectations have been frustrated by the inadequacies, failings and abuses inherent in this country's existing system of employee pension benefit plans. In order to preclude similar pension experiences for future generations of retirees in general, and for future members of our organizations in particular, we have been actively seeking the enactment of comprehensive and effective, federal pension reform legislation.

This statement of our views with respect to: (1) the justification for more stringent federal regulation of employee pension benefit plans; (2) the appropriate vehicle for pension reform; and (3) the merits of S. 4, S. 1179, and S. 1631 is submitted for inclusion in the record of the hearings of May 21–23.

I. INTRODUCTORY REMARKS

Despite the considerable progress made in recent years with respect to social security and other components of retirement income, the degradation of inadequate income persists as a frequent incident to the process of aging. This country's economic, industrial and medical progress have combined to permit an increasing proportion of the population to reach old age; however, these same factors have also combined to reduce the older person to a dependent condition, tending to deprive him of his traditional function, status and dignity.

Excluded from the labor force, the older person finds himself also excluded from participation in the standard of living made possible by the increased economic productivity to which he contributed his labor during his working years. Most older Americans are dependent for a high proportion of their total income on a variety of public programs designed to transfer current purchasing power from the younger, working population, to the older population through a system of transfer payments. Unfortunately, the levels of such payments have been and probably will continue to be, by themselves, quite inadequate to maintain a satisfactory level of income for retired persons.

To ameliorate the impact of age on individual income, new sources must be utilized to supplement the basic, but inadequate retirement benefits provided by the public systems. The need for usch new sources is increasing. With a net in-

BEST COPY AVAILABLE

crease of 3.5 million persons, age 65 and over, between the 1960 and 1970 censuses, one out of every ten persons in this country today is an older American.[1] Moreover, the 1970 level of 20 million older persons is expected to increase to 25 million by 1985, and to 28 million by the year 2000.[2] To accomodate the projected income needs of this increasingly substantial, yet least visible minority population, attention should be focused on encouraging personal savings for retirement and on utilizing more effectively the system of employee pension benefit plans.

Unfortunately, the performance of this country's system of employee pension benefit plans has been demonstrably inadequate. With intolerable frequency, the existing system has failed to provide expected benefits to retirees.

Our Associations are convinced that if this system is ever to contribute effectively to the amelioration of the problem of insufficient income among our older citizens, it must become a reasonably reliable source of supplemental retirement income. We further believe that such reasonable reliability can only be predicated upon the enactment of comprehensive, Federal regulatory legislation that mandates minimum performance standards to which each employee pension benefit plan must conform. Only legislation that contains minimum standards with respect to vesting, funding, portability, termination insurance, disclosure and fiduciary responsibilities will be sufficiently comprehensive to achieve an acceptable degree of reliability and to assure thereby a performance by employee pension benefit plans commensurate with promise.

We are convinced that the abuses and inadequacies inherent in the present system cannot be corrected through the pursuit of a piecemeal, haphazard legislative approach. This, we believe, was the major deficiency of H.R. 12272[3] and its companion S. 3012[4] which were introduced on behalf of the Administration during the 92nd Congress. Enacted standards which result in the expansion of employee coverage under employee pension benefit plans and the liberalization of vesting requirements under such plans will maximize the probability of private pension receipt by future retirees only if such standards are reinforced by an adequate funding standard and a termination insurance program. As we said last June, in our pension reform testimony before the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare:

"Any legislation enacted by the Congress that includes standards for coverage and vesting but fails to include requirements for funding and insurance will be a legislative gesture designed more to assuage worker discontent than to provide retirement benefits."[5]

II. THE JUSTIFICATION FOR PENSION REFORM LEGISLATION

A. The system's inadequate protection of the worker

The inadequate performance of the existing system of employee pension benefit plans has been extensively documented in the Preliminary Report[6] and Statistical Analysis[7] of private plans undertaken by the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare pursuant to Senate resolutions in both the 91st[8] and 92d[9] Congresses. The Preliminary Report disclosed that: "Out of a sample covering a total of 6.9 million [pension plan] participants since 1950, [only] 253,118 or 4 percent have received any kind of normal, early or deferred vested retirement benefit . . . ". . . For every two employees who received a benefit, one employee with more than 15 years of service forfeited. For

[1] H. Brotman, Facts and Figures on Older Americans: The Older Population Revisited, H.E.W. (Social and Rehabilitation Service and Administration on Aging) Pub. No. 182, p. 1, (1971).

[2] H. Brotman, The Older Population: Some Facts We Should Know, H.E.W. (S.R.S. and AoA) Pub. No. 20005, p. 1, (1972).

[3] H.R. 12272, 92d Cong., 1st sess. (1971).

[4] S. 3012, 92d Cong., 1st sess. (1971).

[5] Hearings on S. 3598 before the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare, 92d Cong., 2d sess., pt. 1, at 158 (1972) (hereinafter referred to as Hearings on S. 3598).

[6] Subcommittee on Labor of the Senate Committee on Labor and Public Welfare, 92d Cong., 1st sess., Preliminary Report of the Private Welfare and Pension Plan Study (Committee Print 1971) (hereinafter referred to as Preliminary Report).

[7] Subcommittee on Labor of the Senate Committee on Labor and Public Welfare, 92d Cong., 2d sess., Statistical Analysis of Major Characteristics of Private Pension Plans (Committee Print 1972) (hereinafter referred to as Statistical Analysis).

[8] S. Res. 360, 91st Cong., 2d sess. (1970).

[9] S. Res. 35, 92d Cong., 1st sess. (1971); S. Res. 235, 92d Cong., 2d sess. (1972).

every one employee who received a benefit, one employee with more than 10 years of service . . . nearly three employees with more than 5 years' service . . . [and] 16 employees with 5 years service or less forfeited." [10] It is apparent to us that the present system has failed to provide a reasonable degree of pension security for the present generation of retirees.

More ominous, however, are the findings contained in the Statistical Analysis. About 13% of the plans studied therein did not provide for any vesting of benefits.[11] Eight percent of plans having vesting provisions expressed as a combination of age and service required at least age 50 and 20 years of service for a vested right.[12] Of the plans which contained only a service requirement for vesting, over one-fourth required more than 15 years of service to qualify.[13] Moreover, although a majority of the plans studied were found to be well funded, a significant minority were found to be substantially underfunded.[14] Findings such as these lead us to believe that the past and current inadequacy in the performance of the existing system of employee pension benefit plans is likely to continue as increasing numbers of workers enter upon their retirement years, unless remedial legislation is enacted.

Although our Associations concur in the findings of the Senate Labor Subcommittee, our concurrence is motivated, at least in part, by the empirical evidence we have received over the years through correspondence from our members, among whom are many whose private pension expectations have been frustrated by the very inadequacies documented in the Statistical Analysis. No amount of data can adequately measure or describe the individual hardships worked upon the helpless victims of the present, insensitive, and often capricious, system. Repeatedly, members have described how the private pension, for which they worked so long and on which they based so much of their expectation for that added degree of income security necessary for a reasonably comfortable retirement life, was lost because of unreasonable vesting schedules, inadequate funding, corporate liquidations or reorganizations, breaches of fiduciary duties and other inadequacies.[15]

Excerpts from a random sampling of the correspondence of the NRTA-AARP Legislative Division will illustrate the aspect of the need for reform of employee pension benefit plans that confronts us directly. Mr. Vasco Da Silva of Bradenton, Florida, wrote as follows: "I was a member of the International Brotherhood of Electrical Workers Union Local 3, New York for 13 years and 8 months. In order to be eligible for pension benefits I must have 20 years membership. Taking my age into consideration I would be 72 years of age in order to get, 20 years membership. Since I retired in August 1972 at the age of 65, I do think I am entitled to a percentage of my pension for the 13 years and 8 months in the Union. This money was paid into the union pension fund to my account by contributing contractors for whom I worked."

Mr. Albert J. Rich of San Mateo, California, in a letter dated December 26, 1972, stated: "For thirty years, I was a member of the AFL-CIO. In 1964 I took a withdrawal card, which I have renewed up to date, and moved from New York City to my present address. I was a liquor salesman in New York and a member of the Liquor [S]alesmans' [sic.] union local. . . . In California I continued selling liquor. I now became a member of the Liquor [S]alesman's [sic.] [U]nion local . . . affiliated with the Teamster's [I] [p]aid the initiation fee and received no seniority. I must now be employed for fifteen years before I will be entitled to a pension."

Mrs. Ethel T. Jenkins of Lake Havasu City, Arizona, in a letter dated January 20th, 1971, stated in part: "Can't something be done to companies who ~~[sic]~~ take forty years of man's service; merge after a pension plan had been put into effect, and soon the very company who absorbed . . . Printing Corporation of America have [sic.] as of December 31, 1971 cut off his pension completely. The man is my brother, now 70, in poor health, and depended [sic] upon his pension for his existence."

[10] Preliminary Report, *supra* note 6, at 5.

[11] Statistical Analysis, *supra* note 7, at 37.

[12] *Id.*

[13] *Id.*

[14] *Id.* at 38.

[15] See, e.g., Hearings on S. 4 before the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare, 93d Cong., 1st sess. Prepared statement of Bernard E. Nash, Executive Director, NRTA-AARP (1973) (hereinafter referred to as Hearings on S. 4).

In the light of the findings of the Senate Labor Subcommittee's Report and Statistical Analysis and the corroborating, empirical evidence that has come to our attention through our membership correspondence, we are without doubt that Federal regulation is needed. But other factors also motivate our adherence to this position.

B. The extent of the Federal Government's interest

One of the factors that have contributed to the expansion of, and continuing improvement in the system of employee pension benefit plans has been the extensive income tax subsidies offered by the Federal Government, through I.R.C. §§ 402, 403 and 501, to pension, stock bonus and profit sharing plans which meet the requirements of I.R.C. § 401. The Revenue Act of 1921,[16] providing an exemption from current taxation of the income of a trust created by an employer as part of a stock bonus or profit sharing plan for the exclusive benefits of employees, marked the advent of a continuous Federal policy of favorable income tax treatment of qualified plans. Today, the Internal Revenue Code extends preferential treatment to employer pension, stock bonus, profit sharing, and bond purchase plans, provided such plans inure to the exclusive benefit of employees and their beneficiaries.[17] Subject to specific limitations, contributions to qualified plans, which constitute the bulk of private plans today, are deductible by the employer [18] and excludable from the current income of the employee.[19] Until distributed to plan beneficiaries, the accumulated earnings and appreciation of plan assets are exempt from Federal income taxation.[20] Moreover, even employees with nonforfeitable, vested interests under such plans realize no income until distribution is made [21] and then at preferential rates.[22] In 1968, while private pension contributions by employers were aggregating 9.4 billion dollars, [23] and while payments from such plans were aggregating over 5 bilion,[24] the loss to the Federal Treasury from this combination of tax concessions was about 4 billion.[25]

In the light of the statistically documented inadequacies in the performance of employee pension benefit plans, a continuation of the present policy of perferential Federal income tax treatment of qualified plans would only be justified if effective regulatory legislation were enacted. It is absurd to perpetuate a substantial, annual revenue loss by continuing to treat preferentially plans which perform inadequately and ineffectively, the primary ends which that preferential treatment was designed to induce. Since the present performance of employee pension benefit plans is unacceptable, the only reasonable alternative to the enactment of comprehensive Federal regulatory legislation would be the revocation of existing tax concessions with the additional revenue generated thereby used in some other manner to provide retirement benefits.

Since the Federal Government has a substantial economic interest in the system of pension benefit plans, it has the right to mandate minimum standards of performance with respect to vesting, funding, portability and plan termination insurance. Since the Federal Government's annual economic investment is incurred for the benefit of the worker, and since the worker has not benefitted therefrom as expected, the Federal Government must exercise that right.

C. The accumulated reserve assets of the employee pension benefit plan system

To further justify the enactment of Federal legislation designed to regulate more closely the performance of employee pension benefit plans, our Associations, in their presentation before the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare last June stated: "[P]rivate plans have accumulated reserve assets of over 130 billion dollars, which amount is expected to increase to 225 billion by 1980. . . . [T]he private pension system [has become] a significant source of financial power, the economic impact of which directly or indirectly affects the daily life of each citizen." [26]

[16] The Revenue Act of 1921, 42 Stat. 227 (1921).
[17] I.R.C. § 401(a)(2).
[18] I.R.C. § 404
[19] I.R.C. §§ 402(a), 403(a).
[20] I.R.C. § 501(a).
[21] I.R.C. §§ 72, 401(a), 403(a).
[22] I.R.C. § 72(a), (c), (d), (n).
[23] "Employee-Benefit Plans in 1968," 33 Social Security Bulletin 43 (Table 5 (April 1970).
[24] *Id.*
[25] Staff of the Treasury Department and the Joint Committee on Internal Revenue Taxation for use by the House Committee on Ways and Means, Estimates of Federal Tax Expenditures 5 (Preliminary Committee Print, Oct. 4, 1971) Table 1).
[26] Hearings on S. 3598, *supra* note 5, at 164.

These accumulated reserve assets represent a substantial fund of underregulated investment capital. Under present law, contributions, even those made to trusts which qualify under I.R.C. § 401(a), may be used by trustees within the limitation of the trust agreement and local law. Indeed, Reg. § 1.401-1(b)(5) states: "No specific limitations are provided in section 401(a) with respect to investments which may be made by the trustees of a [qualifying] trust." Moreover, in the case of a qualified trust which provides benefits to employees, some or all of whom are "owner-employees" with in the meaning of I.R.C. § 401(c)(3), although the trustee is required by I.R.C. § 401(d)(1) to be a bank, that paragraph specifically provides that a person (including the employer) other than a bank may be granted, under the trust instrument, the power to control the investment of trust assets, either by directing investments or by disapproving proposed investments.

Of course, I.R.C. § 503 provides for the forfeiture of the tax-exempt status of an otherwise qualified trust if an investment made by trustees constitutes a transaction prohibited by I.R.C. § 503(b). Of greater interest, however, is I.R.C. § 401(f)(1)(C)(i)(ii) which limits the investment of the funds of custodial accounts, which are treated as qualified trusts, to regulated investment company stock or to annuity, endowment or life insurance contracts issued by insurance companies.

Neither the Labor-Management Relations Act[27] nor the Welfare and Pension Plan Disclosure Act[28] has added significantly to the Internal Revenue Code's minimal regulation of the investments of, or performance by, employee pension benefit plans. The Labor-Management Relations Act provides certain guidelines designed to prevent the diversion of employee funds through collusion between labor and management administrators. The Welfare and Pension Plan Disclosure Act, which was amended in 1962 to make theft, embezzlement, bribery and kickbacks Federal crimes if they occur in connection with welfare and pension plans, relies on disclosures of information to the Secretary of Labor and to plan participants as the principal means of policing plan operation and administration.

III. THE OPTIMUM OBJECTIVE OF PENSION REFORM LEGISLATION

Our Associations are convinced that (1) the past and projected inadequacies in the performance of employee pension benefit plans, (2) the substantial annual Federal tax concessions to such plans and (3) the increasingly significant impact on the economy of the accumulated reserve assets of such plans justify the enactment of Federal legislation providing minimum standards with respect to eligibility, vesting, funding, portability, plan termination insurance, disclosure and fiduciary duties. Only such comprehensive legislation would appear to have the potential to raise the performance of those existing plans, which are found to be deficient, to minimally acceptable levels and to guarantee that plans established subsequent to enactment will also perform acceptably. The enactment of such standards will define the degree of adequacy in pension benefit plan performance that will justify a continuation of the existing tax policy of preferential treatment.

We recognize that reasonable men will differ in their judgments with respect to the effectiveness of alternate formulations of the substantive elements of comprehensive pension reform legislation. We also recognize that the resources available for the funding of pension benefit plans are limited and that these limited resources must be utilized to fund not only the increased obligations which would result from more liberal vesting provisions, but also those which result from the granting of past service credit and higher benefit levels. Obviously, the choice of statutory standards must be made with care and deliberation so as to respond to the precise dimension of the need and so as to minimize any retardation in the improvement of existing plans and any disincentive to the establishment of new ones. This should be the optimum objective of pension reform legislation.

IV. THE LEGISLATIVE VEHICLES OF PENSION REFORM

Our Associations hope that comprehensive pension reform legislation will emerge from the legislative process of the 93rd Congress during its first session.

[27] Labor-Management Relations Act, 61 Stat. 136, 157 (1947), 29 U.S.C. § 186 (1964).

[28] Welfare and Pension Plan Disclosure Act of 1958, 72 Stat. 997, 29 U.S.C. §§ 301-09 (1964).

To this end, we are devoting considerable time and effort. We have already testified before the Senate Labor Subcommittee[29] on the Retirement Income Security for Employees Act (S. 4),[30] before the House General Labor Subcommittee[31] on the Employee Benefit Security Act (H.R. 2)[32] and the Employee Retirement Benefit Security Act (H.R. 462),[33] and before the House Committee on Ways and Means on the general subject of pension reform.[34]

We realize, however, that even our most vigorous efforts in support of comprehensive pension reform legislation will not bring about enactment in the absence of a substantial commitment by the considerable cooperation between the various committees of the Senate and House having legislative jurisdiction in this area.

The pension reform bills which are before the Labor committees in both the Senate and House would attempt to effect comprehensive reform through a separate statute administered and enforced by the Department of Labor. We recognize, however, that pension reform could also be effected through Internal Revenue Code amendments, administered and enforced by the Internal Revenue Service. To our Associations, either approach is feasible but not equally desirable.

Whether Subchapter D of the Internal Revenue Code or a separate labor statute is the more appropriate vehicle for effecting pension reform is a question which is subordinate to, and follows automatically from, a determination of whether the Internal Revenue Service or the Labor Department is better suited, on the basis of experience and function, to administer and enforce the minimum standards which are the essence of pension reform legislation. Moreover, to the extent possible, the administrative and enforcement functions contemplated in such legislation should be confined to a single agency.

It has been alleged that the Internal Revenue Service, because of the experience of its Pension Trust Branch in evaluating employee pension benefit plans to determine their qualification for preferential income tax treatment, is better qualified to administer and enforce minimum pension reform standards. We disagree. The primary function of the Internal Revenue Service is the protection of the federal revenues. In determining whether or not an employee pension benefit plan is nondiscriminatory and therefore qualified for preferential income tax treatment, the Pension Trust Branch is primarily protecting the federal revenues against unwarranted deductions, exclusions and exemptions. The primary function of the Labor Department under the Welfare and Pension Plan Disclosure Act is the protection of the interest of participants in and beneficiaries of employee welfare and pension benefit plans.[35]

The Internal Revenue Service, through its Pension Trust Branch, has acquired its experience in the pension plan area by acting in the interest of the federal revenues; the Labor Department has acquired its experience in this area by acting in the interest of plan participants and beneficiaries. Since the thrust of pension reform legislation is to provide protection for plan participants and beneficiaries, the Labor Department is better qualified on the basis of function to perform that task.

Having determined that administration and enforcement responsibilities properly belong in the Labor Department, it follows that the minimum standards which are to be administered and enforced, should be contained in a labor statute. Moreover, since disclosure is absolutely essential to effective administration and enforcement, and since, even under the Administration's pension reform scheme, disclosure would continue to be made to the Labor Department, this agency is in the more advantageous position to assure effective implementation of whatever standards are enacted. The division of functions and responsibilities between two agencies, as is contemplated under the pension reform bills proposed by the Administration,[36] would necessitate agency duplication and would probably impede effective administration and enforcement—to the detriment of plan participants and beneficiaries.

[29] Hearings on S. 4, *supra* note 13.

[30] S. 4, 93d Cong., 1st sess. (1973).

[31] Hearings on H.R. 2 and H.R. 462, before the General Subcommittee on Labor of the House Committee on Education and Labor, 93d Cong., 1st sess., testimony of Cyril F. Brickfield, Legislative Counsel, NRTA and AARP (1973).

[32] H.R. 2, 93d Cong., 1st sess. (1973).

[33] H.R. 462, 93d Cong., 1st sess. (1973).

[34] Hearings on Tax Reform Before the House Committee on Ways and Means, 93d Cong., 1st sess. Prepared statement of Bernard E. Nash, Executive Director, NRTA and AARP (1973).

[35] 29 U.S.C. § 301 (1964).

[36] S. 1631, 93d Cong., 1st sess. (1973); S. 1557, 93d Cong., 1st sess. (1973).

The approach to pension reform embodied in S. 4 is preferable. Administration and enforcement responsibilities would be confined solely to that agency having the greatest experience in protecting the interest of plan participants and beneficiaries. Not only would the Labor Department initially certify that plans comply with enacted minimum standards, but it would also assure subsequent adherence to those standards.

Our organizations forsee no conflict between the Internal Revenue Service's function of determining the qualification of employee pension benefit plans for preferential income tax treatment and the Labor Department's function of assuring conformity of such plans with enacted minimum standards. Under S. 4, a plan which failed certification could not continue to exist regardless of whether it was found to be nondiscriminatory and therefore qualified for preferential tax treatment.

Although minimum standards with respect to vesting, funding, portability and plan termination insurance could be added to I.R.C. § 401 as conditions precedent to qualification for tax purposes, our organizations believe that this would generate conflict and confusion since two separate agencies would be making independent determinations. The I.R.S. and the Labor Department could disagree as to whether a particular plan meets the requirements of the enacted minimum standards for purposes of tax qualification and certification. Even if the I.R.S. were delegated sole responsibility to determine initially whether a plan meets such standards, the Labor Department, on the basis of subsequent disclosure, might determine that it does not. To avoid possible conflict and confusion, therefore, we believe that administration and enforcement duties should be confined solely to the Department of Labor, and the minimum standards should be contained in a labor statute. If deemed desirable, qualification for tax purposes could be made contingent upon Labor Department certification by amending I.R.C. § 401 to require such certification.

V. THE COMPARATIVE MERITS OF THE ELIGIBILITY, VESTING, FUNDING, PORTABILITY, AND PLAN TERMINATION INSURANCE STANDARDS CONTAINED IN S. 1631, S. 1179, AND S. 4

A. Eligibility

Between the one year/age thirty eligibility requirement of section 321 of S. 1179, the three year/age thirty requirement of section 2(a) of S. 1631 and the one year/age twenty-five requirement of section 201 of S. 4, our organizations prefer the latter. Ideally, we desire immediate eligibility to participate but we recognize the administrative burden which would be caused by short-term employees. We think that the one year/age twenty-five requirement of S. 4 would avoid the administrative problem of short-term employee and enable workers to participate at the earliest feasible moment.

B. Vesting

The position of our Associations with respect to the "rule of 50" vesting standard proposed by section 2(a)(2) of S. 1631 is clear. Before the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare last June we stated: ". . . [O]ur Associations must oppose any . . . standard which provides incentive for age discrimination in employment. While we recognize that the "rule of 50" approach would protect the pension rights of those workers who are approaching retirement, we feel that the protection provided by this approach, standing alone, would be counterbalanced by its tendency to promote discrimination in the hiring of older workers."[37] We feel that the enactment of the "rule of 50" will promote unemployment among middle age workers.

With respect to the graded vesting approaches of section 322 of S. 1179, and section 202 of S. 4, we prefer the latter. Although we support the initiation of graded vesting after five years of plan participation as proposed in S. 1179, we think twenty years for full vesting is too long. We, therefore, prefer the fifteen year graded vesting schedule of S. 4 and believe that its retrospective application under section 202(a) thereof will provide the older worker adequate protection without the employment discrimination which would probably attend the enactment of a "rule of 50" standard. Moreover, the study of the cost of mandatory vesting provisions,[38] prepared for the Senate Subcommittee on Labor,

[37] Hearing on S. 3598, *supra* note 5, at 176.
[38] S. Rept. No. 127, 93d Cong., 1st sess. 79 (1973).

indicates that a fifteen year graded vesting schedule, even with retrospective application, would not be so costly as to render it undesirable.

C. Funding and termination insurance

All three bills recognize the need for a funding standard to assure, at the end of a twenty to thirty year period, full funding of all accrued liabilities of an employee pension benefit plan. We, therefore, express no preference between them. However, we believe that a minimum funding standard should be reinforced by a requirement of plan termination insurance. If the Federal Government can insure the obligations of banks, it can undertake to insure the obligations of pension plans. The lack of any provision for plan termination insurance in S. 1631 is a serious deficiency.

D. Portability

Of the three bills under consideration by the Private Pension Plan Subcommittee, only S. 4 contains provisions to create a portability program. Our organizations believe that a portability program, even if only voluntary, should be established to accommodate the reality of labor force mobility, to reduce the administrative burden on and cost to, individual plans which would otherwise have to keep track of a former employee as he moves from job to job within the economy. We view a portability program as a welcomed reinforcement to a minimum vesting schedule.

VI. TAX INCENTIVES TO PROMOTE RETIREMENT SAVINGS

In the view of our Associations, comprehensive pension reform includes within its scope a further element, legislative action with respect to which can be taken only by the tax-writing Committees. In our Associations' prepared statement,[39] submitted for the record of the 1972 hearings conducted by the House Committee on Ways and Means on Tax Proposals Affecting Private Pension Plans, we adopted the following position.

"Since private retirement plans are an essential factor contributing to the retirement security of older persons, it is unreasonable to require a retiree to subsist on Social Security or other public benefit payments merely because he failed to receive coverage under a private plan, or if covered, failed to receive any benefits. The private retirement system should permit both employees and employers to provide for retirement security through a qualified plan. The right to use qualified retirement plans, with their incidental tax advantages, was extended to owner-employees in 1962 by the Self-Employed Individuals Tax Retirement Act; the extension of a similar right to [common law] employees is overdue. Each employee should be permitted to establish his own private retirement plan, irrespective of the wishes of his employer. . . . If properly controlled, such plans would function as a means of providing an additional measure of retirement security for the labor force and would readily accommodate the reality of labor force mobility.

"[Since] [o]ur Associations believe that existing law relating to savings for retirement purposes discriminates substantially against individuals who do not participate in a qualified private retirement plan, or who participate in plans providing only minimal benefits, ... we support the proposal of section 3 of H..R 12272 which would allow to individuals, a deduction in computing adjusted gross income for amounts contributed to individual retirement plans which they have established or to private retirement plans established by their employers."[40]

As our statement of last year indicates, we favor an extension of the privileged use of tax-qualified retirement plans to employed persons. We believe that present law constitutes a serious disincentive to saving for retirement and complicates the retirement income problem confronting that substantial portion of the labor force that has little or no opportunity to participate in employee pension benefit plans. We also believe that self-reliance in securing adequate retirement income should be promoted to the extent possible and recognize that the Internal Revenue Code could serve as the vehicle for introducing incentives designed to promote such self-reliance.

Our Associations' position is not, however, without qualification. First, we do not wish to appear as advocates of an irresponsible proliferation of tax in-

[39] Hearings on Tax Proposals Affecting Private Pension Plans Before the House Committee on Ways and Means, 92d Cong., 2d sess., pt. 2, at 327–34 (1972).

[40] *Id.* at 333–34.

centives to accomplish social or related objectives, since the cumulative impact of such incentives may seriously erode the revenue-raising function of the tax structure. Second, we do not desire the creation of a new tax shelter to benefit primarily higher income individuals, since such tax shelters promote inequity in the distribution of the tax burden. Third, since the use of such a savings incentive requires the availability of sufficient disposible income, we find it difficult to ascertain the extent of the beneficial impact of a savings incentive on lower and moderate income groups.[41] Finally, the annual revenue loss from this savings incentive must be considered[42] and balanced against the projected cost benefits to be derived in the future.

With these reservations in mind, our Associations have, nevertheless, determined to adhere to our position in favor of an extension of the use of tax-qualified plans to employed persons. We believe that, on the balance, the advantages to be derived from such a tax incentive would outweigh the disadvantages, especially if its availability were limited to lower and moderate income groups and its mechanics took the form of a credit rather than a deduction in computing adjusted gross income.

In view of the position taken by our organizations with respect to section 8 of H.R. 12272 last year, we extend our qualified support to section 8 of S. 1631, and to section 342 of S. 1179. However, as between the deduction from adjusted gross income proposed by the former and the credit against income tax liability proposed by the latter, we prefer the latter. We believe it to be more equitable.

VII. CONCLUSION

Our organizations favor the enactment of comprehensive pension reform legislation. We believe that the substantive standards with respect to eligibility, vesting, funding, portability and plan termination insurance, proposed in S. 4, while perhaps not as strong as we would like, are clearly preferable to their counterparts, to the extent there are any, under S. 1179 and S. 1631. Moreover, we believe that S. 4's delegation of administrative and enforcement responsibilities with respect to those standards to the Department of Labor is both desirable and warranted on the basis of that Department's experience in acting on behalf of the interests of employee welfare and pension benefit plan participants and beneficiaries under the Welfare and Pension Plan Disclosure Act. We, therefore urge the Private Pension lan Subcommittee of the Senate Committee on Finance to support the substantive standards and the administration and enforcement scheme of S. 4.

In recognition of the fact that fifty percent of the current labor force is not covered under employee pension benefit plans and would not benefit from the enactment of minimum standards with which such plans would be required to conform, our Associations would hope that the Private Pension Plan Subcommittee would confine its legislative activity to a determination of the need for tax incentives to encourage individual savings for retirement and, if warranted by the dimensions of any such need, to a determination of the most equitable means of fulfillment through Internal Revenue Code amendments. We believe that the availability of a credit against federal income tax liability is a more equitable mechanism for encouraging individual savings for retirement. If tax incentives are to be enacted, we would support and prefer the approach of section 342 of S. 1179.

STATEMENT OF NELSON H. CRUIKSHANK, PRESIDENT, NATIONAL COUNCIL OF SENIOR CITIZENS

The enactment of significant pension reforms during this session of Congress is one of the top goals for the members of the National Council of Senior Citizens. Our 3,000,000 members from throughout the United States are convinced that there has been sufficient time for study and deliberation; action on this critical issue is overdue.

Senior citizens from all over this country will converge on Washington, June 6 for the National Council of Senior Citizens' three-day National Legislative

[41] The Administration in support of H.R. 12272, 92d Cong., 1st sess., § 8 (1971) predicted that some 70 percent of the tax benefits would go to persons with annual incomes below $15,000.

[42] The Administration's estimates for its proposal last year ranged from $800 million in the first year to $480 million in the fourth year.

Conference. One of the highlights of this gathering will be a rally of more than 10,000 older Americans on the Capitol steps at noon on Thursday, June 7.

The reason for the Legislative Conference is stated in the opening paragraph of "A Program For The 93rd Congress," our legislative platform:

"The delegates to the 1973 Legislative Conference of the National Council of Senior Citizens have come to the seat of government to present to the Congress and the nation our proposals for a better life for America's older people. This Conference would not have been necessary but for the failure of the President of the United States to live up to his pledges, enunciated at the 1971 White House Conference on Aging."

Of special concern to the Conference delegates is to reaffirm the need for pension regulation and to urge Congressional action.

Needless to say, our members would not personally benefit from the passage of pension legislation since, for purposes of such legislation, they have completed their working years. But, they know well the effects of inadequate or nonexistent vestings, inadequate funding, fund mismanagement, and pension plan termination. Our members are the retirees described in the numerous and frequently cited "horror" stories about the personal effects of our present pension system. Senior citizens have worked hard so that they could enjoy their retirement, reasonably expecting a decent income from the pensions which they earned. However, not all of them can enjoy fully their retirement years because of inadequate pension regulations. This is one aspect of American life which older Americans do not want passed on to their children and grandchildren. We are determined that our children and their children not suffer similar hardships.

The concern of the National Council with protecting private pension plans is not a hasty position. The last five national conventions of the National Council of Senior Citizens have emphasized the need for a strong private pension system, and our position was unanimously endorsed by the 3400 delegates of the 1971 White House Conference on Aging.

This concern is again reflected in "A Program For The 93rd Congress," which states: "We recommend Congressional action to improve the protection of private pension plans, especially by setting standards in the areas of vesting (guarantee of pension rights), portability (continuance of pension rights upon changing employers), survivors benefit, and by providing a system of Federal reinsurance. In addition, there should be complete disclosure to beneficiaries of eligibility requirements and payment provisions and Federal regulations to assure fiduciary responsibility, including adequate funding."

I don't think it is necessary for me to once again parade by you the tragic individual stories of pension default in order to underline the magnitude of the pension problem with which this committee must deal. I do wish to point out, however, that if we are going to achieve what the White House Conference on Aging recommended—a total cash income for older people in accordance with the American standard of living—a basic element must be an adequate and fully protected pension system.

The strong commitment of the National Council to the development of a meaningful private pension system is attested to by the model pension plan provided to our staff. I dare say, not one provision of our plan would have to be changed by the passage of any of the pensions bill currently before the subcommittee.

I wish to briefly outline the provisions of our plan, so that you may better understand the depth of our commitment to pension reform.

Every staff member of the National Council of Senior Citizens immediately upon employment, enters into a retirement program. This can be accomplished only because the National Council, itself, is paying all the cost.

There is included in our plan, an arrangement for retirement at age 55, as well as an adjusted amount made available for disability pensions for any staff member who has completed five years of service.

We have available a joint and survival pension option—and as indicated earlier, all staff members have a vested right in their pension from day one of employment.

The initiation of this pension plan by the National Council of Senior Citizens, despite the fact that our resources are severely limited, serves to demonstrate that "where there's a will, there's a way." But, unfortunately, the record demonstrates that many employers with far greater resources than we, will never initiate an adequate pension plan for their employees without the Federal commitment to action.

I think it is evident that the goals of the National Council are best satisfied by S. 4, the Retirement Income Security for Employees Act, sponsored by Senators Williams and Javits. We are aware that S. 4 is not a perfect piece of legislation; it is really a compromise proposal. Nevertheless, we hold firmly to the conviction that this proposal represents a significant step forward and can, in the course of time, be substantially strengthened.

Much of the inequity in the present pension system is that caused by employers who have not changed their concept of employee pensions since the turn of the century. When they began their careers in factories and offices, a pension was considered a gift, a bonus from an employer to reward an employee at retirement for a lifetime of loyal service to the company. But since World War II, pensions have been increasingly viewed by the worker as a form of deferred wages and therefore an earned right.

The enactment of Social Security in 1935 was to provide older Americans a middle layer of protection, between the basic level of public assistance and the top level of that acquired by private means, such as savings and pensions. This three-layer concept has been commonly accepted in principle, but the precise boundaries of the layers continues the subject debate.

Pensions are a crucial component of retirement income since Social Security benefits alone are never adequate, and savings are usually an unrealistic expectation. Unless we greatly expand the Social Security program, pensions regulations which provide an opportunity to set aside earnings today with some assurance of their security are essential.

Our brief evaluations of the proposals currently before this Subcommittee—S. 1179 sponsored by Senator Bentsen; S. 1631 introduced for the Administration by Senators Curtis, Hansen, Bennett, Dominick, and Fannin; and the reforms embodied in S. 4—highlight five areas which are of the utmost concern to our members and to working men and women. These areas are administration, vesting, portability, reinsurance, and tax programs.

Vesting.—We reject the President's vesting proposal in S. 1631 for a "Rule of 50" because it would discourage the hiring of mature workers, especially those aged 45 to 60.

The "Rule of 50" calls for half vesting when the worker's age plus years of service equal 50 an additional 10% each succeeding year until full vesting or retirement is reached. This provision has the effect of shortening the vesting period for older workers. Table A is the Administration's example of how these periods of partial and full vesting would shorten.

TABLE A

A worker who begins participating[1] at age	Vests 50 percent at age	After participating for (years)	And is 100 percent vested at age	After participating for (years)
30	40	10	45	15
40	45	5	50	10
50	50	0	55	5

[1] Participation must commence within 3 years of employment for all those over 30; those eligible to participate only within 5 years of normal retirement may be excluded.

However, the faster a worker vests, the more expensive it is for the employer to hire the person and provide the necessary pension coverage. As you can see from Table A, a 55 year old is immediately 50% vested and fully vested within 5 years, whereas a 30 year old worker is not 50% for 10 years and fully vested after 15 years. The "Rule of 50" appears to be another way of saying to the worker: Retire at 50.

The Administration also proposes an optional three waiting period before new employees must begin their participation in pension plans. In addition, plans would not be required to provide pension coverage to new employees 60 years of age and older.

The vesting provisions of S. 4 require 30% vesting after 8 years and an additional 10% per year thereafter. On the other hand, S. 1179 specifies 25% vesting after 5 years plus 5% per year thereafter.

It is important to notice that in either of these formulas, age is not a factor. We can see no justification for age being a determinant of pension vesting. Coverage should be an earned right and not a function of an implied "need" factor as in a welfare program. A positive and unique feature of the Williams-Javits proposal is that it vests a total number of years of service rather than continuous service, thus eliminating the restrictive "break-in-service" requirement which deprives many employees of pensions.

Administration.—We strongly support Department of Labor administration of pension regulations under a new Office of Pension and Welfare Plan Administration. This is crucial, we believe, because this legislation concerns itself with employee benefit plans. In contrast S. 1179 and S. 1631 are tax-oriented approaches to reform and specify administration by the Treasury Department.

Portability.—S. 4 goes further in this area, establishing a national voluntary portability program for vested pensions. S. 1179 and S. 1631 suggest merely a tax-free transfer of pension rights by the employee.

We find this area to be inadequate in all three proposals. Our recommendation is described in the "Program for the 93d Congress": "Additional legislation is needed to achieve pension protection for employees of small businesses as well as individual workers and to set up a timetable for pension portability to become compulsory. These steps would constitute the development of a national portable pension system open to any worker as a companion to the Social Security System."

Reinsurance.—A pension plan termination insurance is a must for any pension reform; without this insurance it is impossible to assure the worker of his pension which he has earned. Only S. 4 and S. 1179 provide for this protection which would be similar to that afforded banks by the Federal Deposit Insurance Corporation.

Admittedly, the number of workers affected by plan terminations is relatively small. But that is all the more reason for the insurance protection because the cost would be very cheap and the benefit would be great.

Taxpayer.—The tax changes in S. 1179 and S. 1631 to induce voluntary savings for workers not covered by pensions are an attempt to create another tax loophole for the rich. S. 1631 proposal would allow individuals an income deduction amounting to 20% of earned income up to $1500 per year for retirement savings.

Relatively few members of the National Council of Senior Citizens have ever been in the position to save 10% or $1500 for retirement, or for anything else. Even more to the point, how many workers in this era of rapidly rising prices can take full advantage of this proposed loophole?

Quite plainly, this tax proposal is not for the large majority of people with low or middle incomes. This loophole is designed for the well-to-do.

The proposal has also been made to increase the deductible limit on previous contributions by the self-employed from 10% of earned income up to $2500, to 15% and $7500. The Keogh retirement plans are already a boon for doctors and lawyers; the three-fold increase in maximum deductible will be a gift.

Similar provisions, but reduced, amounts are embodied in the Bentsen bill. S. 4 contains no provisions which affect the tax codes.

We would like to see the President try to close loopholes instead of creating new ones and to direct his efforts toward a system to provide pension portability.

In summary, although each of these proposals has attractive provisions, it is S. 4 which we believe is the most suitable bill at this time. After the enactment of S. 4, we can turn attention to the attractive features of S. 1179, S. 1631 and other pension proposals and build upon S. 4, as we have done so successfully with the Social Security program.

I would like to point out that a worker's stake in the private pension system is great and will be much greater in the years ahead. But, at best, beneficiaries of private pensions will continue to be concentrated largely among higher paid wage and salaried workers, while those having the greatest need during retirement will be least likely to receive private pensions.

In short, the Social Security System will continue to be America's basic method of assuring the aged an adequate level of income. So, while the National Council of Senior Citizens favors private pension reform, our membership recognizes that the main reliance of wage and salaried workers for retirement income must be for now—and for the foreseeable future—on Social Security benefits.

AMERICAN ACTUARIES, INC.,
Grand Rapids, Mich., May 30, 1973.

Re: Hearings on pension proposals S. 1179; S. 1631, and S. 4.

Mr. TOM VAIL,
Chief Counsel, Committee on Finance,
Dirksen Senate Office Building, Washington, D.C.

MR. VAIL, please enter the following position statements in the record of hearings on the above proposals. My positions are a result of observations over 6 years of experience in the administration of several hundred pension plans at American Actuaries, Inc.; of an additional 6 years of experience as an agent of Northwestern Mutual Life Insurance Company working with benefits for employees of small corporations, and a previous 10 years experience as a stockholder-employee of a small closely held corporation with approximately 35 employees.

PROPOSALS ON REPORTING

I am against complicated forms to be completed annually regarding corporate pension plans. The small corporation already has so many forms to complete that often a business decision is based almost entirely on the complexity of reporting. Many small corporations would forego a pension plan rather than deal with complicated annual reports.

Underfunding is usually not a problem in the small corporation plan. These people view their plans from the angle of deferred taxation; perhaps, 75% of them contribute as much as permissible for a maximum deduction. Well prepared actuarial statements could reveal underfunding; and, current forms already inquire into the possibility of any prohibited transactions.

PROPOSALS ON EMPLOYEE COMMUNICATION

We have not experienced any problem concerning non-communication of a plan to employees. We usually are requested to prepare for each participant a booklet explaining the Plan in layman's language. Attached is a typical example.

Yet, sometimes there is a communicant problem. Is it the fault of the employer, or the fault of the employee who fails to effectively read the booklet? All too often, the employee wishes to believe a lot of money is being set aside for him which he can take any time he decides to quit. He feels cheated when the amount is less. I believe (from interviewing many such employees) that the quitting employee *desires* to find some area in which he can find dissatisfaction to express to the remaining employees. For this reason, most employers are eager to have plans effectively communicated to their employees.

I would be in favor of the requirement that such information be disseminated to participants. Information (like the enclosed booklet*) is a selling tool of the corporation to get and retain good employees. I would not be in favor of any requirement that the information be written in a negative sense. All the employer should be required to do is outline the conditions under which an employee is entitled to a benefit and to keep him regularly informed of his current status.

INVESTMENT ACTIVITY

I would be against any legislation which purports to protect the participant, but which really thwarts legitimate investment choices.

Plans which we administer have a wide range of investment media and results. "Bad" investment is seldom loss of principle; more often, it simply means a lower earnings result. Some investment results are extremely good. Usually, the reason for exceptionally good investment is a special situation, special investment knowledge, or skill of the trustee. No legislation should be enacted which would replace these opportunities with the too often mediocre results of banks, pooled funds, insurance company funds, or mutual funds.

Each company should be permitted to compete for employees with their pension fund results in the same way they compete in the market place with their product.

*This was made a part of the official files of the Subcommittee.

PROPOSAL TO INSURE PENSION PROMISES

Does this mean that each plan would insure (or be taxed) to fund another company's plan which cannot be completed because the company cannot or will not do so? If so, I am against such proposal. The reason is one of competition. Why should an unsuccessful company be subsidized by the successful one?

WHAT ASSURANCE TO PARTICIPANTS

1. I would be in favor of legislation which would require bonding of the trustee.

2. I would be in favor of some sort of insurance to protect pension funds from loss from criminal or fraudulent acts.

3. I would be in favor of a minimum requirement of funding of fixed benefit plans. This requirement should be based upon the facts concerning the relative amounts of: Fund valuation, present value of vested benefits, total past service liability, and current normal cost.

Such test, however, should not prohibit an increase in unfunded past service liability. As a company grows, it may well be best for it to increase the unfunded portion, to the benefit of the corporation's working capital position. This may be more important to the employees than a requirement for funding of their plan in excess of reasonable levels.

One possible ruling might require a minimum deposit of the lowest of the following two figures: (a) Normal cost plus the assumed interest on any unfunded past service liability, or (b) The higher of the following: (1) Excess of the Present Value of Vested Benefits over the fund value, or (2) Excess of 50% of Unfunded Non-Vested Past Service Liability over the fund value.

The result would be to require deposits toward full funding of vested benefits and toward a target of at least 50% funding of non-vested past service liability. This would be adequate protection for participants, yet allow flexibility of funding levels in fixed benefit pension plans according to the needs of the corporation.

4. I would be in favor of requirements for some minimum vesting schedules. I would not be in favor of a requirement for full vesting before say ages 50 or 55, when early retirement might be permitted.

The reason is to discourage the employee from deciding to leave one company for another just to be able to take advantage of full (or nearly full) vesting. I have seen many times this objective in employees who try to determine the amount they could receive if they quit. The new company might provide full pension rights also.

One purpose of a pension plan is to hold good employes. If the employee has nothing to give up if he quits, he is more apt to do so. It is costly for the company to get and train another experienced employee. They should not be required to have a plan which (in effect) subsidizes their competition's employee recruitment.

Vesting requirements probably should be on a sliding scale up to 100% vesting with at least 15 years of service at age 55. Again, if a company desires to offer a greater percentage of vested benefit, they should be able to do so, but they should not be required to do so.

Respectfully,

TED. H. RETAN.

INVESTMENT COMPANY INSTITUTE,
Washington, D.C., May 31, 1973.

Re: Initial hearings on private pension plan reform.

Senator GAYLORD NELSON,
Subcommittee on Private Pension Plans, Committee on Finance, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR NELSON: The Investment Company Institute appreciates this opportunity to express its views concerning the issues being considered at the Subcommittee's initial hearings on private and profit sharing plans.

The Investment Company Institute is the national association of the American mutual fund inudstry. Its membership includes 382 open-end investment companies (popularly called "mutual funds"), their investment advisers and principal underwriters. Our mutual fund members account for almost 90% of industry assets and have approximately eight and one-half million shareholders.

BEST COPY AVAILABLE

Our comments are primarily directed to Section 3 of S. 1631 and Sections 341 through 345 of S. 1179, but we wish to express our views concerning other areas of pension plan reform as well.

A. Section 3 of S. 1631 and Sections 341 Through 345 of S. 1179

Section 3 of S. 1631 and Sections 341–345 of S. 1179 would create a new system whereby individuals would be granted income tax deductions or credits for personal savings for retirement. We strongly support these sections in principle. At present millions of Americans are not covered by private retirement plans and millions of others have inadequate coverage. These sections represent a significant step in the right direction to correct these inequities. We think that the social desirability of adequate retirement income strongly suggests the goal of providing ample rather than meager benefits for our senior citizens.

Our principal concern is that the legislation be designed to insure that administration of individual retirement plans be made as simple and as economical as possible. It has heretofore been recognized that if retirement plans are to have wide acceptance, those who administer the plans must not be confronted with complex and unduly costly administrative burdens. It was this consideration that led to the enactment of Section 401(f) of the Internal Revenue Code to permit a simple bank custodianship arrangement, rather than to require a more complex trust, for Smathers-Keogh plans funded by mutual fund shares.

The need for economy of operation applies even more to the type of individual retirement plans contemplated by S. 1631 and S. 1179. This stems from the fact that the administration of these plans will generally involve many small payments by a participant which, unless the Congress directs otherwise, might involve such costly paperwork as to severely limit the use of the plans.

Based on this concern, we respectfully submit the following comments.

1. Creation of Qualified Retirement Accounts

S. 1631 provides that the assets of a qualified individual retirement account shall be held in trust by, or in the custody of, a bank 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". S. 1179 similarly provides that such assets should be held in trust by, or in the custody of, a bank, a credit union, "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."

We believe that if the bills require the establishment of a trust, custodial account or similar arrangement, the servicing costs will effectively bar many potential participants from establishing individual retirement plans. We anticipate that the average individual retirement plan account would be far smaller than the average Keogh account because of the stricter limits on contributions. Bank charges for administering Smathers-Keogh custodian accounts tend to run between $5.00 and $10.00 per account annually. If similar bank custodian arrangements with similar costs were required for the individual retirement plans contemplated by S. 1631 and S. 1179, it seems probable that the costs of administration would make it economically feasible to set up the smaller individual retirement plans.

More specifically, we suggest it be made clear that, under the provisions of S. 1631 and S. 1179 quoted above, the Secretary or his delegate should permit an individual to create a qualified individual retirement account with a mutual fund or other funding vehicle simply by having the account registered on a form to be provided by the Treasury Department, as, for example, "(Name of Participant) Individual Retirement Account under Section 408 of the Internal Revenue Code." In addition, it should be made clear that such a registration does not result in the creation of a trust relationship. Adoption of this proposal would effect important cost reductions and would be in keeping with a policy of simplification. The reporting requirements discussed below would provide an effective monitoring system to reduce or eliminate the potential for abuse.

2. Reporting Requirements

We submit that the Act should be designed so as to make reporting as simple as possible for participants, their employers and funding vehicles, consistent

BEST COPY AVAILABLE

with effective compliance. We expect that most participants will be average wage earners and will have difficulty in complying with complex and detailed reporting requirements. In addition, we expect that contributions to qualified individual retirement accounts, at least in the early years of participation, will be relatively small. If extensive reporting by funding vehicles is required, many funding vehicles may find that they are unable to service such accounts on an economical basis. Further, we think that many employers may be reluctant to assist in the operation of individual retirement accounts if they are required to file reports for plans in which they are not participants.

We suggest that the Secretary be authorized to require the funding or servicing agent to furnish to the participant and the Internal Revenue Service an annual statement containing appropriate information as to the account. The participant could be required to file a copy of this statement with his individual federal income tax return. This type of system, which we understand is presently used in Canada, would provide the Internal Revenue Service with necessary information to monitor the claimed deduction or credit and a check against premature withdrawals.

3. REDUCTION FOR CONTRIBUTIONS TO EMPLOYER-FINANCED PLANS

S. 1631 and S. 1179 both limit an individual's contributions to his individual retirement account to 20% of the first $7,500 of earned income. S. 1631 would give the participant an income tax deduction equal to the amount of his contributions: S. 1179 would give him an income tax credit equal to the lesser of $375 or 25% of his contributions. In addition, both bills would reduce these tax benefits to reflect employer contributions on the participant's behalf to an employer-financed plan. S. 1631 and S. 1179 provide that an individual would be permitted to assume that employer contributions are equal to 7% of his earned income, or alternatively he could show, in accordance with Treasury Department regulations, that a lesser amount had been contributed by his employer.

These proposed reduction provisions could create severe administrative problems for the individual, his employer and the funding vehicle. Since the bills are designed to assist the average wage earner, administration of the program should be made as simple as possible. Moreover, in the case of many employer-financed plans the amount of employer contributions cannot be ascertained until well after the end of a particular year, which might force an employee to accept the 7% assumption to his detriment. While S. 1631 might mitigate this problem in some situations (by allowing an employee to make a contribution for a particular year up to the time of filing his return) it would not resolve all problems and might actually lead to increased administrative difficulties. In many cases an employer would not be able to produce figures until after the date on which the employee must file his return; in other cases the time required for an employer to produce figures could preclude the employee from filing an early return.

The proposed reduction provisions might also lead to other inequitable results. As the President's message notes, many employer-financed plans presently do not provide for adequate vesting of employee benefits. While other sections of the bills seek to ameliorate this problem, they would not require substantial vesting in the early years of participation. Thus, the proposed reduction provisions would bar many individuals from establishing their own individual retirement accounts without assuring that they have other adequate vested pension coverage. The provisions would also work to the detriment of a participant in an employer-financed plan who receives salary increases during the course of his employment. While such an individual might be permitted to make contributions to his individual retirement plan in the early years of his employment, the bills as proposed would prohibit him from making further contributions to his individual plan after the amount of his employer's annual contributions to the employer's plan had reached a certain level.

For the above reasons we believe that this Subcommittee might consider two alternatives to the proposed reduction provisions. First, consideration might be given to replacing the provision with a two-tier provision, similar to that provided for under the Canadian law. Contributions by individuals who do not participate in employer-financed plans could be governed by one ceiling, while contributions by employees who do participate in such plans could be governed by a lower ceiling. Alternatively, consideration could be given to providing that the reduction provision apply only to an individual having earned income in excess of $15,000. That is, an employee whose earned income does not exceed $15,000 should be entitled to make contributions without regard to the fact that he is also a participant in an employer-financed retirement plan. We believe that either of these alternatives would lessen severe administrative problems and reduce the likelihood of inequitable results.

4. REQUIREMENTS IMPOSED UNDER THE FEDERAL SECURITIES LAWS

We also wish to call this Subcommittee's attention to the need for economies in other areas if retirement savings plans are to be economically feasible. Certain regulations under the federal securities laws require paperwork which seems too costly to be justified in the area of individual retirement plans.

For example, existing rules require that each mutual fund shareholder receive a separate written confirmation whenever he purchases or redeems fund shares. Other rules require that each mutual fund shareholder directly receive a separate copy of the fund's annual, semi-annual and other stockholder reports and proxy statements.

We believe it appropriate for the United States Securities and Exchange Commission to make appropriate changes in certain rules. For example, we believe that the confirmation rules could be amended to provide that qualified individual retirement accounts must receive confirmations in the form of quarterly statements showing all transactions in an account during that quarter. Such a revision would effect major cost reductions and would be in keeping with the basic purpose of the confirmation rules, since the stockholder would receive full information concerning each transaction within a reasonable time after it had occurred. We also believe that the rules should be amended to permit participants in individual retirement accounts to designate their employers as agents to receive and distribute confirmations, stockholder reports and proxy statements. Employees are well-accustomed to having their employers perform various financial obligations and services on their behalf (e.g., withholding federal and state income taxes, F.I.C.A., the purchase of life and health insurance, payroll deduction purchases of United States Government Bonds). We believe that it would be appropriate for employees to be permitted to designate their employers as agents for purposes of confirmations, stockholder reports and proxy statements.

We have been holding discussions with members of the SEC staff concerning rule changes designed to further the economic feasibility of retirement savings plans.

5. OTHER MATTERS

As stated above, we strongly support Section 3 of S. 1631 and Sections 341 through 345 of S. 1179 in principle, and our major concern is with the need for making the administration of the individual retirement account system as simple and as economical as possible, both for participants and their employers, as well as for funding vehicles and governmental agencies. However, we also believe that this Subcommittee should consider whether the proposed $1,500 limitation on annual contributions is generous enough to provide adequate retirement benefits for participants even when other retirement income such as social security is considered. In this connection we call attention to the provisions of the Canadian law concerning registered retirement savings plans which permit greater annual contributions (the lesser of $4,000 or 20% of earned income for individuals who do not participate in employer-financed plans, and the lesser of $2,500 or 20% of earned income for such participants). We are informed that the Canadian retirement savings system has not resulted in greatly reduced tax revenues.

We also believe that consideration should be given to amending S. 1631 and S. 1179 to permit an individual to make additional non-deductible contributions to his individual retirement account. Participants in employer-financed plans and Keogh plans are permitted to make such additional contributions. We suggest that an individual who establishes his own individual retirement account be afforded comparable treatment.

Further, we note that S. 1631 and S. 1179 provide that premature withdrawals from individual retirement accounts would be subject to a penalty tax of 30% of the amount withdrawn. It is likely that participants generally will be in lower income brackets than most Keogh plan participants, and in cases of emergency they will be under greater pressure to require premature distributions. Under present law premature withdrawals from Keogh plans are only subject to a 10% penalty tax. We see no reason for imposing a greater penalty tax on individuals establishing qualified individual retirement accounts.

B. Amendment of Section 403(b)

We believe that it would be appropriate to add a provision to S. 1631 and S. 1179 which would amend Section 403(b) of the Internal Revenue Code. Section 403(b) presently permits public schools and charitable organizations to enter into deferred compensation arrangements with one or more of their employees and to fund these arrangements through the purchase by the organization of "annuity contracts" for the covered employees.

We propose the amendment of Section 403(b) to permit public schools and charitable organizations, under certain conditions, to fund these retirement arrangements through investments in shares of regulated investment companies as well as through purchase of annuity contracts. The employer would be authorized to make contributions to a custodial account which would invest the amounts in mutual fund shares to fund the retirement benefits. In all other types of private retirement plans, the use of mutual fund shares to fund retirement benefits is already authorized under the tax law. There appears to be no valid reason for limiting the permitted types of investment under Section 403(b) to annuities.

A suggestion of the statutory provision necessary to carry out our proposal, conformed to the text proposed by Section 7(e) of S. 1631, is:

Add at the end of Section 403(b) of the Internal Revenue Code the following new paragraph:

"(7) Custodial accounts.—For purposes of this title, amounts paid to a custodial account which satisfies the requirements of Section 401(f) by an employer described in subparagraph (A) of paragraph (1) of this subsection to provide a retirement annuity for an employee shall be treated as amounts contributed by such employer for an annuity contract for such employee. For purposes of this title (other than Section 402(a)(2)), a custodial account which satisfies such requirements shall be treated as an organization described in Section 401(a) with respect to amounts received by it (and income from investment thereof) which are excluded under this subsection from the gross income of the employees on whose behalf such amounts are paid."

C. Proposed Legislation Relating to Fiduciary Responsibilities

The May 2, 1973 press release announcing this Subcommittee's initial hearings stated that the hearings would include the issue of "fiduciary responsibilities of plan administrators and trustees." A number of bills have been introduced in both houses of Congress which deal with these matters, including the Administration's proposed Employee Benefits Protection Act (S, 1557), and S. 4, which has been reported to the Senate by the Senate Labor and Public Welfare Committee. The Institute endorses the declared policies of these bills and the purposes which they seek to achieve. However, we believe a number of bills, particularly S. 1557, contain certain technical ambiguities which, if not clarified, could seriously impede the use of mutual fund shares as an investment medium for employee benefit plans.

Mutual fund shares are a desirable medium for the funding of employee benefit plans. They offer professional management of the shareholder's investment by people who are trained and expert in the investment field. They offer diversification, and therefore a minimizing of investment risk by spreading the shareholder's investment over many carefully selected securities. They are particularly adapted to smaller private employee benefit plans in that they furnish, at modest cost, a complete, professionally managed investment program.

As of the end of 1972, the investment of employee pension and profit-sharing plans in mutual fund shares was nearly $1.5 billion. The mutual fund industry is, therefore, interested in S. 1557 and S. 4 and supports legislation designed to provide effective and meaningful safeguards for employee benefit plans.

Before referring to particular technical ambiguities in S. 1557, it might be helpful to outline the structure of a typical mutual fund complex. There are three distinct functions involved. First, there is the mutual fund itself, which issues its shares to the public and uses the proceeds to acquire its own portfolio of securities. Second, there is the investment adviser, which not only provides investment advisory services to the mutual fund but also performs many important administrative services for the fund. Third, there is usually a principal underwriter, which arranges for the distribution to the public of the fund's own shares. Often the investment adviser and the principal underwriter are the same entity or are under common control.

Mutual fund organizations are strictly regulated under the federal securities laws—namely, the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act of 1940. In addition, virtually every state in the Union regulates the sale of mutual fund shares.

As a matter of existing federal securities law, the investment adviser to a mutual fund has a fiduciary obligation to the fund. This obligation is enforceable by the United States Securities and Exchange Commission, the mutual fund itself and individual shareholders of the fund. Moreover, the SEC has substantial authority under the Investment Company Act of 1940 to regulate the operations of mutual funds, including authority, among other things, to promulgate rules with respect to the custody of fund assets and to prescribe requirements for fidelity bonding of fund officers and employees. In addition, the 1940 Act forbids transactions between a fund and its affiliated persons except with SEC approval. The SEC has adopted numerous rules concerning these matters (see, for example, extensive rules under Section 17 of the 1940 Act).

As some of the members of this Subcommittee are aware, there were amendments to the Investment Company Act of 1940 which were enacted into law in 1970 after a detailed SEC study of the mutual fund industry and extensive hearings by Congress. These amendments were primarily directed to an increase in control over various fees paid by mutual funds. However, there was no question raised in the SEC study or the hearings about the honesty and integrity of those handling fund assets or the adequacy of SEC authority. In fact, it was agreed that the 1940 Act had been quite effective in controlling potential conflicts of interest and in preserving the integrity of mutual funds.

The problems we have with S. 1557 are centered in Section 11 which places fiduciary duties on those who have power to deal with plan assets. We have no quarrel with this objective—mutual funds are already subject to stringent limitations in this regard under the Investment Company Act. The difficulty arises because definitions in Section 3 of "fiduciary" and "party in interest" are so broadly drafted as to possibly sweep up a mutual fund, its investment adviser and principal underwriter, and impose on them duties and restrictions which are inappropriate. If the bill is so interpreted, it would confuse the investment medium selected by those who have no discretion over benefit plan assets with the persons who have such discretion.

Mutual fund shares are securities, and like stocks and bonds, are a potential investment medium for employee benefit plans. We think that the term "fiduciary", for purposes of the bill, should cover those who decide what securities, whether they be stocks, bonds or mutual funds, are to be selected as benefit plan investments. But once a selection of one or more mutual funds as an investment medium has been made, we see no reason why the scope of the term "fiduciary", as used in the bill, should be extended to the mutual fund or those who manage it. We are reinforced in this belief by the fact that full details as to the operations of the mutual fund appear in its prospectus, including a statement of its investment policies. Failure to stay within the stated restrictions in the prospectus would create liabilities under the federal securities laws.

Section 3(h)(w) (page 7 of S. 1557) defines the term "fiduciary" as: "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."

It is unclear from this language whether, if assets of an employee benefit fund are invested in shares of a mutual fund registered under the Investment Company Act of 1940, such mutual fund or its investment adviser would thereby become a "fiduciary" within the meaning of Section 3(h)(w), on the theory that the mutual fund or its investment adviser exercises an investment discretion with respect to moneys or property which originally came from the employee benefit fund.

Section 3(g)(m) contained on pages 3–4 of S. 1557, defines the term "party in interest" as: "any administrator, officer, 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 of any of the above-described persons."

The term "benefit plan services" is not defined in S. 1557. As the bill is presently drafted, it might be argued that the services performed by the mutual fund, its investment adviser or principal underwriter constitute "benefit plan services", and that therefore the fund, its adviser or underwriter might be a "party in interest".

If a mutual fund registered under the Investment Company Act of 1940, its investment adviser or principal underwriter were considered to be a "fiduciary" or a "party in interest" for purposes of Section 11, this could produce a number of inappropriate, and we believe unintended, results by reason of the specific prohibitions applicable to a fiduciary under Section 11(b)(2) of the bill.

By way of illustration, it is possible that the following bizarre and unintended results could follow from the present drafting of S. 1557 (the clauses referred to are clauses of Section 11(b)(2) contained on pages 29–30 of the bill):

1. Clause (A) forbids a fiduciary to sell property of an employee benefit fund to any party in interest. Suppose a bank trustee for an employee benefit fund buys shares of a mutual fund and then wishes to redeem part of the shares—i.e., sell them back to the fund at asset value. Such a transaction might be forbidden by Clause (A) because the bank trustee (a fiduciary) would be selling pension plan property to the mutual fund (a party in interest).

2. Clause (G) prohibits a fiduciary from furnishing goods or services to any party in interest. It is unclear from the definition of "party in interest" whether all officers, employees, or agents of an employer whose employee benefit plan is funded with mutual fund shares are parties in interest. If they are parties in interest, this clause might prohibit a mutual fund from selling its shares and furnishing services directly to thousands of employees of a large employer, because the mutual fund is a fiduciary and the employees are parties in interest.

Or, a large bank might manage the assets of an employee benefit fund and thus be a fiduciary. If the employee benefit plan includes mutual fund shares in its assets, this section might prevent the bank from providing normal banking services, e.g., as depositary, custodian or transfer agent, for the mutual fund, since the bank is a fiduciary and the mutual fund might be a party in interest.

3. Clause (H) provides that a fiduciary may not permit the transfer of any property of the employee benefit fund to any party in interest. This section might prevent the fiduciary of an employee benefit fund from purchasing *additional* shares in a mutual fund, since this might involve the transfer of property of the employee benefit fund to a mutual fund which is a party in interest.

In view of the existing pattern of federal regulation of mutual funds, their investment advisers and principal underwriters, including the fiduciary duty owed to a fund by its investment adviser, and in light of the undesirable results which could follow if a mutual fund, its investment adviser or principal underwriter were caught up in the definition of a "fiduciary" or a "party in interest" for purposes of Section 11, we suggest that mutual funds, their investment advisers and principal underwriters be excluded from the definitions of "fiduciary" and "party in interest". At the same time it should be made clear that such exclusions are not intended in any way to diminish existing fiduciary obligations under other statutes or under the common law. This could be accomplished by adding the following language at the end of Section 3(g)(m) (on page 4 of the bill).

"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."

We note that the bipartisan pension reform bill introduced in the Senate last year, S. 3598, contained definitions of "fiduciary" and "party in interest" virtually identical to those contained in S. 1557. The Institute stated its position before the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare that the bill should properly be amended to exempt mutual funds, their investment advisers and principal underwriters from these definitions. Thereafter the bill was amended to contain the exemptive language set forth above, and was reported out by both the Senate Committee on Labor and Public Welfare (see S. 3598, Senate Report No. 92–1150, 92d Congress, 2d Session, September 15, 1972), and by the Senate Finance Committee (see Report to Accompany S. 3598, Senate Report No. 92–1224, 92d Congress, 2d Session, September 25, 1972).

In addition, the bipartisan pension reform bill which has been reported to the Senate this year by the Senate Labor and Public Welfare Committee contains the exemptive language quoted above. (See Section 502(f)(13), pages 158–59 of S. 4, Senate Report No. 93–127, 93d Congress, 1st Session, January 4, 1973).

We respectfully request that S. 1557 be amended to contain exemptive language similar to that in S. 4.

D. Use of Individual Retirement Plans for Portability of Vested Credits

Title III of S. 4, which has been reported to the Senate by the Senate Labor and Public Welfare Committee, would establish a voluntary program for portability of vested credit benefits. Under this program an employee who is separated from an employee benefit plan prior to retirement may request that his plan pay to the Secretary monies representing the value of his vested rights in such plan. If the employee later joins a new plan he may request that the Secretary transfer his credits to that new plan. If no such transfer is requested, the Secretary must use the monies to purchase a single premium life annuity when the participant reaches age 65 or, in the event of the participant's death, pay out the monies to his designated beneficiary.

We believe that the proposed voluntary portability program could be made more effective by utilizing the individual retirement plans provided for in S. 1631 and S. 1179. More specifically, we suggest that S. 4 be amended to provide that an individual who has had monies paid to the Secretary be permitted to direct that the Secretary pay such monies to an individual retirement account established pursuant to S. 1631 or S. 1179. Such a provision would permit an individual who has been separated from an employer-financed plan to have his monies remain invested prior to the date of his retirement. Further, we suggest that the Title III of S. 4 be amended to provide that when an individual having credits with the Secretary reaches age 65, he be permitted to request that the Secreary pay him his credits or use his credits to purchase either a life annuity or mutual fund shares under a systematic withdrawal plan.

We appreciate this opportunity to submit our views concerning the proposed pension legislation being considered by this Subcommittee.

Respectfully yours,

Robert L. Augenblick,
President.

"A Review of United States Private Pension Plans" a Research Report Prepared for the United States Senate Committee on Finance Subcommittee on Private Pension Plans

(By Frank Rodio, Jr.)

Mr. Chairman and distinguished Members of the Subcommittee on Private Pension Plans:

Who receive private pension plans? The majority are 20 million "senior citizens" over age 65. Private pension plans have combined assets of some $157 billion and assets are growing at a rate of $10 billion a year, about half of this nation's full-time non-farm labor force of some 35 million are covered by privately-run pension plans. Surprises are in store for many. There is a difference between being covered and actually collecting benefits.

Employees cannot collect pension benefits until they are vested. Benefits become vested when a worker is given an irrevocable right to collect a pension even if he leaves the firm before retirement. A Treasury Department study revealed most USA employees are required to be on the job 15 consecutive years and reach age 45 before their benefits become vested. Half of all men between 60 and 64 have worked less than 15.4 years for any one employer. This situation would not meet "average" vesting requirements.

For the covered who collect private pension plan benefits alone won't guarantee a comfortable living standard. The Labor Department has revealed a retired couple in Boston living on a low budget needs $3,645 a year. The economic "cancer" of inflation hits hardest at "senior citizens" and those on "fixed income" namely pensioners. Most employees do not contribute directly to private pension plans.

The Life Insurance Institute figures 75% of all private plans are wholly financed by employers and only 1% of private pension plans are supported exclusively by workers contribution. The United States private pension plan system is largely unregulated. All pension plans are required to fill an annual report with the Labor Department and must include information about each plan's incomes, investments, payouts and administrative costs. Somewhat more rigorous regulation is imposed on private pension plans seeking "tax-exempt" status from Internal Revenue Service.

Most companies want their pension plans IRS "qualified." Such funds a company spends in this effort are tax exempt. About one-third of private pension assets ($46.5 billion) are managed by insurance companies. Some 80% of assets not covered by insurance companies ($88.4 billion) are in hands of bank trust departments. A handful of banks control majority of pension plan assets held by bank trust departments. Four largest control $47.5 billion. Ten largest manage $75.5 billion.

The national early retirement plan threatens private pension plans as well as the Social Security Trust Funds. IBM requires 30 of its very top officers to retire at 60. United States military personnel can retire after 20 years of service at 50% pay and after 30 years of service they can collect three-fourths of their preretirement check. At Bank of America employees with three years seniority participate in a Family Estate plan.

Employees get a share of the bank's profits determined by wage and seniority level. Private pension plans are not in a rosy condition. The United Mineworkers Union pension plan is a case in point. During the 1950's the United States Senate's famed McClellan Select Committee investigated improper abuse of several labor unions and management pension plans. Such incidents achieved considerable notoriety. Several small and large union pension funds were spent by union officials on their own personal use. Congress has several pieces of remedial legislation which I support enactment into law.

I support S. 4 cointroduced by Senators Harrison Arlington Williams and Jacob Koppel Javits and cosponsored by 51 other Senators. I also support S. 1179 introduced by Texas Senator Lloyd Millard Bentsen because vesting regulations of private pension plans should be in the worker's cabinet portfolios, namely the Labor Department. I also support H.R. 2 and 462 introduced by Pennsylvania Representative John Dent. These pieces of legislation could be combined with President Richard Nixon's April 11, 1973 Private Pension Plan Special Message to Congress in one single bill.

Congress should also enact into law the following pieces of legislation dealing in certain respects with pensions. They are S. 1714, 1715, 1716, 1717 and 1718 introduced on May 7, 1973, by Senator George Stanley McGovern dealing with returning Vietnam veterans, "forgotten men" of the tragic Indochina War and S. 1695 introduced on May 3, 1973 by Senator Edward Moore Kennedy dealing with loss of civilian jobs by closing military installations.

The President of the United States defined the need for urgency of reform private pension plans when he observed on April 11, 1973: ". . . If the working men and women are to have a genuine incentive to set aside some of their earnings today for a more secure retirement tomorrow, they need solid assurances that such savings will not be erased late in their career by the loss of a job, wiped out by insufficient financing of promised benefits nor penalized by tax laws." The American worker deserves no less.

FORD MOTOR CO.,
June 1, 1973.

Hon. GAYLORD NELSON,
Chairman, Finance Subcommittee on Pensions, U.S. Senate, Dirksen Office Building, Washington, D.C.

PENSION FUNDING AND REINSURANCE UNDER S. 1179 AND S. 1631

DEAR MR. CHAIRMAN: Ford Motor Company wishes to express its opposition to the "reinsurance" provisions of S. 1179 and its endorsement of the minimum funding requirements for corporate plans in S. 1631.

Although we take pride in the accomplishments of private plans, including the success of the Company's Retirement Plans, we do not close our eyes to the shortcomings of the private pension system. The Subcommittee's hearings have produced further evidence that parties to the private system are reaching agreement upon the need for measures on fiduciary standards, disclosures to employes, vesting and funding. Newly legislated requirements should be administered under the existing regulatory framework with vesting, funding, and other financial requirements under the Treasury Department.

There is, however, one issue on which neither need nor feasibility has been established; that is "reinsurance" of vested benefits against plan termination. Reinsurance would tax sound and continuing plans to pay for mismanaged or terminated plans. Reinsurance is controversial. Only a few unions support it, while the Administration and most employers, including Ford Motor Company, are opposed. Our detailed statement on reinsurance and funding is enclosed.

Reinsurance is not needed according to the Government's own studies. Only one in 5,000 workers lost any vested benefits because of plan termination in 1972. In other words 99.98% were unaffected. Reinsurance will not work without changes that will result in massive standardization and regulation of private plans and their investments. Reinsurance also will remove a prime incentive for pension funding and distort the collective bargaining process between management and labor.

We do not suggest that the loss of vested benefits be ignored because the problem is small. We ask, however, for consideration of an alternative solution, improved minimum funding standards to assure that assets are available to meet pension obligations. Improved funding will meet the problem directly without seriously damaging the voluntary system. If plans with lagging funding improve their funding of vested liabilities, the losses from plan termination will decline or be eliminated. Legislative reform should help each employer keep its own pension promises, not pass the problem on to others.

Very truly yours,

MARC M. TWINNEY, Jr.,
Fellow, American Academy of Actuaries,
Pension Manager.

Enclosures.

STATEMENT OF MARC M. TWINNEY, JR., PENSION MANAGER, FORD MOTOR CO.

This statement is submitted in my capacity as Manager of the Pension Department in the Treasurer's Office of Ford Motor Company. My professional qualifications include membership in the Society of Actuaries, the American Academy of Actuaries, and the Institute of Actuaries in Great Britain. My experience in employee benefits extends over a period of 16 years, the first 11 years in private practice as a consulting actuary. At Ford Motor Company I am responsible for funding and cost aspects of retirement plans, including the preparation of financial information used in reports to employees, to stockholders, and to governmental authorities. My office is the primary contact with the independent actuary retained to perform the actuarial determinations required to administer financial aspects of the pension plans.

The opportunity to submit comments on proposals for pension legislation, specifically S. 1179 and S. 1631, is appreciated. The Company also would like to commend the Senate Finance Committee for its thoughtful action last year in insisting upon deliberate and objective discussions of pension issues.

OPPOSITION TO PENSION REINSURANCE

S. 1179, as S. 4, would establish a Federal program to which all private plans would be required to contribute for the purpose of "insuring" the benefits of employees in the event of plan termination. "Reinsurance" is, of course, a misnomer. It is really a system to exact from sound and continuing plans money to pay for the losses of mismanaged or terminated plans. Legislative reform if soundly based would assure that an employer keeps its own pension promises, and would not encourage it to pass its burdens on to other employers.

A reinsurance program is not essential. An Interim Report on Plan Terminations in 1972 prepared jointly by the Treasury and Labor Departments demonstrates that plan-terminations cause the loss of relatively few *vested* benefits. In 1972 one in 5,000 employees covered by private plans lost any vested benefit (2/100 of 1%). In other words 99.98% were unaffected. This is not perfect but what price are private plans to pay for perfect results?

Ford Motor Company has participated in a study group that has tried to work out a system to "reinsure" vested benefits but has been unsuccessful. The casualty and the life insurance industries have been no more successful in developing a workable approach without standarization of benefits and over-regulation. A plan cannot buy true reinsurance in today's insurance market.

A reinsurance system would require burdensome government control and regulation over private plans, particularly as to investments and actuarial determinations if adverse selection and outright manipulation is to be avoided. Reinsurance would also tempt some employers to adopt benefits they could not afford and would distort the collective bargaining process by making unfunded or underfunded obligations popular in negotiated settlements.

Program curtailments and toughened requirements stemming from abuses of FHA mortgage insurance and private investor's security insurance are instructive in considering pension reinsurance. Reinsurance would tempt fund managers into unwise speculation in investment of pension funds. Investment controls as to proportion and types of investment could, of course, be used to stop the speculative investment, but such controls would substantially reduce a fund's rate of return. A very small variation in the long term rate of return can greatly affect benefits. For example a decrease of 1% in long term rate of return would decrease benefits per dollar of contribution by 25%. If in the long run benefits will be decreased 25% because of reinsurance, employees will have paid a dear-price for reinsurance.

Advocates of reinsurance admit that other constraints would be necessary to prevent an underfunded plan from "dumping" vested liabilities onto the program. Although this practice could be partly deterred by requiring a pledge of the employer's assets; the cure itself would be objectionable because it would hurt the employer's credit rating for borrowing, at a time when it may need financial help to stay in business. In some industries, construction for example, where an employer has corporate life only for the duration of its project, the pledge might be unenforceable. On the other hand, a good risk, like Ford Motor Company, pays its own costs in connection with plants closed to stay efficient, and its pledge would pay the vested rights even if the plan terminated in its entirety.

Reinsurance would neutralize a primary incentive for adequately funding pension obligation. We find this alarming because the fundamental solution to the problem of benefit losses from plan termination is *more* funding, not less. The reason so few employees in the 1972 study were hurt by plan terminations was not that so few plans terminated but that the funding was adequate for so many of the plans that terminated. If Congress imposes with one hand an obligation to vest, we respectfully submit that it should not with the other hand impose a reinsurance scheme that would encourage employers not to fund the vested benefits.

ENDORSEMENT OF MINIMUM FUNDING STANDARDS

Ford Motor Company has made studies of the legislative proposals for pension reform. We favor many of the features of S. 1631, including its specific requirement for funding, while recognizing that some amendments may be needed to improve the Bill.

Governmental regulation of private pension plans should be at the Federal level. New provisions on vesting and funding can be added as requirements to tax qualifications of plans under the Internal Revenue Code and administered by the experienced personnel in the Internal Revenue Service of the Treasury Department. An entirely new agency obviously need not be created to regulate plans under new legislation. Any additional disclosure requirements can be made to the Department of Labor and be effected by way of amendment of the present Welfare and Pension Plans Disclosure Act.

The Treasury's Internal Revenue Service has administered the key provisions of the laws relating to private pension plans with efficiency and fairness for more than 30 years. Under this system, Congress determines what provisions a private retirement plan should contain in the public interest, the Internal Revenue Code requires that those provisions be incorporated in plans to assure tax deductibility for corporate contributions and tax exemption for the investment income of the trusts, and the Internal Revenue Service provides advance clearances for plans and plan amendments that meet the statutory requirements.

We urge that this system be used for the proposed reform provisions relating to funding, vesting, and any other financial requirements that may be provided by law for private pension plans. Retention of the present system would place reliance on the existing expertise of personnel in the IRS's district offices and in Washington. This would preserve the outstanding virtue of the present system, the complete impartiality of the Internal Revenue Service as between competing private interests.

As Secretary Shultz pointed out in his testimony before the Subcommittee last Tuesday, it would be a serious mistake, and a costly one, to attempt to transfer jurisdiction at this stage to another department of government lacking the expertise, personnel, and experience of the Treasury in this area.

The vast majority of cases of participants losing an expected benefit can be cured by improved vesting in private pension plans. Despite steady improvement in voluntarily adopted vesting provisions, there is now a recognized need for Congress to enact mandatory minimum vesting standards. It is extremely important, however, that Congress be mindful of the cost burden of any new standards it may impose. The standard for pension vesting should specify performance requirements, not dictate the design of a plan or the details of its administration. The relative merits of one or another set of standards or rules for vesting are still debatable, whereas there is no longer any doubt that benefits should be required to vest reasonably early.

Ford Motor Company for many years has been providing such vesting, 100% after ten years of service (see Attachment I). This is prompt vesting under any reasonable standard, although it would not explicitly qualify under any of the principal Senate bills now under consideration with the exception of S. 75. Although we do not suggest all private plans be required to vest pensions after ten years of service, we do believe that any minimum standards enacted should allow the Company plans' vesting to continue unchanged.

GENERAL COMMENTS ON MINIMUM FUNDING STANDARDS

Reasonable and orderly funding is also essential to the pension undertaking. If an employer sets up a pension plan, he should organize its funding so that the legitimate pension expectations of his employees are fulfilled under ordinary circumstances. If Congress requires early vesting, it should also consider how the employer is to fund the vested rights Congress has mandated.

Contrary to the general impression, employes normally do not have individual pension accounts in a corporate plan and pension contributions are not allocated among individual employes or pensioners. (Only profit-sharing and thrift plans, which have other objectives than retirement security, and a relatively few pension plans of the "money purchase" type allocate to individual accounts.) Normally, all pension contributions are made on behalf of all employes as a group. All assets stand behind all benefit claims. (See Attachment II, Funding Information on Ford Motor Company's Plans.)

Another unwarranted impression seemingly held by some critics is that a small unfunded pension liability is good and, by the same token, a large unfunded liability is bad. Indeed, the mere existence of a large unfunded liability is often taken as proof that funding practices are somehow unsound or else that investments have been poorly managed. But in actuality, the largest source of unfunded liabilities are new or improved benefits that extend to past service to provide more adequate benefits for those already or nearly retired. Thus, an unfunded obligation may simply be an indication that the plan sponsors are improving benefits or facing up to the challenge of maintaining benefit levels in times of inflation.

A sound funding requirement should not be the product of concern over ratios of vested to funded benefits; it should be related to providing protection for vested rights at a reasonabble rate in view of the employer's resources. This should aim for the greatest employe security while recognizing the complexity of the technical problems involved. Above all, the system should avoid rigidities that could cause costs to fall inequitably upon different businesses. For these reasons, we favor the funding requirement in Section 2(a) of S. 1631 over other proposals. S. 1631 requires annual funding of normal cost plus interest on past service costs for all benefits, plus 5% of the unfunded liability for vested benefits. These requirements are clear and determinable. If adopted, they would substantially improve the present limited funding requirement which has existed as an administrative matter since 1939.

A plan, of course, should be able to base its compliance with any funding requirement on reasonable actuarial methods and assumptions approved by its qualified actuary. This practice has been followed in the past and has worked well. There is also a need in administering funding requirements to establish standards for qualification of the actuaries to assure employes and the public of the reliability and source of actuarial determinations.

It is surprising to us that S. 4 and S. 1179 would require that actuarial "deficiencies" be identified and funded, since an actuarial "deficiency" is no more than a variance at any given date between the plan's actual experience and the actuary's earlier projections. In particular, we regard S. 4's proposal that an employer be required to liquidate such "deficiencies" in five years as punitive and unproductive.

Also use of the term "deficiencies" may unduly alarm employees because it falsely suggests a real shortage when there is simply a variance from forecast. The largest source of these variances are fluctuations in security prices that are almost invariably of a temporary nature. The terms "actuarial gains and losses" are more accurate. Such variances are expectable and may continue until the last pensioner is deceased.

SPECIFIC RECOMMENDATIONS ON FUNDING STANDARD

1. Minimum funding standards should be properly related to the obligation for vested benefits. Section 2(a) of S. 1631 contains a proposed minimum funding provision for vested benefits which appears sound and should in our view be included in any new pension legislation.

2. The vesting standard should provide that any vested right required by law would first become payable at age 65 without reduction for age. We regard the retirement age definition in paragraph (15) of S. 1179 as preferable to the definition in paragraph (11) of Sec. 2(a) (2) of S. 1631. (Congress may wish, however, to consider authorizing the Secretary of Treasury to fix an age higher than 65 as a transition arrangement for the relief of some industry-wide plans where cost effects may be unusual.)

3. Plans which define the benefits by a unit per year of service should be allowed to have the plan provisions govern in determining vested rights. Thus, paragraph 12(d) in Sec. 2(a) (2) of S. 1631 should be revised so that it would clearly apply only to plans which do not provide defined benefit units per year of service.

4. Consideration should be given to increasing allowable tax deductions for pension contributions so that more rapid deduction of contributions will be permitted when the vested benefits are not fully funded.

5. The proposal that would require separate identification and rapid liquidation of so-called actuarial "deficiencies" presently appearing in S. 4 and S. 1179 should *not* be included in any legislation.

6. A plan should remain free to base compliance with funding requirements on reasonable actuarial assumptions and methods. The law should affirmatively provide this right to employers.

7. The Treasury Department should be granted authority to determine who may certify actuarial statements. Any legislation establishing funding requirements should include a provision along the lines of section 328 of S. 1179 (page 12, lines 7–12) which would grant this authority to the Secretary of Treasury.

ATTACHMENT I

Outline of Vesting Provisions in Benefit Coverage of Ford Motor Co.'s Employees

NONCONTRIBUTORY PENSIONS (ALL PERSONNEL)

The life income benefit payable at age 65 is vested after ten years of credited service. Because service credit is granted for up to 0.9 of one year of lay-off or sick leave, as few as 9.1 years of work would be required to vest. Reduced benefits are payable as early as age 60.

CONTRIBUTORY PENSIONS (SALARIED PERSONNEL)

The contributory retirement benefit payable at age 65 vests after seven years of employment, during five of which the employee must have contributed. Reduced benefits are payable as early as age 60.

CONTRIBUTORY SAVINGS & STOCK INVESTMENT (SALARIED PERSONNEL)

The Company's contributions for each year vest progressively during the third year following the year of contribution and are 100% vested at the end of that year. At that time employees may elect distribution immediately, defer distribution (limited to their contributions) to a later date, or defer distribution to retirement, disability or death.

SOCIAL SECURITY OLD AGE BENEFITS (ALL PERSONNEL)

Social Security benefits require that a male employee age 62 in 1973 must have 22 quarters (5½ years) of coverage. Younger employees (born 1929 or later) must have 40 quarters of coverage (ten years) without regard to age to maintain eligibility.

ATTACHMENT II

Funding Information on Ford Motor Co.'s Retirement Plans

CONTRIBUTIONS AND ASSETS

There are two principal retirement plans for employees of Ford U.S. with separate trust funds. The Ford-UAW Retirement Plan covers hourly employees represented by the UAW, and the General Retirement Plan covers substantially all other employees of the Company and certain consolidated and unconsolidated domestic subsidiaries. In addition to these two principal plans, certain other subsidiaries of the Company have separate plans covering their employees.

The financial operations of the Ford U.S. trusts for the year 1972 were as follows (in millions):

Funds at January 1, 1972—with securities valued at cost	$1, 845. 6
Additions:	
Payments into trusts	(263. 2)
Interest and dividends received	(67. 7)
Net gain realized on sales of securities	(21. 8)
Net additions	352. 7
Less: Retirement payments and expenses	(140. 3)
Funds at December 31, 1972—with securities valued at cost	2, 058. 0

Payments into the trusts included contributions by the Company and by salaried personnel. Company contributions included current service costs and $101 million attributable to prior service costs. Prior service costs are being funded by the Company over periods of not more than 30 years.

No portion of the Company contributions to the trust fund, or of the assets thereof, is paid or set aside for the account or benefit of any individual employee.

World-wide consolidated pension costs in 1972 were $312.1 million, up $72.9 million or 30.5% from $239.2 million in 1971. The substantial increase in pension costs in 1972 resulted from certain amendments to the two principal plans that took effect late in 1971, as well as adjustments based upon actual experience. The actuarially computed value of vested benefits under the various plans exceeded the market value of fund assets by approximately $190 million at December 31 1972.

Ford-UAW and General Retirement Plan Actuarial Methods and Assumptions

ACTUARIAL COST METHOD

Entry Age Normal Cost (projected benefit method) with frozen supplemental liability for past service costs.

ACTUARIAL INTEREST RATE

Six percent per annum, compounded annually.

WRITE-UP METHOD

Assets valued at adjusted cost and at a minimum are equal to cost. Book value is adjusted in an amount equal to the difference between the 6% actuarial rate and actual cash income and realized net gains, but after write-up cannot exceed 90% of market value. If required asset write-up/(down) exceeds limits imposed, past service costs are adjusted.

NORMAL RETIREMENT AGE

Age 65.

AVERAGE BENEFIT UNIT

$7.50 life income per month per year of service.

SURVIVORSHIP OPTION

Elected by 70% of those retiring, 80% of employees married with male employees having wives three years younger and female employees having husbands three years older than themselves.

ILLUSTRATIVE FORD-UAW ACTUARIAL RATES

							Early retirement		
Age	Non-retired lives mortality[1]	Termination of employment: 1st year	2d year	3d year	Ultimate	Disability retirement	Less than 30 years	30 or more years	Mutually satisfactory
20	0.0006	0.2340	0.1580	0.1300	0.1097	0.0007			
25	.0007	.1880	.1220	.0990	.0831	.0008			
30	.0011	.1500	.0940	.0730	.0622	.0010			
35	.0016	.1220	.0720	.0545	.0466	.0013			
40	.0025	.0990	.0560	.0405	.0362	.0017			
45	.0037	.0800	.0440	.0300	.0281	.0025			
50	.0057	0	0	0	.0211	.0042		0.0500	
55	.0089	0	0	0	.0168	.0076	0.0325	.1500	0.0025
56	.0098	0	0	0	.0164	.0088	.0390	[2] .1700	.0030
58	.0117	0	0	0	.0166	.0112	.0520	[2] .2100	.0040
60	.0141	0	0	0	.0174	.0150	.1700	[2] .2700	.0120
62	.0174	0	0	0	.0189	.0205	.3750	[2] .3000	.0500
64	.0213	0	0	0	.0216	.0280	.2250	[2] .2000	.0120

[1] Mortality table after service retirement: 1963 George B. Buck Mortality Table rated back 1 year. A special mortality table is used for disability retirements.

[2] Rate applicable to the age at which the employee first becomes eligible for an unreduced supplemental allowance is increased by 100 percent.

The Associated General Contractors of America, Inc.,
Washington, D.C., June 4, 1973.

Statement by the Associated General Contractors of America

The Associated General Contractors of America is a national trade association representing more than 9,500 general construction firms with 128 chapters in all 50 states, Puerto Rico and the District of Columbia. Our membership per-

BEST COPY AVAILABLE

forms the greater part of all heavy, building, highway and utilities construction in the United States, or some $80 billion annually. We also represent approximately 35,000 associate members who are engaged in supplying material and services for our construction firms. The construction industry employs approximately 5 million workers, 3.5 to 4 million cf which are employed by or through members of our Association, and accounts for approximately 15% of the Gross National Product.

We wish to thank the members of the Committee for this opportunity to comment on pending legislation relating to private welfare and pension plans.

Employers have, up to now, voluntarily provided retirement income and have been willing to assume the financial burden involved. We do not believe any action should be taken that would impede the growth of private pension plans.

The current rules and regulations contained in the Internal Revenue Code and the Federal Welfare and Pension Plan Disclosure Act help to assure legally binding pension arrangements, permanency, exclusive benefit of employees, determinable benefits and irrevocable commitment of employer contributions.

The Federal Disclosure Act of 1958 was based on self-enforcement by public disclosure of a plan's operation. The Secretary of Labor was given enforcement authority by the 1962 amendments which required bonding of administrators and criminal provisions against embezzlement bribery and the like. The required annual report (D–2 Form) is now a most comprehensive and detailed 15-page document. In addition to these laws, provisions covering pension funds are contained in state laws and regulations. Therefore, we do have considerable Government regulation in the private pension plan area at this time.

The AGC supports basic goals and objectives which are designed to strengthen and to protect the interests of participants and beneficiaries of welfare and pension plans. We subscribe to the concept of requiring an annual independent audit, assuring fiduciary responsibility, providing adequate disclosure, and granting additional investigatory and enforcement powers to the Federal government to determine malfeasance in the operation of pension and welfare funds, since they are in the best interests of all concerned.

We would like to comment generally on some of these provisions.

FIDUCIARY RESPONSIBILITY

AGC supports the concept of imposing fiduciary responsibilities upon the trustees of welfare and pension plans in order to safeguard the rights of the participants of such programs. We support the "prudent man" accountability rule as the standard for investment of employee benefits; however, we suggest that a fiduciary be held personally liable only when he has been willfully or grossly negligent in discharging his duties. It is important that we do not limit the effectiveness of flexibility of the "prudent man" rule.

DISCLOSURE

Any reporting or disclosure requirements should be confined to data which are pertinent to the plan. We support constructive and effective steps to assure honest administration by providing for an annual independent audit of the fund, by requiring an "adequate summary" of the latest annual report be furnished to a participant or beneficiary upon written request, by granting the Secretary of Labor the power to make investigations when he has reasonable cause to believe a violation exists, and by barring persons convicted of certain crimes from serving as a fiduciary on employee benefit funds.

S. 4 establishes minimum standards for vesting and funding of private pension plans and proposes an insurance program guaranteeing plan termination protection. While vesting and funding programs are desirable, we question whether they should be required by law.

VESTING

As we understand it, there are two basic reasons for mandatory vesting. One is that employees should retain accrued benefits after changing employment and the other is that it would increase the mobility of labor. Such a vesting requirement would restrict flexibility in the development of pension funds due to the increase in cost. Money for vesting would be diverted from other types of improvements in benefits which can best be determined by the individual company and labor organization through the collective bargaining process. A requirement

BEST COPY AVAILABLE

of early vesting would cause a substantial increase in costs of the program and could eliminate other modifications of more value to the retiree. As far as the mobility of labor in the construction industry is concerned, wages, hours and seasonality determine the mobility of labor. When an employee reaches the normal retirement age, he is entitled to a proportionate pension benefit based on service to date of termination if he meets age and length-of-service conditions. This right is not dependent upon his continued employment. We find that vesting periods are becoming shorter.

FUNDING, PLAN TERMINATION INSURANCE AND PORTABILITY

In his message to the Congress on December 8, 1971, President Nixon stated that there was insufficient information to determine what Federal policy should be on questions of funding, the nature of the employer's liability, and termination insurance. A major study has been undertaken at the President's direction by the Departments of Labor and Treasury to determine the extent of benefit losses under pension plans that are terminated. These are highly technical areas as indicated by an interim report, and we look forward to reviewing the final statistics coming from this study. Unions and employers operating on the basis of free bargaining and independent judgment have arrived at decisions leading to the adoption of a wide variety of plan provisions and funding policies adapted to their special requirement. We are not opposed to reasonable funding requirements per se, but we believe that there should be flexibility within such programs.

—We are opposed to compulsory insurance and the imposition of rigid standards which would impair the flexibility of pension plans. Employee benefit plans in the construction industry are established on a multi-employer basis. So as far as we are concerned, money spent for such protection would be unwarranted, since the entire industry in an area would have to go out of business before the employee benefit programs could be terminated. We believe that this is inconceivable.

Portability would increase administrative costs since investment yields in current plans would be less, due to necessary changes in investment practices. As stated earlier, as far as the mobility of labor in the construction industry is concerned, wages, hours and seasonality determine the mobility of labor. Sound vesting satisfies the needs related to portability.

ENCOURAGEMENT OF PENSION GROWTH

AGC supports programs that would encourage pension growth among employees of small firms which have no pension or profit sharing plans. Therefore, we would support proposals to provide income tax deferral for employees who defer income for their retirement, and those which would increase the present tax deferral available to the self-employment who have pension plans.

ECONOMIC STABILIZATION

Economic stabilization is the key to maintaining the purchasing power of private pension retirement benefits. Control of inflation through the efforts of the Congress and the Administration will help all retirees living on fixed incomes as well as those who are looking forward to retirement. This is a priority issue relative to successful pension programs.

SUMMARY

We appreciate having this opportunity to present our views to the Committee. We will support efforts that will continue the growth and expansion of private pension plans with a minimum of governmental restrictions, so that employers and employees may be able to develop pension plans that are best suited to their own retirement security. Public policy should be designed to reward and reinforce these qualities.

UNITED STEELWORKERS OF AMERICA,
Pittsburgh, Pa.

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

MY DEAR SENATOR LONG: At the Senate Finance Sub-Committee Hearing on May 21st on private pension plan protection legislation you asked me to submit to you a memorandum on whether, in my opinion, the negotiation of private pension plans might not be advanced by amending existing laws to provide that either party to a pension negotiation could fullfill its obligation to bargain collectively by negotiating a sum of money which woud be turned over to the Union to spend as the Union saw fit.

I find many things wrong with such an approach, which as you pointed out, is an 180 degree reversal of the direction of present laws and practices. My two basic objections to this suggestion are that, first, the suggestion does not address itself to the fundamental, current private pension plan protection problem which is how to increase pension plan security for workers who lose their pension rights when their Company ceases operations or when they change jobs. The reason we seek legislation is that experience teaches that these grave problems of pension plan protection cannot be solved through collective bargaining—no matter how collective bargaining is tinkered with. My second objection is that the suggestion at this time cannot possibly further the goal of improved labor-management relations. It is entirely possible that at some future time, in circumstances different from those existing today, some aspects of your proposal—which I interpret in part as a greater voice for Unions in the administration of pension funds—might very well be a practical goal. But at the present time this proposal does not add anything to pension plan protection or pension plan bargaining.

Since pensions are an economic benefit they necessarily involve costs. But after that has been said, not much has been said. While most employers would like to minimize labor costs and most Unions would like to maximize them, the important, serious disputes over pensions have always involved principled questions of what provisions should be included in the pension plans, rather than what these proposed provisions cost. In other words, it is how the available moneys should be spent—not the existence of the costs—which usually creates conflicts between Unions and managements during negotiations. This has been true since the original disputes between the Unions and industry as to whether Unions even had any right to negotiate with respect to pensions.

In order to express my views as briefly as possible, my objections are summarized in four categories, as follows:

1. Negotiating a flat sum of money and turning it over to the Unions to spend as they please is contrary to sound public policy. Present policy is based on the assumption that there does not yet exist those essential traditions of sound and prudent management of vast sums of money which will be required before Unions can manage pension funds by themselves.

I am proud of the fact that my Union, the United Steelworkers of America, has been completely free of scandal in the handling of pension funds, notwithstanding that the Steelworkers have negotiated more pension agreements covering more workers than has any Union in the United States. The reason for this lies in our determination that as a matter of inflexible policy we have never permitted any of our Union representatives to have any say over how pension funds were to be invested. Our pension plans all provide for the exclusive financing of benefits by the employer. Where we have an agreement on the joint handling of funds, these agreements always provide for the pension fund to be handled by either a commercial trust company or by an insurance company—never by the Union.

We would consider it a catastrophe if the law was changed to provide that companies could meet their obligations for pensions for their employees by simply turning over sums of money to Unions each year for the Unions unilaterally to invest and pay out as pensions.

2. The actual administration of huge sums of money and the monthly or other periodic payment of large numbers of claims either as pensions or other benefits would completely change the function of Unions. If Unions were forced to accept this responsibility they would be required to establish extensive new bureaucracies to handle their new managerial, investment, and fiduciary responsibilities. This would involve the duplication of functions now being performed by employers, insurance companies, banks, consultants and management service organizations. I am unaware of any major Union in industry that either seeks or approves of such functions for itself.

Furthermore, the concept of the Union—rather than the employer—being responsible for providing pension benefits to employees is contrary to the major premise on which most pension plans in the major industries of this nation have been established. The two essential premises of industrial pension plans are, first, that pensions are deferred compensation for services rendered. Second, that an employer has a fundamental obligation to provide for his worn out and disabled workers, and the cost of doing so is a legitimate cost of doing business. It is obvious to our Union that these premises make the provision of pensions a basic obligation of the employer, not the Union. The Union's role is to act as representative of the worker in his relations with his employer. The Union does not represent the worker when it substitutes itself for the employer in an area where the employer has a basic responsibility.

3. It is utopian to believe that employers who oppose Unions, as a matter of principle, on such pension issues as vesting, funding, surviving spouses' benefits, cost-of-living adjustments, the inclusion of specific types of benefits or benefit formulas in their pension plans, will suddenly withdraw their objections to these matters if they can resolve any dispute by simply turning over dollar contributions to the Union. If the total cost of a pension package is in dispute it is hard to see how such a dispute is resolved by turning a sum of money over to the Union. If objection is made to any specific proposal on the grounds the employer doesn't want to grant it, it is hard to see how the payment of money to the Union to spend as the Union sees fit will solve the problem.

Possibly worst of all, if pension benefits are treated as if they were synonymous with the payment of cash sums, the concept of pensions as social insurance would be destroyed. At one time it was thought by some (who now know better) that if only wages could be raised to a high enough level, no social insurance programs would be necessary. If it makes sense to turn money over to the Unions in lieu of pension plan agreements, it is but a short extension of this logic to turn the money over to each individual worker directly so that he might provide pensions for himself. The essential fallacy of this approach is that no individual can save for the possibility of his eventual retirement, while raising and educating his family and saving against every other possible insecurity of modern industrial life. If Social Insurance did not exist in its many varied private and public forms workers would have to simultaneously attempt to provide for their daily cost of providing for families and for the possibility of sickness, accidents, unemployment, health care bills, and premature death. Imagine a worker trying to raise a family, buy a home, an automobile, appliances and all the other essentials of the American standard of living, and at the same time trying to provide for his eventual retirement. All experience teaches us it cannot be done.

4. Money is not necessarily the common denominator of different pension plans in an industry, or a location, or in some other traditional grouping of pension plans. Any effort to introduce such a common denominator where it does not presently exist would cause trouble, not reduce it. In the steel industry, for example, the common denominator of all pension plans is their identity of benefits. Despite identical pension benefits, no two steel companies have identical costs. If an identical sum of money was contributed by every steel company to the Union for the Union to provide pension benefits, the Union would have but two choices: the establishment of an industry-wide pension fund or the provision of different benefits at each Company. At this time, either of these alternatives, far from generating solutions, would create insoluble problems for both the Industry and the Union.

Some rank and file workers are confused over pension cost determination. If pension costs are described as, say, 35 cents per hour they begin to think of the

35 cents as a part of their wages. But the fact is that if 35 cents is contributed for the support of a pension plan, the distribution of costs for the plan's benefits must be based on such considerations as:

the cost of pension service earned prior to the establishment of the plan;
the cost of pension rights which will vest prior to normal retirement;
the cost of early retirement due to establishment;
the cost of surviving spouses' benefit in the event of death of the employee or retiree;
the cost of early retirement due to partial permanent shutdown of plants and departments;
the cost of current service performed by employees.

It is no more possible to think of the cost of pensions as the same as ordinary wages than it is possible to think of medical-care or any other social insurance as the same as ordinary wages. The common denominator of social insurance is its function of insuring workers against the insecurities of industrial society. Each form of social insurance has its own form of financing and its own form of benefits. For example, in a pension plan what is of critical importance to the participants is the relationship of retirement income to income received while actively employed. While uniformity of the proportion of earnings to be paid as pension benefits can be viewed as a common denominator, uniformity of costs cannot be viewed as a common denominator since pension costs are related to age, sex and service as well as earnings.

Perhaps the conflicts exhibited at hearings before Congressional Committees make us all wish at times it was possible to solve the problem of pension security by simply saying, "Here's a regular annual sum of money. Spend it any way you like." Unfortunately, pension security does not come so simply. Pension security can come only through arrangements in which government, industry and Unions all have a role to play. Fortunately, the hearings before Congressional Committees have succeeded in clearly defining the problem areas and the necessary solutions. The protection of private pension plans have generated opposition from some who adamantly resist change because they believe in standing pat on all their present privileges which has richly rewarded them while also irreparably harming workers whose old age has been blighted by lost pension rights. On the other hand, as demonstrated by the unanimous action of the Senate Labor Committee, a great consensus exists in the nation today that men and women who by their labor earned the right to a pension on their retirement should not be denied that right because of the termination of any employer's business. As the Congressional hearings have brought out, this is not so much a matter of who is in charge of the pension fund as it is a matter of premature plans terminations which are beyond anyone's control.

Sincerely yours,

BERNARD GREENBERG,
Insurance, Pension, and Unemployment Benefits Department.

O

BEST COPY AVAILABLE