ERISA IMPROVEMENTS ACT OF 1978

JOINT HEARINGS

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

COMMITTEE ON HUMAN RESOURCES

AND THE

SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

S. 3017

TO AMEND THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 AND THE INTERNAL REVENUE CODE OF 1954 FOR THE PURPOSE OF SIMPLIFYING, CLARIFYING, AND IMPROVING FEDERAL LAW RELATING TO THE REGULATION OF EMPLOYEE BENEFIT PLANS, TO FOSTER THE ESTABLISHMENT AND MAINTENANCE OF PLANS, AND FOR OTHER PURPOSES AND RELATED BILLS (S. 901, S. 2992, S. 3193, S. 1745, S. 1383, AND S. 250)

AUGUST 15, 16, AND 17, 1978

Printed for the use of the Committee on Human Resources and the Committee on Finance

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ERISA IMPROVEMENTS ACT OF 1978

TUESDAY, AUGUST 15, 1978

U.S. SENATE, SUBCOMMITTEE ON LABOR OF THE COMMITTEE ON HUMAN RESOURCES; AND SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS OF THE COMMITTEE ON FINANCE,

Washington, D.C.

The subcommittees met in joint hearing in room 4232, Dirksen Senate Office Building, Senator Harrison A. Williams, Jr. (chairman, Subcommittee on Labor of the Committee on Human Resources), and Senator Lloyd Bentsen (chairman, Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Committee on Finance) presiding.

Present: Senators Williams, Bentsen, Javits, and Matsunaga.

OPENING STATEMENT OF SENATOR WILLIAMS

Senator WILLIAMS. We shall come to order, please.

Today we are beginning 3 days of hearings on legislation to amend the Employment Retirement Income Security Act of 1974.

I am especially pleased that we have been able to arrange to have these hearings conducted jointly by our Labor Subcommittee and Senator Bentsen's Pension Plans Subcommittee. Senator Bentsen and other members of the Finance Committee share our avid interest in improving ERISA, just as they shared our interest in developing it 4 years ago, and I am sure that I speak for all the members of the Human Resources Committee when I say that I hope we can continue our cooperative efforts in this field.

Over the next 3 days, we will hear testimony from a wide range of witnesses on several bills to amend ERISA and related provisions of the Tax Code. These seven bills—S. 3017, S. 901, S. 2992, S. 3193, S. 1745, S. 1383, and S. 250—cover a variety of subjects. But all of them are intended by their sponsors to improve the operation of ERISA.

S. 3017 is designed to foster and encourage the establishment and maintenance of private sector employee benefit plans, to promote improvements in the plans, and to streamline the Government's regulatory efforts in this field. The concepts underlying the "ERISA Improvements Act" are, in my judgment, most important. But they will be even more important in the future, as the shifts now taking place in the American population culminate in a significantly larger proportion of retirees, with a significantly larger necessity for adequate retirement income. The most economically efficient, least painful way to assure that retirement income is through the private pension system.

Through this system private pensions can be funded soundly while, at the same time, making billions of dollars available in investment capital.

To achieve this goal, we must have more private plans covering more workers. They must be plans that assure decent retirement income, and that deliver what they promise.

In further developing S. 3017, we must also keep in mind the need to improve plans for the benefit of American workers and their families.

For example, our proposal to enhance the rights of surviving spouses of plan participants who die before reaching retirement age will eliminate a glaring deficiency that exists in the present law.

And our proposal to permit deductions for employee contributions to plans is aimed at eliminating the inequities that now surround the Individual Retirement Account provisions of the law.

ERISA went a long way toward upgrading plan standards and insuring plan fiscal integrity. With the benefit of over 3½ years of observations, it is obvious that this law can be improved. If we can make those improvements, and complete the difficult task of conforming existing plans to ERISA's rules, I believe we will see a return to the pattern of expansion of private pension plan coverage that characterized the three decades before ERISA's enactment.

[The text of S. 3017, S. 901, S. 2992, S. 3193, S. 1745, S. 1383, and S. 250 follows:]

95TH CONGRESS
2D SESSION

S. 3017

IN THE SENATE OF THE UNITED STATES

MAY 1 (legislative day, APRIL 24), 1978

Mr. WILLIAMS (for himself and Mr. JAVITS) introduced the following bill; which was read twice and referred to the Committees on Finance and Human Resources jointly by unanimous consent

A BILL

To amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 for the purpose of simplifying, clarifying, and improving Federal law relating to the regulation of employee benefit plans, to foster the establishment and maintenance of plans, and for other purposes.

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

SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "ERISA Improvements Act of 1978".

(b) TABLE OF CONTENTS.—

TITLE I—CONSOLIDATION OF FEDERAL AGENCY RESPONSIBILITIES FOR EMPLOYEE BENEFIT PLANS

Subtitle A—Findings; Declaration of Policy

Subtitle B—Employee Benefits Commission

TITLE II—AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

Subtitle A—Declaration of Policy; Definitions

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Part 1—Reporting and Disclosure

Part 2—Minimum Standards

Part 3—Funding

TITLE II—AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974—Continued

Part 4—Fiduciary Responsibility

Part 5—Administration and Enforcement

TITLE III—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

TITLE IV—SPECIAL MASTER AND PROTOTYPE PLANS

SEC. 2. TECHNICAL AND CONFORMING CHANGES.

The Secretary of the Treasury and the Secretary of Labor shall, as soon as practicable but in any event not later than 90 days after the date of the enactment of this Act, submit to the Congress a draft of any technical and conforming changes in the Internal Revenue Code of 1954, and the Employee Retirement Income Security Act of 1974, respectively, which are necessary to reflect throughout such Code and Act the changes in the substantive provisions of law made by this Act.

TITLE I—CONSOLIDATION OF FEDERAL AGENCY RESPONSIBILITIES FOR EMPLOYEE BENEFIT PLANS

Subtitle A—Findings; Declaration of Policy

SEC. 101. FINDINGS AND DECLARATION OF POLICY.

(a) The Congress finds that the free flow of commerce and the implementation of the provisions of the Employee Retirement Income Security Act of 1974 and the provisions of subchapters D and F of chapter 1 of the Internal Revenue Code of 1954 (insofar as they relate to such Act) have been restricted and hampered by administrative difficulties encountered by the Labor Department, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation; that the implementation of such provisions and the free flow of commerce have been further hampered and restricted by assertions of applicability of Federal and State securities and other laws to certain employee benefit plans; that the paperwork burdens and compliance costs resulting from such

Act and Code provisions and affecting employee benefit plans and persons sponsoring such plans can be reduced in certain respects without jeopardizing the interests of employees in such plans and in the integrity of the assets of such plans; and that present and future needs for retirement income can best be met by strengthening and improving private employee pension benefit plans and that it is in the national interest to do so.

(b) It is hereby declared to be the policy of this Act to consolidate the administration of the Employee Retirement Income Security Act of 1974 and certain provisions of the Internal Revenue Code of 1954 as relate to plans which are subject to such Act in a single agency; to clarify prospectively the extent to which Federal and State securities and other laws may affect employee benefit plans which are subject to such Act and to protect certain persons and plans and hold them harmless from liability due to certain types of past, present, or future allegations under such Federal or State securities laws; to provide new incentives to foster the establishment and maintenance of private employee pension benefit plans; and to further improve such plans by clarifying, simplifying, and otherwise improving such Act and the provisions of such Code.

Subtitle B—Employee Benefits Commission

SEC. 121. SPECIAL LIAISON OFFICERS FOR LABOR AND TREASURY DEPARTMENTS.

(a) Labor Department Officer.—There is established within the office of the Secretary of Labor, the position of special liaison officer to the Employee Benefits Commission. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of Labor and shall serve for a term of years in accordance with the provisions of section 122(b). The special liaison officer shall serve as chairman of the Employee Benefits Commission and shall report regularly to the Secretary of Labor on the activities of the Commission.

(b) Treasury Department Officer.—There is established within the office of the Secretary of the Treasury the position of special liaison officer to the Employee Benefits Commission. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of the Treasury and shall serve for a term of years in accordance with the provisions of section 122(b). The special liaison officer for the Treasury shall serve as vice-chairman of the Employee Benefits Commission and shall report regularly to the Secretary of the Treasury on the activities of the Commission.

SEC. 122. EMPLOYEE BENEFITS COMMISSION.

(a) ESTABLISHMENT.—There is established, as an independent agency within the executive branch of the Government, the Employee Benefits Commission. The Commission is composed of—

(1) the special liaison officer for the Secretary of Labor appointed under subsection (a) of section 121,

(2) the special liaison officer for the Secretary of the Treasury appointed under subsection (b) of section 121, and

(3) three additional members appointed by the President, by and with the advice and consent of the Senate, selected from a list of nominees submitted jointly by the Secretary of Labor and the Secretary of the Treasury.

(b) TERMS OF OFFICE.—

(1) NUMBER OF YEARS.—Members of the Commission shall serve for terms of 6 years, except—

(A) the special liaison officer for the Secretary of the Treasury first appointed after the date of enactment of this Act shall serve for a term of 3 years, and

(B) of the 3 members of the Commission initially appointed under paragraph (3) of subsection (a), one shall serve for a term of 2 years, one shall serve for a term of 4 years, and one shall serve for a term of 6 years.

(2) SERVICE BEYOND EXPIRATION DATE.—A member of the Commission may serve as a member of the Commission after the expiration of his term until a successor has taken office as a member of the Commission.

(3) VACANCY APPOINTMENTS.—An individual appointed to fill a vacancy occurring other than by the expiration of a term of office shall be appointed only for the unexpired term of the member such individual succeeds.

(4) POLITICAL AFFILIATION.—Not more than 3 members of the Commission may be affiliated with the same political party.

(c) COMPENSATION.—Members of the Commission shall receive compensation equivalent to the compensation paid at level III of the Executive Schedule.

(d) FUNCTIONS.—The Commission shall—

(1) formulate policy respecting Federal laws which now or may hereafter relate to employee benefit plans described in section 3(3) of the Employee Retirement Income Security Act of 1974.

(2) administer and enforce titles I and IV of such Act, and

(3) administer and seek to obtain compliance with sections 401, 410, 411, 412, 413, 414, 6057, and 6058 of the Internal Revenue Code of 1954 insofar as such sections relate to employee benefit plans (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974) described in section 4(a) of such Act and not exempt under section 4(b) of such Act.

(e) RULES, ETC.—The Commission shall prepare written rules for the conduct of its activities, shall have an official seal which shall be judicially noticed, and shall have its principal office in or near the District of Columbia (but it may meet or exercise any of its powers anywhere in the United States).

(f) ADMINISTRATIVE AUTHORITY.—

(1) STAFF DIRECTOR; GENERAL COUNSEL.—The Commission shall have a staff director and a general counsel who shall be appointed by the Chairman. The staff director and the general counsel shall be paid at a rate not in excess of the rate in effect for level IV of the Executive Schedule. With the approval of the Chairman, the staff director may—

(A) appoint and fix the compensation of such additional personnel as he considers necessary, and

(B) procure temporary and intermittent services to the same extent as authorized by section 3109 (b) of title 5, United States Code.

(2) USE OF OTHER AGENCIES' RESOURCES.—In carrying out its responsibilities, the Commission may avail itself of the assistance, including personnel and facilities, of other agencies and departments of the United States Government. The heads of such other agencies and departments may make available to the Commission such personnel, facilities, and other assistance, with or without reimbursement, as the Commission may request.

SEC. 123. POWERS OF COMMISSION.

(a) IN GENERAL.—The Commission has the powers expressly granted to the Secretary of Labor and the Pension Benefit Guaranty Corporation under the Employee Retirement Income Security Act of 1974 and, in addition, has the power—

(1) to require, by special or general orders, any person to submit in writing such reports and answers to questions as the Commission may prescribe, and such submission shall be made within such reasonable period

of time and under oath or otherwise as the Commission may require;

(2) to administer oaths or affirmations;

(3) to require by subpoena, signed by the chairman or the vice chairman, the attendance and testimony of witnesses and the production of all documentary evidence relating to the execution of its duties;

(4) in any proceeding or investigation, to order testimony to be taken by deposition before any person who is designated by the Commission and has the power to administer oaths and, in such instances, to compel testimony and the production of evidence in the same manner as authorized under paragraph (3);

(5) to pay witnesses the same fees and mileage as are paid in like circumstances in the courts of the United States;

(6) to initiate (through civil actions for injunctive, declaratory, or other appropriate relief), defend, or appeal from a decision in, any civil action in the name of the Commission for the purpose of enforcing the provisions of titles I and IV of the Employee Retirement Income Security Act of 1974, through its general counsel;

(7) to develop such prescribed forms and to make

amend, and repeal such rules, pursuant to the provisions of chapter 5 of title 5, United States Code, as are necessary to carry out the provisions of this Act and of titles I and IV of the Employee Retirement Income Security Act of 1974;

(8) to conduct investigations and hearings, to encourage voluntary compliance, and to report apparent criminal law violations to the appropriate law enforcement authorities; and

(9) to certify to the Secretary of the Treasury that an employee benefit plan described in section 122 (d) (3) of this Act—

(A) satisfies or does not satisfy (or has or has not satisfied) the requirements of sections 401, 410, 411, 412, 413, 414, 6057, or 6058 of the Internal Revenue Code of 1954, or

(B) satisfies or does not satisfy (or has or has not satisfied) the requirements of sections 44C and 44D of the Internal Revenue Code of 1954.

(b) ENFORCEMENT OF ORDERS OF THE COMMISSION.—Any United States district court within the jurisdiction of which any inquiry is carried on may, upon petition by the Commission in case of refusal to obey a subpena or order of the Commission issued under subsection (a), issue an order requiring compliance therewith. Any failure to obey the order of the court may be punished by the court as contempt.

(c) TRANSFER OF FUNCTIONS.—All functions of the Secretary of Labor under the Employee Retirement Income Security Act of 1974 are transferred to, and shall be carried out by, the Commission. All functions of the Pension Benefit Guaranty Corporation under such Act are transferred to, and shall be carried out by, the Commission. All functions of the Secretary of the Treasury under sections 401, 410, 411, 412, 413, 414, 6057, and 6058 of the Internal Revenue Code of 1954, insofar as such sections relate to employee benefit plans described in section 122 (d) (3) of this Act, are transferred to, and shall be carried out by, the Commission.

(b) TRANSFER PROVISIONS.—

(1) PERSONNEL, ETC.—All personnel, liabilities, contracts, property, and records determined by the Director of the Office of Management and Budget to be employed, held, or used primarily in connection with the functions of the Secretary of Labor under the Employee Retirement Income Security Act of 1974, of the Pension Benefit Guaranty Corporation under such Act, and of the Secretary of the Treasury under sections 401, 410, 411, 412, 413, 414, 6057, and 6058 of the Internal Revenue Code of 1954, insofar as such sections

relate to employee benefit plans described in section 122 (d) (3) of this Act, are transferred to the Commission.

(2) TRANSFER OF PERSONNEL.—

(A) Except as provided in subparagraph (B), personnel engaged in functions transferred under paragraph (1) shall be transferred in accordance with applicable laws and regulations relating to the transfer of functions.

(B) The transfer of personnel pursuant to paragraph (1) shall be made without reduction in classification or compensation for one year after such transfer.

(3) PROCEDURAL EFFECTS OF TRANSFER.—

(A) All laws and regulations relating to the functions transferred under this Act shall, insofar as such laws and regulations are applicable and not amended by this Act, remain in full force and effect. All orders, determinations, rules, and opinions made, issued, or granted under such laws by the Secretary of Labor, the Pension Benefit Guaranty Corporation, or by the Secretary of the Treasury, which are in effect at the time of the transfer provided by paragraph (1), and which are consistent with the amendments made by this Act, shall continue in effect to the same extent as if such transfer had not occurred.

(B) The provisions of this Act shall not affect any proceeding pending before the Secretary of Labor, the Pension Benefit Guaranty Corporation, or the Secretary of the Treasury on the date of enactment of this Act.

(C) No suit, action, or other proceeding commenced by or against the Secretary of Labor, the Pension Benefit Guaranty Corporation, or the Secretary of the Treasury shall abate by reason of the transfer made under paragraph (1). The court before which such suit, action, or other proceeding is pending may, on motion or supplemental petition filed at any time within 12 months after the date of enactment of this Act, allow such suit, action, or other proceeding to be maintained against the Commission if the party making the motion or filing the petition shows a necessity for the survival of the suit, action, or other proceeding to obtain a settlement of the question involved.

SEC. 124. CERTIFICATION OF CERTAIN IMPROVED PLANS.

(a) GENERAL RULE.—The Commission shall, upon application made by an employer who maintains a qualified employer retirement plan (as defined in section 221 (c) (3) (A) through (E) of the Internal Revenue Code of 1954), certify such plan to the Secretary of the Treasury as an improved plan for purposes of the credit allowed by section 44D of the Internal Revenue Code of 1954 if, for the plan year for which certification is requested—

(1) the Commission determines that there has been a substantial improvement in the employee benefits under the plan as compared with the preceding plan year, and

(2) rights of employees under the terms of the plan exceed the minimum requirements described in part 2 of title I of the Employee Retirement Income Security Act of 1974.

(b) MINIMUM IMPROVEMENT STANDARDS.—The Commission shall not certify any plan as an improved plan under subsection (a) unless, under the plan—

(1) the age and service requirements for participation

(1) the age and service requirements for participation in such plan permit significantly earlier participation than must be permitted under the age and service requirements of section 202 of the Employee Retirement Income Security Act of 1974, and

(2) the rate at which a participant's right to his normal retirement benefit becomes nonforfeitable is significantly more rapid than the least rapid rate permitted under section 203 of such Act, or

(3) the Commission determines that there is some other significant improvement in a participant's benefits and rights under the plan which is at least equivalent to an improvement which would satisfy the requirements of paragraphs (1) and (2).

SEC. 125. TERMINATION OF TREASURY DEPARTMENT'S JURISDICTION OVER CERTAIN ASPECTS OF CERTAIN PLANS; AGENCY COOPERATION.

(a) TERMINATION OF TREASURY JURISDICTION.—Except as provided in subsections (b) and (c), the Secretary of the Treasury shall not administer, seek to obtain compliance with, or otherwise exercise responsibility or power respecting sections 401, 410, 411, 412, 413, 414, 6057, 6058, 4971, and 4975 of the Internal Revenue Code of 1954 insofar as such sections relate to an employee benefit plan (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974) described in section 4(a) of such Act and not exempt under section 4(b) of such Act.

(b) CERTIFICATIONS BY COMMISSION.—Certifications made by the Employee Benefits Commission to the Secretary of the Treasury pursuant to section 123 (a) (9) of this Act shall be treated by the Secretary as if he had made such certifications himself.

(c) COOPERATION.—Pursuant to procedures they shall jointly formulate and establish, the Employee Benefits Commission, the Secretary of Labor, and the Secretary of the Treasury shall make arrangements for—

(1) notification by the respective Secretaries to the Commission regarding information which concerns the Commission's functions under section 122 (d), and

(2) notification by the Commission to the Secretaries regarding information which concerns their respective functions under laws relating to employee benefit plans.

SEC. 126. EFFECTIVE DATE AND REPEAL.

This title shall take effect one year after the date of enactment of this Act. Subtitle A of title III of the Employee Retirement Income Security Act of 1974 is repealed on such effective date.

TITLE II—AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

Subtitle A—Declaration of Policy; Definitions

SEC. 201. DECLARATION OF POLICY; DEFINITIONS.

(a) DECLARATION OF POLICY.—Section 2 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(d) It is hereby further declared to be the policy of this Act to foster the establishment and maintenance of employee benefit plans sponsored by employers, employee organizations, or both.".

(b) Section 3 of the Employee Retirement Income Security Act of 1974 is amended by—

(1) redesignating paragraph (4) as paragraph (4)(A) and by adding at the end thereof the following new subparagraph:

"(B) For purposes of this paragraph, the term 'employee's beneficiary association' shall mean an association in which employees participate as members and in which eligibility for membership is based on a commonality of interest with respect to the members' employment relationships.";

(2) striking out subparagraphs (A), (B), (C), (D), (H), and (I) of paragraph (14) and inserting in lieu thereof, respectively, the following subparagraphs:

"(A) any fiduciary, counsel, or employee of such plan;

"(B) a person providing professional services to such plan, or a person providing nonprofessional services on a continuous basis to such plan;

"(C) an employer any of whose employees are covered by such plan, if the employees of such employer constitute 5 percent or more of all employees covered by the plan;

"(D) an employee organization any of whose members are covered by such plan, if the members of such employee organization constitute 5 percent or more of all employees covered by the plan;

"(H) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) or a person described in subparagraph (d) (D), (E), or (G); or

"(I) a 10 percent or more (in capital or profits) partner, or joint venturer with, a person described in subparagraph (C), (D), (E), or (G).";

(3) inserting in paragraph (15) "brother, sister," immediately before "spouse,";

(4) striking out "The" in paragraph (20) and inserting in lieu thereof "Except as otherwise provided in section 514 (d) (2), the";

(5) (A) striking out clauses (i), (ii), and (iii) of subparagraph (A) of paragraph (37) and inserting in lieu thereof the following:

"(i) which is maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer,

"(ii) to which ten or more employers contribute, or to which more than one and fewer than ten employers contribute if the Secretary finds that treating such a plan as a multiemployer plan would be consistent with the purposes of this Act, and",

(B) redesignating clauses (iv) and (v) of paragraph (37) (A) as clauses (iii) and (iv), respectively, and

(C) striking out subparagraph (B) of paragraph (37) and inserting in lieu thereof the following new subparagraph:

"(B) For purposes of this paragraph, all corporations which are members of a controlled group of corporations (within the meaning of section 1563 (a) of the Internal Revenue Code of 1954, determined without regard to section 1563 (e) (3) (C) of such Code) shall be deemed to be one employer.".

Subtitle B—Simplifying and Clarifying Amendments

PART 1—REPORTING AND DISCLOSURE

SEC. 221. DISCLOSURE OF ACCRUED BENEFITS.

Section 105 of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"REPORTING OF PARTICIPANT'S BENEFIT RIGHTS

"SEC. 105. (a) (1) Each administrator of an employee pension benefit plan shall furnish to any plan participant or beneficiary who so requests in writing a statement indicating, on the basis of the latest available information—

"(A) the total benefits accrued, and

"(B) the nonforfeitable pension benefits, if any, which have accrued, or the earliest date on which benefits will become nonforfeitable.

"(2) In no case shall a participant or beneficiary be entitled under this subsection to receive more than one report described in paragraph (1) during any one twelve-month period.

"(3) If an administrator furnishes an annual statement which contains the information required by this subsection, the furnishing of such annual statement shall satisfy the requirements of this subsection.

"(4) This subsection shall apply to a plan to which more than one unaffiliated employer is required to contribute only to the extent provided by regulations prescribed by the Commission.

"(b) (1) Each administrator of an employee pension benefit plan shall report, in such manner and at such time as may be provided in regulations prescribed by the Commission, to each plan participant who during a plan year—

"(A) (i) terminates his service with the employer, or

"(ii) has a 1-year break in service, and

"(B) is entitled to a deferred vested benefit under the plan as of the end of such plan year, and

"(C) with respect to whom retirement benefits are not paid under the plan during such plan year.

The report required under this subsection shall inform the employee of the nature, amount, and form of the deferred vested benefit to which such participant is entitled, and such other information as the Commission may require.

"(2) Not more than one report shall be required under

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paragraph (A) (ii) with respect to consecutive one year breaks in service.

"(c) (1) Except as provided by paragraph (2) of this subsection, each employer shall, in accordance with regulations prescribed by the Commission, maintain records with respect to each of his employees sufficient to determine the benefits due or which may become due to such employees. The employer shall furnish the plan administrator information necessary for the administrator to make the reports required by subsections (a) and (b).

"(2) If more than one employer adopts a plan, each such employer shall, in accordance with regulations prescribed by the Commission, furnish to the plan administrator information necessary for the administrator to maintain the records and make the reports required by subsections (a) and (b). Such an administrator shall maintain the records and, to the extent provided under regulations prescribed by the Commission, make the reports, required by subsections (a) and (b).

"(3) If any person who is required under this section (other than under subsection (a) (1)) to furnish information or to maintain records fails to comply with such requirements, he shall pay to the plan a penalty of $10 for each employee with respect to whom such failure occurs, unless it is shown that such failure is due to reasonable cause.".

SEC. 222. EXEMPTION FOR REPORTING AND DISCLOSURE REQUIREMENTS.

(a) IN GENERAL.—Section 110 of such Act is amended to read as follows:

"EXEMPTIONS AND MODIFICATIONS

"SEC. 110. The Secretary may by regulation exempt any employee benefit plan or person, or any class of employee benefits plans or persons conditionally or unconditionally from any requirement of this part or may modify any such requirement if he determines that such exemption or modification is—

"(1) appropriate an dnecessary in the public interest, and

"(2) consistent with the purposes of this title.".

(b) CONFORMING CHANGES.—Section 104(a) of such Act is amended—

(1) by striking out paragraphs (2) and (3), and by redesignating paragraphs (4) and (5) as (2) and (3), respectively, and

(2) by striking out "paragraph (4)" in paragraph (3) (as redesignated) and inserting in lieu thereof "paragraph (2)".

SEC. 223. ELIMINATION OF SUMMARY ANNUAL REPORT.

Section 104(b) is amended—

(1) by striking out paragraph (3) and redesignating paragraph (4) as (3), and

(2) by inserting before the period at the end of the last sentence of such paragraph a comma and the following: "but the charge for furnishing a copy of the latest annual report may not exceed $10".

SEC. 224. CONSOLIDATION OF FORMS.

Not later than 18 months after enactment of this Act, the Commission shall, with respect to employee benefit plans described in section 122 (d) (3) of this Act, prescribe a single form (or a single series of forms) which shall be used to satisfy the requirements of section 102 (a) (2) of the Employee Retirement Income Security Act of 1974 and such additional reporting requirements as the Commission deems necessary for the reporting of information presently reported on Internal Revenue Service Forms 5300, 5301, and 5303.

SEC. 225. IMPROVEMENT OF REPORTING REQUIREMENTS.

In order to avoid the reporting of unnecessary information, the Commission shall develop reporting forms and requirements for employee benefit plans described in section 122 (d) (3) of this Act which, to the maximum extent feasible and consistent with the purposes of this Act and the Employee Retirement Income Security Act of 1974, take into account the different types and sizes of employee benefit plans. Not later than 18 months after the date of enactment of this Act, the Commission shall report to the Congress on the actions taken and proposed to be taken to implement this directive. Not later than 24 months after the enactment of this section, the Commission shall submit to the Congress its final written report on the implementation of this section.

SEC. 226. OPINIONS OF ACTUARIES AND ACCOUNTANTS.

Section 103 (a) of the Employee Retirement Income Security Act of 1974 is amended—

(1) by inserting ", except to the extent required by subparagraph (B)," in paragraph (3) (A) after "Such examination shall be conducted in accordance with generally accepted auditing standards,",

(2) by striking out "may" in paragraph (3) (B) and inserting in lieu thereof "shall",

(3) by striking out "if he so states his reliance" in such paragraph,

(4) by striking out "may" in paragraph (4) (D) and inserting in lieu thereof "shall", and

(5) by striking out "if he so states his reliance" in such paragraph.

SEC. 227. UPDATE OF SUMMARY PLAN DESCRIPTION.

Section 104 (b) (1) of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"(1) The administrator shall furnish to each participant, and each beneficiary receiving benefits under the plan, a copy of the summary plan description, and all modifications and changes referred to in section 102 (a) (1)—

"(A) within 90 days after he becomes a participant, or (in the case of a beneficiary) within 90 days after he first receives benefits, or

"(B) if later, within 120 days after the plan becomes subject to this part.

Not less frequently than every tenth year after the plan becomes subject to this part, the administrator shall furnish to each participant and to each beneficiary receiving benefits under the plan, the summary plan description described in section 102 which shall be updated by the integration into the summary plan description of all plan amendments, if any, made within such 10-year period. If there is a modification or change described in section 102 (a) (1), a summary description of such modification or change shall be furnished not later than 210 days after the end of the plan year in which the change is adopted to each participant and to each beneficiary who is receiving benefits under the plan.".

SEC. 228. SCOPE OF ACCOUNTANT'S OPINION.

Section 103 (a) (3) (C) of the Employee Retirement Income Security Act of 1974 is amended by striking out "need" and inserting in lieu thereof "shall".

SEC. 229. EFFECTIVE DATES.

The amendments made by sections 222 and 227 shall be effective, and the amendments made by sections 223, 226, and 228 shall apply with respect to plan years beginning on and after the date of enactment of this Act. Sections 224 and 225 shall be effective 12 months after such enactment date. The amendments made by section 221 shall be effective 18 months after such enactment date.

PART 2—MINIMUM STANDARDS

SEC. 231. RECIPROCAL AGREEMENTS.

Section 209 of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"RECIPROCAL AGREEMENTS

"SEC. 209. Notwithstanding any other provision of this title, the contributions made with respect to the employment of an employee pursuant to a collective-bargaining agreement and payable to a pension or welfare plan maintained pursuant to that agreement (hereinafter in this section referred to as the 'away plan') may be transferred to a similar pension or welfare plan established pursuant to another collective bargaining agreement under which the employee had previously become a participant (hereinafter referred to in this section as the 'home plan') if such transfer is pursuant to a written agreement between the administrator of the away plan and the administrator of the home plan. In any case where contributions received with respect to the employment of an employee are transferred from an away plan to a home plan in accordance with this section, such employment shall be considered as employment under the jurisdiction of the home plan for purposes of computing the accrued benefit and vesting of such employee, but the employer who contributed to the away plan on behalf of such employee shall not be deemed to be an employer maintaining the home plan solely because of such transferred contributions. The Secretary may by regulation establish additional conditions, and such variances and exemptions as are consistent with the purposes of this Act, in order to facilitate such transfer arrangements in the interest of portability and to protect the pension and welfare benefits of employees who become employed under two or more collective bargaining agreements associated with different pension or welfare plans.".

SEC. 232. DETERMINING PARTICIPATION ON A PLAN YEAR BASIS.

The second sentence of section 202(a)(3)(A) of the Employee Retirement Income Security Act of 1974 is amended by inserting "(i)" after "first day of a plan year" and by inserting after "date his employment commenced" the following: "or (ii) in the case of a plan where rights and benefits under this part are determined on the basis of all of an employee's service without regard to the date on which the employee's participation in the plan commenced".

SEC. 233. SPECIAL RULE FOR 125 DAYS OF SERVICE IN THE CASE OF A MARITIME INDUSTRY.

Section 204(b)(3)(F) of the Employee Retirement Income Security Act of 1974 is amended by striking out "a year of participation" and inserting in lieu thereof the following: "1,000 hours of employment".

SEC. 234. SUMMATION OF DIFFERENT BENEFIT ACCRUAL RATES.

Section 210(a) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new paragraph:

"(4) a multiemployer plan may provide that the accrued benefit to which a participant is entitled upon his separation from the service is—

"(A)(i) the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates, or

"(ii) the sum of different rates of benefit accrual for different periods of participation, as defined by employment in different bargaining units, and

"(B) determined, for purposes of subparagraphs (A) and (C) of subsection 204(b)(1), by projecting the normal retirement benefit to which a participant would be entitled if he continued to accrue benefits at the average of the rates applicable to his period of actual participation.".

SEC. 235. SUSPENSION OF BENEFITS BECAUSE OF REEMPLOYMENT.

Section 203 (a) (3) (B) of the Employee Retirement Income Security Act of 1974 is amended—

(1) by striking out "in the same trade" in clause (ii) and inserting in lieu thereof ", trade,", and

(2) by striking out "'employed'." in the last sentence and inserting in lieu thereof the following: "which may, with respect to clause (ii), include self-employment. The permissible period of benefit suspension shall include a period determined pursuant to regulations promulgated by the Commission in addition to the months in which the employment occurs to the extent necessary to prevent the periodic payment and suspension of pension benefits to workers who have not retired but who continue to work on an irregular basis. The imposition of a financial penalty on a pensioner who fails to report his employment as required by the rules of a plan shall not be deemed a violation of the vesting requirements of this section. The amount of the financial penalty permitted by the preceding sentence shall be determined pursuant to regulations promulgated by the

Commission but in no event shall the penalty exceed an amount equal to one year's benefit.".

SEC. 236. AMENDMENTS TO CONFORM PLANS TO FINAL REGULATIONS.

Section 204 of the Employee Retirement Income Security Act of 1974 is amended by redesignating subsection (h) as (i) and inserting after subsection (g) the following new subsection:

"(h) Any plan amendments adopted prior to January 1, 1980, which comply with final regulations issued under this Act shall not be deemed to violate any provision of this title by reason of the fact that such amendment changes or revises any amendment adopted after September 2, 1974, and prior to issuance of such final regulations, unless such amendment has the effect of decreasing vested rights or accrued benefits under such plan as in existence on September 2, 1974.".

SEC. 237. REDUCTIONS IN RETIREMENT OR DISABILITY BENEFITS.

Section 206(b) of the Employee Retirement Income Security Act of 1974 is amended—

(1) by inserting after "plan" in paragraph (1) the following: "or is receiving disability benefits under a welfare plan",

(2) by inserting immediately after "this Act" the

following: "(or, in the case of a participant or beneficiary who is receiving disability benefits under a welfare plan, the date of enactment of the ERISA Improvements Act)", and

(3) by adding at the end thereof the following new sentence: "A pension plan may not reduce pension benefits being received by a participant or beneficiary or pension benefits in which a participant who is separated from the service has a nonforfeitable right by reason of any payment made to the participant or beneficiary by the employer maintaining the plan as the result of an award made under a workers compensation law.".

SEC. 238. JOINT AND SURVIVOR ANNUITY.

(a) Section 205 of the Employee Retirement Income Security Act of 1974 is amended—

(1) by inserting "(1)" after "(a)" in subsection (a), and by adding at the end of such subsection the following new paragraph:

"(2) If a pension plan does not provide for the payment of benefits in the form of an annuity, with respect to any participant who under the plan has a nonforfeitable right to not less than 50 percent of his accrued benefit derived from employer contributions and who dies before receiving such percentage of his benefit which is nonforfeitable, such plan shall provide that the participant's account balance shall be distributed in the form of a lump sum to the participant's surviving spouse not later than 60 days after the end of the plan year in which the participant died.".

(2) by striking out subsection (b) and inserting in lieu thereof the following:

"(b) (1) A plan which provides for the payment of benefits in the form of an annuity shall not be treated as satisfying the requirements of this section unless, with respect to any participant who under the plan has a nonforfeitable right to not less than 50 percent of his accrued benefit derived from employer contributions and who dies before the annuity starting date, the plan provides a survivor's annuity for the participant's spouse—

"(A) which begins on the annuity starting date (determined as if the participant had lived until his earliest retirement age, or his actual date of death if later, and had retired on such date prior to his death), if the spouse is living on such date, and

"(B) the payments under which are not less than the payments which would have been made under the survivor's annuity to which such spouse would have been entitled if the participant had terminated employment on his date of death, had survived and retired on such annuity starting date. and had died on the day following such date.

"(2) A plan shall not be treated as not satisfying the requirements of subsection (a) and paragraph (1) if the plan provides for the payment of benefits actuarially equivalent to the survivor's annuity required by paragraph (1) to a surviving spouse beginning not later than the annuity starting date specified in paragraph (1).",

(3) by striking out subsection (c) and subsection (h) and by redesignating subsections (d), (e), (f), and (g) as (c), (d), (e), and (f), respectively,

(4) by striking out "(whether or not an election has been made under subsection (c))" in subsection (c) (as redesignated under paragraph (3)), and

(5) by striking out "subsection (c) or (e)" in subsection (e) (as redesignated under paragraph (3)) and inserting in lieu thereof "subsection (d)".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to plan years beginning on or after the date which is 24 months after the date of enactment of this Act.

SEC. 239. ELAPSED TIME.

Section 211 of the Employee Retirement Income Security Act of 1974 is amended by inserting immediately after subsection (e) the following new subsection:

"(f) Notwithstanding anything to the contrary in this part, the Secretary may prescribe by regulation one or more systems of measuring service for purposes of sections 202, 203, and 204 which are based upon measurement of the elapsed time of an employee's service. Any such regulations shall include safeguards to assure that employees whose service is measured in terms of elapsed time are, in the aggregate, not disadvantaged by the use of such system of measurement when compared to employees whose service is measured in the manner prescribed in sections 202, 203, and 204.".

PART 3—FUNDING

SEC. 251. FUNDING TO TAKE ACCOUNT OF FUTURE AMENDMENTS.

Section 302(c)(1) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following: "The funding method may take account, and for any plan year beginning after December 31, 1980, shall take account, of all provisions of the plan, including provisions which have not yet affected any participant as to entitlement to, or accrual of, benefits. In the event any such provision is not implemented at the time specified when the provision was adopted, the funding standard account shall be appropriately adjusted in accordance with regulations prescribed by the Secretary. A provision adopted but contingent on a future event shall be deemed not to be in effect as a provision of the plan prior to the occurrence of that event.".

PART 4—FIDUCIARY RESPONSIBILITY

SEC. 261. GENERAL ASSET ACCOUNT.

Section 401(b) of the Employee Retirement Income Security Act of 1974 is amended by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) In the case of a plan the benefits of which are insured, the assets of the plan shall include the policy under which the benefits are insured but shall not, solely by reason of the issuance of such policy, include the assets of the insurer issuing the policy except to the extent that such assets are maintained by the insurer in one or more separate accounts and do not constitute surplus in any such account. For purposes of this paragraph. the term 'insurer' means an insurance company, insurance service, or insurance organization, qualified to conduct business in a State.".

SEC. 262. OBLIGATION OF EMPLOYER TO PAY CONTRIBUTIONS.

(a) Section 402 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(d) Every employer who is obligated under the terms of a collectively bargained plan (or under the terms of a collective bargaining agreement related to such plan) to make periodic contributions to the plan shall, to the extent not inconsistent with law, make such contributions in accordance with the terms and conditions of such plan or such agreement.

SEC. 263. REFUND OF MISTAKEN CONTRIBUTIONS.

Section 403 (c) (2) (A) of the Employee Retirement Income Security Act of 1974 is amended by inserting before the period at the end thereof the following: "or, in the case of a plan maintained by more than one employer, within one year after the plan administrator knows that the contribution was made by a mistake of fact.".

SEC. 264. COFIDUCIARY RESPONSIBILITY.

Section 405 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(e) (1) In the case of a fiduciary other than an individual, the term 'knowledge' in subsection (a) (3) shall mean knowledge actually communicated (or knowledge which, in the normal course of business, should have been communicated) to the fiduciary's officer or employee who is authorized to carry out the fiduciary's responsibilities, obligations, or duties (or who in fact carries out such responsibilities, obligations or duties) regarding the matter to which the knowledge relates.

"(2) In the case of an employer who is a fiduciary and who fails to satisfy the requirement of section 402 (d), subsections (a) (2) and (3) shall not apply to any cofiduciary of such employer respecting such failure.".

SEC. 265. EXEMPTION FOR RECIPROCITY ARRANGEMENTS.

Section 408(b) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new paragraph:

"(10) Any transfer of contributions between plans pursuant to section 209, if a plan to which the contributions are transferred pays not more than a reasonable charge for any administrative expenses reasonably incurred by a plan transferring such contributions.".

SEC. 266. SOLVENCY STANDARDS FOR CERTAIN UNINSURED WELFARE PLANS.

(a) IN GENERAL.—Part 4 of subtitle B of title I of the Employee Retirement Income Security Act of 1974 is amended by redesignating sections 413 and 414 as 414 and 415, respectively, and by inserting after section 412 the following new section:

"CERTAIN UNINSURED WELFARE PLANS

"SEC. 413. (a) Every uninsured welfare plan described in subsection (b) shall be subject to such solvency and reserve standards as the Secretary shall require by regulation.

"(b) The term 'uninsured welfare plan' means a welfare plan (or portion of a welfare plan) under which the benefits are not funded by insurance under a policy issued by an insurer (as defined in section 401 (b) (2)) and the participants of which have no commonality of interest respecting terms or conditions of employment other than their participation in such plan.

"(c) Regulations promulgated by the Secretary under this section shall take effect not later than 18 months after the date of enactment of the ERISA Improvements Act.".

(b) CLERICAL AMENDMENTS.—The table of contents for such Act is amended by redesignating the items relating to sections 413 and 414 as relating to sections 414 and 415, and by inserting after the item relating to section 412 the following new item:

"Sec. 413. Uninsured welfare plans.".

PART 5—ADMINISTRATION AND ENFORCEMENT

SEC. 271. REMEDIES.

Section 502 of the Employee Retirement Income Security Act of 1974 is amended by—

(1) striking out "105(c)" in subsection (a) (4) and inserting in lieu thereof "105";

(2) striking out subsection (b) and inserting in lieu thereof the following:

"(b) The Commission shall not bring an action to enforce section 402 (d).";

(3) striking out subsection (g) and inserting in lieu thereof the following:

"(g) (1) Except as provided in paragraph (2), in any action under this title by a participant, beneficiary, or fiduciary, the court in its discretion may allow a reasonable attorney's fee and costs of the action to either party.

"(2) In any action under this title by a fiduciary on behalf of a plan to enforce the provisions of section 402 (d) and in which a judgment in favor of the plan is awarded, the court shall allow a reasonable attorney's fee and costs of the action, to be paid by the defendant.";

(4) striking out subsection (i) and redesignating subsections (j) and (k) as subsections (i) and (j), respectively; and

(5) inserting a new subsection (k), to read as follows:

"(k) (1) Notwithstanding any provision of law to the contrary, in the case of an employee benefit plan other than an eligible individual account plan (as defined in section 407 (d) (3) of this Act) in which participation is voluntary under the terms of the plan—

"(A) no person or employee benefit plan shall be subject to liability or punishment, civil or criminal, or be required to reimburse or pay money or any other thing of value, as the direct or indirect result of a cause of action explicitly or implicitly alleging that the interest of an employee in such a plan is, or ought to be characterized as or deemed to be, a security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934, or any law of any State which regulates securities; and

"(B) no court of the United States shall have jurisdiction of an action or proceeding at law or in equity, whether instituted prior to or on or after the date of enactment of the ERISA Improvements Act of 1978, to the extent such action or proceeding involves a cause of action explicitly or implicitly alleging that the interest of an employee in such a plan is, or ought to be characterized as or deemed to be, a security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934, or any law of any State which regulates securities.

"(2) For purposes of this subsection and section 514 (d) (2), participation is not voluntary under the terms of a plan—

"(A) if, as an incident of employment with the employer or employers maintaining the plan or as an incident of membership in one or more employee organizations, the members of which are covered under the plan, and upon satisfaction of the plan's age and service requirements, if any, an employee becomes a participant in the plan, and

"(B) even if a provision of the plan permits an employee, subject to approval by the plan administrator, to waive participation in the plan.".

SEC. 272. ADVISORY COUNCIL.

Paragraph (3) of section 512(a) of the Employee Retirement Income Security Act of 1974 is amended by striking out "(at least one of whom shall be representative of employers maintaining or contributing to multiemployer plans)" and inserting in lieu thereof the following: "(one of whom shall be representative of employers maintaining or contributing to multiemployer plans and one of whom shall be representative of employers maintaining small plans)".

SEC. 273. IMPACT OF INFLATION ON RETIREMENT BENEFITS.

Section 513 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(d) The Secretary shall conduct a study of the feasibility of requiring employee pension benefit plans to provide cost-of-living adjustments to benefits payable under such plans. The Secretary shall compile data and analyze the effect inflation is having and may be expected to have on retirement benefits provided by private pension plans. The Secretary shall submit the study required by this subsection to the Congress no later than 24 months after the date of enactment of the ERISA Improvements Act.".

SEC. 274. PREEMPTION.

Section 514 of the Employee Retirement Income Security Act of 1974 is amended by—

(1) striking out "subparagraph (B)," in subsection (b) (2) (A) and inserting in lieu thereof "subparagraph (B) and subsection (d) (2),";

(2) striking out "Nothing" where it appears in subsection (d) and inserting in lieu thereof "(1) Except as provided in paragraphs (2) and (3), nothing"; and

(3) adding at the end of subsection (d) the following new paragraphs:

"(2) Notwithstanding any provision of law to the contrary, the interest of an employee in an employee benefit plan described in section 4 (a) and not exempt under section 4 (b) is not, and shall not be characterized as or deemed to be, a security within the meaning of the Securities Act of 1933, the Securities and Exchange Act of 1934, or any law of any State which regulates securities, unless such plan is an eligible individual account plan (as defined in section 407 (d) (3) of this Act) in which participation is voluntary under the terms of the plan.

"(3) Notwithstanding any provision of law to the contrary, an interest or participation—

"(A) in a single or collective trust maintained by a bank or in a separate account maintained by an insurer, and

"(B) issued to an employee benefit plan or plans described in section 4 (a) and not exempt under section 4 (b)

is not, and shall not be characterized as or deemed to be, a security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934, or any law of any State which regulates securities, and such a single or collective trust or separate account is not, and shall not be characterized as or deemed to be, an investment company within the meaning of the Investment Company Act of 1940 or any law of any State which regulates investment companies. For purposes of this paragraph, the term 'insurer' shall have the meaning given in section 401 (b) (2).".

TITLE III—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

SEC. 301. LUMP SUM DISTRIBUTIONS; PLANS TREATED AS SINGLE PLAN.

(a) GENERAL RULE.—Section 402 (e) (4) (C) of the Internal Revenue Code of 1954 (relating to aggregation of certain trusts and plans) is amended to read as follows:

"(C) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under subparagraph (A)—

"(i) all trusts which are part of a plan shall be treated as a single trust,

"(ii) in the case of a multiemployer plan (as defined in section 3 (37) of the Employee Retirement Income Security Act of 1974), all defined benefit plans maintained by an employer shall be treated as a single plan, and all defined contribution plans maintained by an employer shall be treated as a single plan,

"(iii) in the case of any plan not described in subsection (ii), all pension plans maintained by an employer shall be treated as a single plan, all profit-sharing plans maintained by an employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan, and

"(iv) trusts which are not qualified trusts under section 401 (a) and annuity contracts which do not satisfy the requirements of section 404 (a) (2) shall not be taken into account.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of enactment of this Act.

SEC. 302. LUMP SUM DISTRIBUTIONS; SEPARATION FROM THE SERVICE.

(a) GENERAL RULE.—Section 402(e)(4) of the Internal Revenue Code of 1954 (relating to definitions and special rules) is amended by adding at the end thereof the following new subparagraph:

"(M) SEPARATION FROM THE SERVICE.—For purposes of subparagraph (A), in the case of any multiemployer plan (as defined in section 3(37) of the Employee Retirement Income Security Act of 1974), a separation from the service shall be deemed to have occurred in the case of any employee if such employee has not worked in service covered by the plan for a period of 6 consecutive months after severing his employment relationship with any employer maintaining the plan.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to plan years beginning after the date of enactment of this Act.

SEC. 303. DEDUCTION FOR CERTAIN EMPLOYEE CONTRIBUTIONS TO QUALIFIED RETIREMENT PLANS.

(a) IN GENERAL.—Part VII of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to additional itemized deductions for individuals) is amended by redesignating section 221 as 222, and by inserting immediately after section 220 the following new section:

"SEC. 221. CERTAIN EMPLOYEE CONTRIBUTIONS TO QUALIFIED RETIREMENT PLANS.

"(a) GENERAL RULE.—In the case of an individual who—

"(1) has not attained age 70½ before the close of the taxable year, and

"(2) is an active participant in a qualified employer retirement plan,

there is allowed as a deduction an amount equal to the sum of the amounts contributed by the individual as an employee to or under such plan for the taxable year.

"(b) MAXIMUM AMOUNT OF DEDUCTION.—

"(1) IN GENERAL.—The amount allowable as a deduction under subsection (a) to any individual for the taxable year shall not exceed the lesser of—

"(A) an amount equal to 10 percent of the compensation includible in the individual's gross income for such taxable year, or

"(B) $1,000.

"(2) REDUCTION OF DEDUCTION BASED ON ADJUSTED GROSS INCOME.—The amount of the deduction allowable under subsection (a) for a taxable year after the application of paragraphs (1) and (2) shall be reduced by 20 percent of the amount by which the adjusted gross income of the taxpayer exceeds $30,000 ($15,000 in the case of a married individual making a separate return).

"(c) DEFINITIONS; SPECIAL RULES.—

"(1) RECONTRIBUTED AMOUNTS.—No deduction shall be allowed under this section with respect to a rollover contribution described in section 402(a) (5), 403(a) (4), 408(d) (3), or 409(b) (3) (C).

"(2) AMOUNTS CONTRIBUTED UNDER ENDOWMENT CONTRACT.—In the case of an endowment contract described in section 408(b), no deduction shall be allowed under this section for that portion of the amounts paid under the contract for the taxable year which are properly allocable, under regulations prescribed by the Secretary, to the cost of life insurance.

"(3) QUALIFIED EMPLOYER RETIREMENT PLAN.—The term 'qualified employer retirement plan' means—

"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan described in section 403 (a), "(C) a qualified bond purchase plan described in section 405 (a),

"(D) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing,

"(E) any plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403 (b) (whether or not such individual's rights in such contract are nonforfeitable), and

"(F) a group retirement trust maintained by a labor organization described in section 501 (c) (5) which is financed exclusively by assessments of employees who are members of such labor organization which was established prior to January 1, 1974, and in which the assessments paid to the trust by any participant are 100 percent nonforfeitable.

"(4) COMPENSATION.—For purposes of this section, the term 'compensation' includes earned income as defined in section 401 (c) (2).

"(5) MARRIED INDIVIDUALS.—In the case of an individual who is married (as determined under section 143 (a)), the maximum deduction under subsection (b) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

"(6) TIME WHEN CONTRIBUTIONS DEEMED MADE.—For purposes of this section, a taxpayer shall be deemed to have made a contribution to or under a qualified employer retirement plan on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than 45 days after the end of such taxable year.".

(b) CLERICAL AMENDMENT.—The table of sections for such subpart is amended by striking out the last item and inserting in lieu thereof the following:

"Sec. 221. Certain employee contributions to qualified retirement plans.
"Sec. 222. Cross references."

(c) CONFORMING AMENDMENT.—Paragraph 10 of section 62 of such Code (relating to retirement savings) is amended—

(1) by striking out "and" and inserting in lieu thereof a comma, and

(2) by inserting "the deduction allowed by section 221 (relating to deduction for certain employee contributions to qualified retirement plans)" before the period at the end of such paragraph.

(d) ACCEPTANCE OF EMPLOYEE CONTRIBUTIONS.—

Section 401 of such Code (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by redesignating subsection (k) as (l), and by inserting after subsection (j) the following new subsection:

"(k) EMPLOYEE CONTRIBUTIONS.—A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part accepts employee contributions for which a deduction is allowable under section 221 (as determined without regard to the limitation of subsection (b) (1) of such section) of up to $1,000 per calendar year per employee and treats such contributions as separate accounts.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years and plan years beginning after December 31, 1978.

SEC. 304. CREDIT FOR THE ESTABLISHMENT OF QUALIFIED PLANS BY SMALL EMPLOYERS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended by inserting immediately before section 45 the following new section:

"SEC. 44C. ESTABLISHMENT OF NEW SMALL BUSINESS EMPLOYER RETIREMENT PLANS.

"(a) GENERAL RULE.—In the case of a small business employer who maintains or makes contributions to or under a qualified employer retirement plan, there is allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to a percentage (determined under subsection (b)) of the amount allowable for the taxable year to such employer as a deduction under section 404.

"(b) DETERMINATION OF PERCENTAGE.—The percentage applicable under subsection (a) for a taxable year is—

"(1) 5 percent for the first taxable year for which a deduction under section 404 is allowable to the taxpayer,

"(2) 3 percent for each of the succeeding 2 taxable years, and

"(3) 1 percent for each of the 2 taxable years succeeding the 2 taxable years referred to in paragraph (2).

"(c) DEFINITIONS; SPECIAL RULES.—For purposes of this section—

"(1) QUALIFIED EMPLOYER RETIREMENT PLAN.—The term 'qualified employer retirement plan' has the meaning given to such term by section 221(c)(3)(A) through (E).

"(2) SMALL BUSINESS EMPLOYER.—The term 'small business employer' means an employer (within the meaning of section 404) which is a small business (as determined by the Administrator of the Small

Business Administration under section 112 of the Small Business Act (15 U.S.C. 632)).

"(3) DISREGARD FOR AMOUNTS ATTRIBUTABLE TO EMPLOYER SECURITIES.—In determining the amount of the credit allowable under subsection (a) for any taxable year, any portion of the deduction allowed for such year which is attributable to the transfer to or under the plan of employer securities (as defined in section 407(d)(1) of the Employee Retirement Income Security Act of 1974) shall be disregarded.

"(d) APPLICATION WITH OTHER SECTIONS.—The amount of the deduction allowable under section 404 for any taxable year shall not be reduced because of the allowance of a credit under this section for the taxable year. The credit allowable under subsection (a) for any taxable year shall not be allowed if the taxpayer claims the credit allowable by section 44D for the taxable year.

"(e) TERMINATIONS.—No credit is allowable under subsection (a) in the case of an employer who terminates a qualified employer retirement plan (or successor to such an employer) at any time after January 1, 1978.".

(b) CLERICAL AMENDMENT.—The table of sections for such subpart is amended by inserting immediately before the item relating to section 45 the following new item:

"Sec. 44C. Establishment of new small business employer retirement plans.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1978.

SEC. 305. CREDIT FOR THE IMPROVEMENT OF QUALIFIED RETIREMENT PLANS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended by inserting immediately before section 45 the following new section:

"SEC. 44D. IMPROVED QUALIFIED EMPLOYER RETIREMENT PLAN CREDIT.

"(a) GENERAL RULE.—In the case of an employer who maintains an improved qualified employer retirement plan (other than such a plan which is described in section 401 (d)), there is allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 5 percent of the amount allowable for the taxable year to such employer as a deduction under section 404.

"(b) LIMITATION BASED ON TAX LIABILITY; CARRYOVER OF EXCESS CREDIT.—

"(1) LIMITATION.—The amount of the credit allowed under subsection (a) for the taxable year shall not exceed the liability of the taxpayer for tax under this chapter for the taxable year.

"(2) CARRYOVER OF EXCESS AMOUNT.—If the

amount of the credit determined under subsection (a) for the taxable year exceeds the amount of the limitation imposed by paragraph (1) for such taxable year (hereinafter in this paragraph referred to as the 'unused credit year'), such excess shall be a credit carryover to the taxable year following the unused credit year, and, subject to the limitation imposed by paragraph (1), shall be taken into account under subsection (a) in such following taxable year.

"(c) DEFINITION OF IMPROVED QUALIFIED EMPLOYER RETIREMENT PLAN.—For purposes of this section, the term 'improved qualified employer retirement plan' means a qualified employer retirement plan (as defined in section 221 (c) (3) (A) through (E)) which is certified by the Employee Benefits Commission as an improved plan under section 124 of the ERISA Improvements Act.

"(d) APPLICATION WITH OTHER SECTIONS.—The amount of the deduction allowable under section 404 for any taxable year shall not be reduced because of the allowance of a credit under this section for the taxable year. The credit allowable under subsection (a) for any taxable year shall not be allowed if the taxpayer claims the credit allowable by section 44C for the taxable year.".

(b) CLERICAL AMENDMENT.—The table of sections for such subpart is amended by inserting immediately before the item relating to section 45 the following new item:

"Sec. 44D. Improved qualified employer retirement plan credit.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years and plan years beginning after December 31, 1978.

SEC. 306. DENIAL OF IRA, ETC., BENEFITS TO OWNER-EMPLOYEES; CORPORATE OFFICERS AND SHAREHOLDERS.

(a) IN GENERAL.—

(1) RETIREMENT SAVINGS.—Subsection (b) of section 219 of the Internal Revenue Code of 1954 (relating to limitations and restrictions) is amended by inserting after paragraph (6) of such subsection the following new paragraph:

"(7) No deduction is allowed under subsection (a) in the case of an owner-employee (as defined in section 401 (c) (3)) or an officer or 10 percent or more stockholder directly or indirectly of a corporation.".

(2) RETIREMENT SAVINGS FOR MARRIED INDIVIDUALS.—Subsection (b) of section 220 of such Code (relating to limitations and restrictions) is amended by inserting after paragraph (7) the following new paragraph:

"(8) No deduction is allowed under subsection (a) in the case of an owner-employee (as defined in section 401 (c) (3)) or an officer or 10 percent or more stockholder directly or indirectly of a corporation.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1978.

SEC. 307. RETROACTIVE DISQUALIFICATION OF PLANS.

In the administration of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954, the Secretary of the Treasury shall not treat an employee benefit plan described in section 122 (d) (3) of the ERISA Improvements Act of 1978 as not meeting the requirements of such part for any taxable year or plan year preceding the year in which the Employee Benefits Commission determines that the plan does not meet such requirements unless the Commission has also determined that the failure to meet such requirements in such preceding year was a result of intentional failure or willful neglect on the part of the person or persons maintaining the plan.

TITLE IV—SPECIAL MASTER AND PROTOTYPE PLANS

SEC. 401. SPECIAL MASTER AND PROTOTYPE PLANS.

(a) IN GENERAL.—Subtitle B of title I of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new part:

"PART 6—SPECIAL MASTER AND PROTOTYPE PLANS

"SPECIAL MASTER AND PROTOTYPE PLANS

SEC. 601. (a) For purposes of this section—

"(1) 'special master plan' means a master or prototype individual account employee pension benefit plan which has been approved by the Commission in accordance with subsection (d), all of the assets of which are controlled by one or more investment managers,

"(2) 'investment manager' means an investment manager described in section 3(38) (A) and (B) (without regard to the parenthetical clause) and in the case of an investment adviser to a regulated investment company (as defined in section 851 of the Internal Revenue Code of 1954), shall include the principal underwriter of such investment adviser,

"(3) 'master sponsor' means an investment manager who is the sponsor of a special master plan, and

"(4) 'employer sponsor' means an employer any of whose employees are covered under a special master plan, an association of such employers, or an employee organization, any members of which are covered under such a plan.

"(b) Notwithstanding any other provisions of this Act or the Internal Revenue Code of 1954 to the contrary, in the case of a special master plan—

"(1) except as provided in subsection (e), the responsibilities, duties, and obligations of an employer sponsor under parts 1, 2, 3, and 4 of this title shall be limited to making such timely contributions and payments, and furnishing such timely, complete, and accurate information, as may be required under the terms of the plan; and

"(2) the requirements of sections 401 and 410, 411, 412, 413, and 414 of the Internal Revenue Code of 1954 which are applicable to the plan of the employer sponsor shall be deemed to be initially satisfied as of the date the employer sponsor and master sponsor execute the special master plan joinder.

"(c) Notwithstanding any other provisions of this title or the Internal Revenue Code of 1954 to the contrary, in the case of a special master plan—

"(1) except as provided in subsection (e), the master sponsor shall be the administrator and named fiduciary of each empolyer sponsor's plan for the purposes of this title;

"(2) the requirements of section 102(b), if otherwise satisfied, will not be violated if—

"(A) the plan description includes plan provisions common to the plans of all employer sponsors adopting the special master plan, together with a description of each type of variation from such common provisions that is permitted under the terms of approval by the Commission, and an identification, by name of employer sponsor, employer sponsor identification number, name of plan, and plan identification number, of the employer sponsors who have adopted each such type of variation, and

"(B) the summary plan description of each employer sponsor's plan describes provisions common to the plans of all employer sponsors adopting the special master plan, together with a description of any provisions of such employer sponsor's plan which vary from such common provisions, with appropriate cross-references;

"(3) the requirements of section 103, if otherwise satisfied, will not be violated merely because data in the annual report reflect the aggregate assets of the special master plan, if the annual report also includes an identification, by name of employer sponsor, employer sponsor identification number, name of plan, and plan identification number, of the percentage of total special master plan assets attributable to each employer sponsor's plan;

"(4) (A) the exemption described in section 408 (b) (2) shall be applied as if any investment manager sponsoring a special master plan and any investment manager providing services to such a plan were a party in interest respecting such plan for a reason other than by virtue of such investment manager's being a fiduciary, and

"(B) the term 'bank or similar financial institution's in section 408 (b) (6) shall be deemed to mean any investment manager who is a master sponsor, and the term 'sound banking and financial practice' in such section shall, in the case of an investment manager other than a bank, be deemed to mean 'sound fiduciary practice';

"(5) no master sponsor shall have a responsibility, obilgation, or duty under sections 404 or 405—

"(A) to ascertain whether information required to be furnished to the master sponsor by an employer sponsor pursuant to the terms of a special master plan is accurate or complete, or

"(B) due to the failure of an employer sponsor to satisfy the requirements of subsection (b) (1); and

"(6) the special master plan shall be deemed to be the employee benefit plan referred to in section 503, and the term 'person' in section 504 shall not be deemed to exclude any investment manager, master sponsor or employer sponsor described in subsection (a).

"(d) (1) The Commission shall prescribe such regulations, and furnish such rulings, opinions, forms, and other types of guidance as are necessary to implement this section. To the greatest extent consistent with the purposes of this Act, such regulations and other types of guidance shall be designed to facilitate the establishment of special master plans and their adoption by employer sponsors.

"(2) The Commission shall approve a special master plan only if it determines that the plan of an adopting employer sponsor, in design and in operation, will satisfy the requirements of this section, other applicable requirements of this Act, the requirements of section 401 of the Internal Revenue Code of 1954 (to the extent that such Act and Code are not inconsistent with this section).

"(3) Approval of special master plans and amendments to such plans shall be accomplished by a process carried out in the national office of the Commission, until such time as the Commission may establish procedures for field office approval under which uniformity of treatment by field offices is assured.

"(4) Upon approval by the Commission of a special master plan, or of any amendment to such a plan for which approval is required, a special master plan certificate shall be issued to the master sponsor by the Commission. Except as provided in paragraph (5), for a period of 60 months from the date of adoption of the plan by an employer sponsor or from the effective date of an amendment for which approval is required, a duly notorized copy of such certificate shall be prima facie evidence in any administrative or judicial proceeding that the terms of the plan meet the requirements of this section, this title, and the requirements of sections 401, 410, 411, 412, 413 and 414 of the Internal Revenue Code of 1954.

"(5) The Commission, after notice and hearing, shall revoke the certificate described in paragraph (4)—

"(A) respecting the plan of any employer sponsor, if the Commission finds that there has been a failure on the part of the employer sponsor to observe the terms of the plan and that such failure has been detrimental to the rights of any plan participant under the terms of the plan or this title, and

"(B) respecting the special master plan, if the Commission finds that there has been a failure to observe the terms of the plan or the provisions of this section on the part of the master sponsor and that such failure has been detrimental to the rights of plan participants under the terms of the plan or this title.

"(6) Upon the request of a master sponsor, the certificate issued by the Commission upon the approval of a special master plan, or upon the approval of an amendment to such a plan for which approval is required, shall specify those plan amendments or types of amendments for which, in the discretion of the Commission, approval need not be obtained.

"(7) The Commission shall study the feasibility of permitting defined benefit special master plans and shall report to the Congress regarding such study not later than 36 months after the effective date of this section.

"(e) Any employer sponsor who fails to make such timely contributions and payments or who fails to furnish such timely, complete and accurate information as may be required under the terms of a special master plan shall, in accordance with the terms of such plan, be deemed to be the plan administrator of the plan (to the extent the plan covers the employees of such employer sponsor), as of the time, not earlier than the date of such failure, specified in such plan, and as of such specified date the master sponsor shall cease to be the administrator and named fiduciary of such employer sponsor's plan.".

(b) The table of contents for the Employee Retirement Income Security Act of 1974 is amended by inserting immediately after the item relating to section 514 the following:

(c) The amendments made by this section shall take effect 18 months after the date of enactment of this Act.

95TH CONGRESS
1ST SESSION

S. 901

IN THE SENATE OF THE UNITED STATES

MARCH 3 (legislative day, FEBRUARY 21), 1977

Mr. BENTSEN introduced the following bill; which was read twice and referred jointly to the Committees on Finance and Human Resources

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A BILL

To make it easier to comply with certain Federal employee benefit plan requirements by amending the Internal Revenue Code of 1954 and the Employee Retirement Income Security Act of 1974 to eliminate dual Treasury and Labor Department jurisdiction over certain requirements, to reduce the number of reports and other paperwork required thereunder, and for other purposes.

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

SECTION 1. SHORT TITLE.

This Act may be cited as the "Pension Simplification Act".

VII—O

SEC. 2. TERMINATION OF LABOR DEPARTMENT'S JURISDICTION OVER PARTICIPATION, VESTING, AND FUNDING.

(a) PARTICIPATION, VESTING, AND FUNDING.—Subtitle B of title I of the Employee Retirement Income Security Act of 1974 is amended by striking out part 2 (relating to participation and vesting) and part 3 (relating to funding).

(b) YEAR OF SERVICE REGULATIONS.—Section 410 (a) (3) of the Internal Revenue Code of 1954 (relating to definition of year of service) is amended by striking out "of Labor" wherever it appears.

(c) CLERICAL AMENDMENT.—The table of contents of such Act is amended by striking out the items relating to part 2 and part 3.

SEC. 3. TERMINATION OF TREASURY DEPARTMENT'S JURISDICTION OVER PROHIBITED TRANSACTIONS.

(a) IN GENERAL.—Chapter 43 of the Internal Revenue Code of 1954 (relating to qualified pension, etc., plans) is amended by striking out section 4975.

(b) CLERICAL AMENDMENT.—The table of sections for such chapter is amended by striking out the item relating to section 4975.

SEC. 4. AUTHORITY TO REQUIRE REPORTS.

(a) IN GENERAL.—Section 103 of the Employee Retirement Income Security Act of 1974 (relating to annual reports) is amended to read as follows:

"REPORTS

"SEC. 103. The Secretary may require employee benefit plans to which this part applies to file such reports as he determines are necessary to carry out the policy declared in section 2 of this Act. The Secretary may require such plans to furnish or make available for inspection copies or summaries of reports and other information required under this section to participants and beneficiaries.".

(b) REPEAL OF CERTAIN SPECIFIC REPORTING REQUIREMENTS.—Section 104(a)(1) of such Act (relating to filing with Secretary and furnishing information to participants) is amended—

(1) by inserting "and" after the semicolon in subparagraph (A);

(2) striking out the semicolon in subparagraph (B) and inserting in lieu thereof a period;

(3) by striking out subparagraphs (C) and (D); and

(4) by striking out ", summary plan descriptions," in the second sentence.

(c) CLERICAL AMENDMENT.—The table of contents of such Act is amended by striking out the item relating to section 103 and inserting in lieu thereof the following:

"Sec. 103. Reports.".

SEC. 5. CIVIL ENFORCEMENT ACTIONS BY TREASURY DEPARTMENT.

Section 3002 of the Employee Retirement Income Security Act of 1974 (relating to procedures with respect to continued compliance with requirements relating to participation, vesting, and funding standards) is amended to read as follows:

"(e) The Secretary of the Treasury may bring a civil action to enforce compliance by a plan or a trust with the requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954. Such an action is in addition to any procedures available to the Secretary under such Code for such purpose.".

SEC. 6. NOTIFICATION OF JUSTICE AND LABOR DEPARTMENTS BY TREASURY DEPARTMENT OF PROHIBITED TRANSACTION VIOLATIONS; SINGLE ANNUAL REPORT FOR BOTH DEPARTMENTS.

Section 3004 of the Employee Retirement Income Security Act of 1974 (relating to coordination between the Department of the Treasury and the Department of Labor) is amended by adding at the end thereof the following new subsections:

"(c) Whenever the Secretary of the Treasury knows or has reason to believe that a violation of section 406 of this Act has occurred, he shall notify the Attorney General and the Secretary of Labor.

"(d) Within 60 days after the date of enactment of the Pension Simplification Act, the Secretary of the Treasury and the Secretary of Labor, acting jointly, shall prescribe a single form and a single annual filing date for employee benefit plans (as defined in paragraph (3) of section 3 of this Act) which will satisfy the requirements of both section 103 of this Act and sections 6057 and 6058 of the Internal Revenue Code of 1954.".

SEC. 7. DECLARATORY JUDGEMENTS.

Section 2201 of title 28, United States Code (relating to creation of declaratory judgment remedy) is amended—

(1) by inserting "(a)" immediately before the first word of text of such section, and

(2) by adding at the end of such section the following new subsection:

"(b) For purposes of this section a failure by the Secretary of Labor, the Secretary of the Treasury, or the Pension Benefit Guaranty Corporation to issue or deny a determination or ruling or to take any other action with respect to an employee benefit plan (as defined in paragraph (3) of section 3 of the Employee Retirement Income

Security Act of 1974) within 180 days after such determination, ruling, or other action is requested—

"(1) shall be considered to constitute an actual controversy, and

"(2) shall not be considered to be a controversy with respect to Federal taxes

if it involves an issue arising under the Employee Retirement Income Security Act of 1974 of part I of subchapter D of chapter 1, or under chapter 43, of the Internal Revenue Code of 1954.".

SEC. 8. TECHNICAL AND CONFORMING AMENDMENTS.

(a) AMENDMENT OF EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.—

(1) Section 3 of the Employee Retirement Income Security Act of 1974 is amended by striking out paragraphs (22), (25), (28), (30), and (31).

(2) Subsection (i) of section 502 of such Act is amended to read as follows:

"(i) (1) In the case of a transaction prohibited by section 406 by a party in interest with respect to a plan to which this part applies, the Secretary may assess an initial civil penalty against such party of not more than 5 percent of the amount involved. If the transaction is not corrected (in such manner as the Secretary may prescribe by regulation) within 90 days after notice from the Secretary (or such longer period as the Secretary may permit), the Secretray may assess an additional civil penalty of not more than 100 percent of the amount involved.

"(2) For purposes of this subsection, the term 'amount involved' means, with respect to a prohibited transaction, the greater of—

"(A) the amount of money and the fair market value of the other property given, or

"(B) the amount of money and the fair market value of the other property received,

except that, in the case of services described in section 408 (b) (2) or (c) (2), the amount involved shall be only the excess compensation.

"(3) The fair market value—

"(A) for the purpose of assessing the initial civil penalty, shall be determined as of the date on which the prohibited transaction occurs, and

"(B) for the purpose of assessing the additional civil penalty, shall be the highest fair market value during the period granted by the Secretary for correction of the transaction.".

(3) Sections 2003 and 3003 of such Act are repealed, section 3004 of such Act is redesignated as section 3003, and the table of contents of such Act is amended—

(A) by striking out the items relating to sections 2003 and 3003, and

(B) by striking out "Sec. 3004." in the item relating to section 3004 and inserting in lieu thereof "Sec. 3003.".

(4) Section 3022 (a) (4) of such Act is amended by striking out "section 4975 (e) (7)" and inserting in lieu thereof "section 414 (m)".

(5) Section 4042 (d) (3) of such Act is amended by striking out "and under section 4975 (e) of the Internal Revenue Code of 1954", and by striking out "and of such section 4975".

(b) AMENDMENT OF THE INTERNAL REVENUE CODE OF 1954.—

(1) Section 401 (a) (13) of the Internal Revenue Code of 1954 is amended by striking out the third sentence and inserting in lieu thereof the following: "For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt, under section 408 (b) (1) of the Employee Retirement Income Security Act of 1974, from the prohibitions imposed by section 406 of that Act.".

(2) Section 408 (e) (2) (A) of such Code is

amended by striking out "section 4975" and inserting in lieu thereof "section 406 of the Employee Retirement Income Security Act of 1974".

(3) Section 414 (k) of such Code is amended—

(A) by inserting "and" at the end of paragraph (1),

(B) by striking out ", and" at the end of paragraph (2) and inserting in lieu thereof a period, and

(C) by striking out paragraph (3).

(4) Section 414 of such Code is amended by adding at the end thereof the following new subsection:

"(m) EMPLOYEE STOCKOWNERSHIP PLAN.—The term 'employee stockownership plan' means a defined contribution plan—

"(1) which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401 (a), and which are designed to invest primarily in qualifying employer securities; and

"(2) which is otherwise defined in regulations prescribed by the Secretary.

For purposes of this subsection, the term 'qualifying employer security' means an employer security which is stock or otherwise an equity security, or a bond, debenture, note, or certificate or other evidence of indebtedness which is described in paragraphs (1), (2), and (3) of section 503 (c).".

(5) Section 415 (c) (6) (B) of such Code is amended—

(A) by striking out "section 4975 (e) (7)" each place is appears and inserting in lieu thereof "section 414 (m)", and

(B) by striking out "section 4975 (e) (8)" in clause (ii) and inserting in lieu thereof "such section".

(6) Section 503 (a) (1) (B) of such Code is amended by striking out "referred to in section 4975 (g) (2) or (3)" and inserting in lieu thereof the following: "a governmental plan (within the meaning of section 414 (d)) or a church plan (within the meaning of section 414 (e)) with respect to which the election provided by section 410 (d) has not been made.".

(7) Section 1504 (a) of such Code is amended by striking out "section 4975 (e) (8)" and inserting in lieu thereof "section 414 (m)".

(8) Section 6213 (e) of such Code is amended—

(A) by striking out ", 4975 (relating to excise taxes on prohibited transactions)", and

(B) by striking out "4971 (c) (3), or 4975 (f) (4)" and inserting in lieu thereof "or 4971 (c) (3)".

(9) Section 6503 (g) of such Code is amended—

(A) by striking out "or section 4975", and

(B) by striking out "4971 (c) (3), or 4975 (f) (4)" and inserting in lieu thereof "4971 (c) (3)".

(10) Section 7422 (g) of such Code is amended—

(A) by striking out "4971, or 4975" each place it appears and inserting in lieu thereof "or 4971",

(B) by striking out "4975 (a) (relating to initial tax on prohibited transactions)," in subsection (a),

(C) by inserting "or" before "section 4971 (b)" in subsection (a), and

(D) by striking out "or section 4975 (b) (relating to additional tax on prohibited transactions)".

(c) AMENDMENT OF OTHER ACTS.—

(1) Section 273 (f) (5) (A) of the Trade Act of 1974 is amended by striking out "section 4975 (e) (7)" and inserting in lieu thereof "section 414 (m)".

(2) Section 301 (d) (2) (C) of the Tax Reduction

Act of 1975 is amended by striking out "section 4975 (e) (7)" and inserting in lieu thereof "section 414 (m)".

SEC. 9. TECHNICAL AND CONFORMING CHANGES.

The Secretary of the Treasury shall, as soon as practicable but in any event not later than 90 days after the date of enactment of this Act, submit to the Committee on Ways and Means of the House of Representaives and to the Committee on Finance of the Senate a draft of any technical and conforming changes in the Internal Revenue Code of 1954 and the Employee Retirement Income Security Act of 1974 which are necessary to reflect throughout such Code and Act the changes in the substantive provisions of law made by this Act.

SEC. 10. EFFECTIVE DATE.

The amendments made by this Act, other than the amendment made by section 5, take effect 90 days after the date of enactment of this Act.

95TH CONGRESS
2D SESSION

S. 2992

IN THE SENATE OF THE UNITED STATES

APRIL 26 (legislative day, APRIL 24), 1978

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

A BILL

To amend the Internal Revenue Code of 1954 to provide uniform accounting of pension liabilities of tax-exempt pension funds.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 412 of the Internal Revenue Code of 1954 is amended by adding the following new subsection (j):

"(j) UNIFORM ACCOUNTING.—Within 90 days of the date of enactment of this subsection, the Secretary shall promulgate uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions used in such calculations.",

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95TH CONGRESS
2D SESSION

S. 3193

IN THE SENATE OF THE UNITED STATES

JUNE 12 (legislative day, MAY 17), 1978

Mr. BENTSEN introduced the following bill; which was read twice and referred to the Committees on Finance and Human Resources jointly by unanimous consent

A BILL

To amend the Internal Revenue Code of 1954 and the Employee Retirement Income Security Act of 1974 to simplify paperwork requirements and streamline enforcement.

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

SECTION 1. SHORT TITLE.

This Act may be cited as the "ERISA Paperwork Reduction Act".

SEC. 2. REQUIREMENT FOR A DETERMINATION LETTER.

Section 6057 of the Internal Revenue Code of 1954 (relating to registration of and information concerning pension, etc. plans) is amended by redesignating subsection (g) as (h) and adding the following new subsection (g)

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"(g) DETERMINATION LETTER.—Pursuant to regulations promulgated by the Secretary, in order for a plan to qualify under section 401, the plan must obtain a determination letter from the Secretary granting qualification.".

SEC. 3. CONSOLIDATED FORM FOR INITIAL QUALIFICATION.

Subtitle A of title III of the Employee Retirement Income Security Act of 1974 (relating to jurisdiction, administration, and enforcement) is amended by adding at the end of section 3004 the following new subsection (c):

"(c) Within 60 days after the date of enactment of the ERISA Paperwork Reduction Act, the Secretary of the Treasury and the Secretary of Labor, acting jointly, shall prescribe a single form for employee benefit plans (as defined in paragraph (3) of section 3 of this Act) which will satisfy the requirements of section 102(a)(2) of this Act and of the initial qualification requirements of the internal Revenue Code of 1954.".

SEC. 4. CONSOLIDATED ANNUAL REPORTS.

Section 103 of the Employee Retirement Income Security Act of 1974 (relating to annual reports) is amended to read as follows:

"ANNUAL REPORTS

"SEC. 103. (a) PERIODIC ANNUAL REPORTS.—Subject to the limitations in subsections (b) and (c), the Secretary of the Treasury and the Secretary of Labor shall require employee benefit plans to which this part applies to file every 5 years a single annual report with the Secretary of the Treasury to carry out the policy declared in section 2 of this Act and to satisfy the requirements of sections 6057 (a) and 6058 (a) of the Internal Revenue Code of 1954. The Secretaries may require such plans to furnish or make available to participants and beneficiaries for inspection copies of summaries of reports and other information required under this section.

"(b) SIMPLIFIED ANNUAL REPORT.—For years when a full report under subsection (a) is not required, the Secretary of the Treasury and the Secretary of Labor are directed to prescribe a simplified annual report which could be incorporated with the tax return of the sponsor of the plan.

"(c) STAGGERED FILING.—The Secretary of the Treasury and the Secretary of Labor are directed to stagger filing of the annual reports required under subsection (a) so that only 20 percent of existing plans would file such reports each year.".

SEC. 5. TREASURY AND LABOR DEPARTMENT BOOKLET.

Subtitle A of title III of the Employee Retirement Income Security Act of 1974 (relating to jurisdiction, administration, and enforcement) is amended by adding at the end of section 3004 the following new subsection (d):

"(d) Within 60 days of enactment of the ERISA Paperwork Reduction Act, the Secretary of the Treasury and the Secretary of Labor shall publish a booklet to assist plan sponsors (particularly smaller businessmen) in developing or revising recordkeeping systems in order to simplify compliance with the provisions of this Act.".

SEC. 6. TECHNICAL AND CONFORMING CHANGES.

The Secretary of the Treasury and the Secretary of Labor shall, as soon as practicable but in any event not later than 60 days after the date of the enactment of this Act, submit to the Congress a draft of any technical and conforming changes in the Internal Revenue Code of 1954, and the Employee Retirement Income Security Act of 1974, respectively, which are necessary to reflect throughout such Code and Act the changes in the substantive provisions of law made by this Act.

95TH CONGRESS
1ST SESSION

S. 1745

IN THE SENATE OF THE UNITED STATES

JUNE 22 (legislative day, MAY 18), 1977

Mr. MCINTYRE (for himself and Mr. NELSON) introduced the following bill; which was read twice and referred to the Committees on Finance and Human Resources jointly by unanimous consent

A BILL

To amend the Employee Retirement Income Security Act of 1974 to implement certain recommendations of the Commission on Federal Paperwork with respect to such Act, to facilitate the establishment of employee retirement plans by small businesses, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "ERISA Small Business Paperwork Reduction and Investment Act".

SEC. 2. SINGLE ANNUAL REPORT.

Within 60 days after the date of enactment of this Act, the Secretary of the Treasury and the Secretary of Labor, acting jointly, shall prescribe a single form and a single

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annual filing date for employee benefit plans (as defined in paragraph (3) of section 3 of the Employee Retirement Income Security Act of 1974) which will satisfy the requirements of both section 103 of that Act and sections 6057 and 6058 of the Internal Revenue Code of 1954.

SEC. 3. COORDINATION BETWEEN INTERNAL REVENUE SERVICE, DEPARTMENT OF LABOR, AND PENSION GUARANTY CORPORATION WITH RESPECT TO THE GATHERING OF CERTAIN INFORMATION.

Section 3004 of the Employee Retirement Income Security Act of 1974 (relating to coordination between the Department of the Treasury, the Department of Labor, and the Pension Benefit Guaranty Corporation) is amended by adding at the end thereof the following new subsection:

"(c) The Secretary of the Treasury, the Secretary of Labor, and the Executive Director of the Pension Benefit Guaranty Corporation shall enter into an agreement within 180 days after the date of enactment of the ERISA Small Business Paperwork Reduction and Investment Act under which one agency, but not all three, shall collect the information required to be submitted under sections 103 and 104 (a) (1) (B), section 3001, and title V of this Act and under sections 6057 and 6058 of the Internal Revenue Code of 1954 and transmit that information which is within the administrative responsibility of the other agencies to the appropriate officials of the Department of Labor, the Department of the Treasury, or the Pension Benefit Guaranty Corporation, as may be appropriate. The Secretaries and the Executive Director shall also explore the feasibility of having only one agency collect information similar to the information reported for 1976 on Internal Revenue forms 5498, 5499, 5501, 5504, and 5505.".

SEC. 4. SIMPLIFIED STATEMENTS OF ACCRUED BENEFITS OF BENEFICIARIES.

Paragraph (3) of section 104(b) of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"(3) Within 210 days after the close of the fiscal year of the plan, the Administrator shall furnish to each participant, and to each beneficiary receiving benefits under the plan a simplified statement of—

"(A) in the case of a plan which is a defined contribution plan (as determined by the Secretary)—

"(i) the account balance at the beginning of the year, for the participant or beneficiary,

"(ii) the amount of contributions made on his behalf during the year,

"(iii) any forfeiture allocated to his account,

"(iv) the amount of profit or loss allocated to his account, "(v) the account balance at the end of the year,

"(vi) the amount of his vested benefits, and

"(vii) a statement of any loans which may have accrued against his account;

"(B) in the case of a plan which is a defined benefit plan—

"(i) a statement with respect to current benefits under the plan,

"(ii) a statement as to future benefits anticipated under the plan, and

"(iii) a statement by the employer that the employer is required by law to fund the benefits under the plan and that he is using acceptable actuarial assumptions in doing so; and

"(C) for all plans—

"(i) where and how additional information may be obtained, and

"(ii) what assistance in connection with the plan is available from the Department of Labor and other sources."

SEC. 5. SMALL BUSINESS REPRESENTATION ON ADVISORY COUNCIL.

(a) Subsection (a) of section 512 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1142) is amended—

(1) by striking out "fifteen members" in paragraph (1) and inserting in lieu thereof "sixteen members", and

(2) by inserting after "pension plan;" the following: "at least one of whom shall be a representative of small businesses sponsoring plans or small businesses rendering services predominantly to such small business plans;"

(b) Subsection (b) of such section is amended—

(1) by inserting "and the Executive Director of the Pension Benefit Guaranty Corporation" after "the Secretary" each place it appears, and

(2) by inserting after "this Act" the following: ", and the Secretary of the Treasury with respect to the carrying out of his functions under part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954,".

(c) Subsection (c) of such section is amended by inserting immediately after the first sentence thereof the following: "Beginning in 1978, the executive secretary shall be furnished to the Council in even-numbered years by the Secretary of the Treasury.".

SEC. 6. CERTAIN STUDIES.

The Secretary of Labor shall consult with the Internal Revenue Service and the Commission on Federal Paperwork or its successor, if any, for the purpose of exploring the feasibility of implementing the Commission's recommendations numbers 13 and 14 contained in the report by the Commission of December 3, 1976, on the Employee Retirement Income Security Act of 1974.

SEC. 7. DELAY IN ACTING UPON REQUESTS.

If a business applicant for an exemption, waiver, or other administrative action under the Employee Retirement Income Security Act of 1974, or under those provisions of the Internal Revenue Code of 1974 relating to employee benefit plans, has not received a determination thereon postmarked within 180 days of its submission to the agency concerned, such applicant will be held harmless from any penalty or other adverse governmental action as a result of acting in accordance with such request for the period beginning 180 days after submission and extending for one calendar year thereafter.

SEC. 8. PROGRESS REPORT.

The Secretary of Labor and the Secretary of the Treasury shall report jointly to the Congress on their progress in carrying out sections 2 through 7 of this Act within 180 days of the date of enactment.

SEC. 9. CERTAIN MODIFICATIONS IN THE PRUDENT MAN RULE.

Paragraph (1) of section 404(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1104) is amended—

(1) by inserting after "their beneficiaries" the following: "over the long term, taking account of the necessity of improving the productivity of the economy of the United States and its international competitiveness and its capacity to sustain the real income value of future retirement benefits to beneficiaries of the plan", and

(2) by inserting after "with like aims" the following: "noting the special character of such plans as set forth in the text of this section preceding subparagraph (A)".

SEC. 10. ADDITIONAL CONSIDERATIONS AND STATUTORY DUTIES.

Section 409 of the Employee Retirement Income Security Act of 1974 is amended by inserting after "each such breach," the following: "(taking into account the policy set forth in section 404 (a) of this Act)".

SEC. 11. APPLICATION OF PRUDENT MAN RULE TO DEFINED BENEFIT PLANS.

Section 404 (a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1142) is amended by adding the following new paragraph:

"(3) In the case of defined benefit plan, as defined in section 3(35), the prudence requirement of paragraph (1)(B) is not violated solely because an investment may be in a venture capital organization or in a smaller business.".

95TH CONGRESS
1ST SESSION

S. 1383

IN THE SENATE OF THE UNITED STATES

APRIL 26 (legislative day, FEBRUARY 21), 1977

Mr. INOUYE (for himself and Mr. MATSUNAGA) introduced the following bill; which was read twice and referred to the Committee on Human Resources

A BILL

To amend the Employee Retirement Income Security Act of 1974 to clarify the status of the Hawaiian Prepaid Health Care law under title I and title IV of such Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That paragraph (3) of section 4 (b) of the Employee Retirement Income Security Act of 1974 is amended by striking out "or unemployment compensation or disability insurance laws" and inserting in lieu thereof the following: ", or unemployment compensation laws, or disability or health insurance laws".

II

95TH CONGRESS
1ST SESSION

S. 250

IN THE SENATE OF THE UNITED STATES

JANUARY 14, 1977

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

A BILL

To amend title I of the Employee Retirement Income Security Act of 1974, and the Internal Revenue Code of 1954 to prohibit the reduction of disability payments under employer-maintained disability compensation plan whenever certain social security benefit payments are increased.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 206(b) of the Employee Retirement Income Security Act of 1974 is amended by striking out "pension plan" in paragraph (1) and inserting in lieu thereof "employee welfare benefit plan".

SEC. 2. (a) Section 264 of the Internal Revenue Code of 1954 (relating to certain amounts paid in connection with

II

insurance contracts) is amended by adding at the end thereof the following new subsection:

"(d) CERTAIN DISABILITY COMPENSATION PLANS.—Notwithstanding the provisions of sections 162, 212, and 404, no deduction is allowed for amounts paid or contributed to or under a disability compensation plan by the employer maintaining that plan if under the plan the benefits payable to an individual receiving benefits under the plan are reduced, or any schedule increase in such benefits is omitted, on account of any increase in monthly insurance benefits to which such an individual is entitled under title II of the Social Security Act if such increase occurs after such individual begins to receive benefits under such plan. For purposes of this subsection, the term 'disability compensation plan' means a program (including a program of insurance) established by an employer under which employees receive periodic payments or a lump-sum payment in compensation for physical or mental disability resulting from their employment.".

(b) (1) The caption of section 264 of such Code is amended by inserting after "CONTRACTS" the following: "OR UNDER CERTAIN DISABILITY COMPENSATION PLANS".

(2) The table of sections for part IX of subchapter B of chapter 1 of such Code is amended by striking out the

item relating to section 264 and inserting in lieu thereof the following:

> "Sec. 264. Certain amounts paid in connection with insurance contracts or under certain disability compensation plans.".

SEC. 3. The amendment made by the first section of this Act applies to plan years beginning after the date of enactment of this Act. The amendment made by section 2 applies to taxable years beginning after the date of enactment of this Act.

Senator WILLIAMS. As I mentioned, we are in joint hearing with the subcommittee of the Finance Committee that handles pension matters.

Senator Javits and I are very pleased to have this opportunity with Senator Bentsen and would certainly like to extend at this opening the opportunity for Senator Bentsen to express himself.

OPENING STATEMENT OF SENATOR BENTSEN

Senator BENTSEN. Thank you very much, Senator Williams.

Last week President Carter sent a reorganization proposal to Congress to help eliminate duplicate implementation of the pension reform law. This proposal is very similar to my bill (S. 2352) which was approved by the Senate Finance Committee last year. The President's proposal will more carefully allocate jurisdiction between the Treasury and Labor Departments helping prevent inconsistent rulings and unreasonable regulatory delays. Administrative reorganization is only one step, though, in the process of streamlining pension laws. In addition, the law must be amended to eliminate unnecessary and execessively complex government forms.

A study prepared earlier this year for the Joint Economic Committee puts the cost of Federal regulation to business, consumers and taxpayers at over $100 billion a year. In 1955 some 10,000 pages were published each year in the Federal Register. By 1970, 15 years, that number had doubled to 20,000. But by 1977, the number of pages in the Federal Register had mushroomed to 70,000!

It is essential that Congress make every effort to reduce the costs of complying with Federal regulations. Unnecessary Federal redtape and regulation drains our economy and adds to inflation. This is true with respect to ERISA, the Employee Retirement Income Security Act, as well as other Federal programs. Congress can provide greater protection to senior citizens by simplifying ERISA and strengthening enforcement of the law.

Our subcommittees have conducted an extensive study of the issue of pension simplification over the past year and one-half through public hearings and the formulation of many legislative proposals. We have worked closely with the Departments of Treasury and Labor. There is great similarity between our pension simplification proposals. The purpose of the hearings this week is to enable us to refine these proposals and prepare a joint Finance Committee-Human Resources Committee bill to present to the full Senate for speedy approval next month. I am confident that we can formulate such a bill which has the full support of the Treasury and Labor Departments.

Last April the General Accounting Office issued a report on the impact of ERISA. This report concluded that ERISA has made a major contribution in providing greater retirement security for tens of millions of American workers and retirees.

The GAO report stated:

> Overall, the minimum participation, vesting and funding standards and other provisions of ERISA should enhance responsible management of new and continuing plans and give tens of millions of workers a better chance to earn and receive vested benefits without having to work a unreasonable number of years and reach an unreasonable age. In addition, we believe that clarifying ERISA

requirements and reducing burdens on plan administrators should be a continuing goal of the three agencies. However, a reduction in administrative burden should not be accomplished by compromising participant protection.

ERISA simplification legislation will strengthen our private retirement system and provide greater protection to senior citizens.

Everybody recognizes that ERISA has created unintended governmental paperwork and redtape. Excessive costs for administering a pension plan simply mean that employers will have less funds available to provide benefits for the plan participants. Duplicate paperwork, inconsistent regulations and long regulatory delays in the implementation of ERISA are harmful to pension plan participants, employers, and unions as well as Government regulators. Failure of Congress to address this problem this year will be simply inexcusable.

The Departments of Treasury and Labor have taken numerous administrative actions to reduce paperwork under ERISA and the President submitted a reorganization proposal to Congress. I applaud these actions which will help strengthen our private retirement system.

However, additional legislation is clearly needed.

Congress should adopt a cyclical annual reporting system to simplify the annual pension report (Form 5500) and to strengthen and enforce ERISA audits.

The summary annual report (SAR) should be eliminated. This report has not been of much value to pension plan participants.

Form EBS-1 should be abolished. Pension plan participants and Federal agencies receive sufficient information through the annual pension report and the summary plan description (SPD).

Employers should be given the option to participate in special master plans or pooled pension arrangements. This would reduce the costs of administering pension plans, particularly for small employers.

SEC enforcement of ERISA should be limited. The Treasury and Labor Departments are fully capable of enforcing the minimum pension standards established by ERISA.

The Secretary of Labor should be directed to promulgate uniform standards for reporting pension assets and liabilities and for disclosing actuarial assumptions used in such calculations.

The pension advisory councils which cost taxpayers hundreds of thousands of dollars should be absolished. If we are ever going to balance the budget, every congressional committee must reduce unnecessary expenditures within its area of jurisdiction.

The purpose of these three mornings of hearings is to formulate a constructive pension simplification bill to strengthen our private retirement system.

Thank you very much.

[Senator Bentsen's analysis of pension simplification bills follows:]

**PENSION SIMPLIFICATION BILLS
INTRODUCED BY
SENATOR LLOYD BENTSEN**

**(S. 2352) ERISA Reorganization and
Paperwork Reduction**

1. Overlapping Jurisdiction -- S. 2352 proposes a careful allocation of pension jurisdiction between the Departments of Labor and Treasury in line with the original Senate version of ERISA which passed the Senate in 1973 by a vote of 93-0. S. 2352 was unanimously approved by the Senate Finance Committee in 1977.

Under S. 2352, the Internal Revenue Service (IRS) would be given exclusive jurisdiction over the areas of vesting, funding and participation while the Labor Department would be given exclusive jurisdiction over the areas of fiduciary responsibility and prohibited transactions. The Pension Benefit Guaranty Corporation which is within the Labor Department would continue to implement the termination insurance program. Today most of the vesting, funding and participation requirements under ERISA are already administered by IRS and thus the IRS is clearly the most appropriate agency to have exclusive jurisdiction over these particular standards. Similarly, because the Labor Department has been the primary enforcement agency for prohibited transactions and fiduciary responsibility under ERISA, the Labor Department should have exclusive jurisdiction over that portion of the law.

2. Single Annual Form With a Single Filing Date -- Under the legislation, the Secretary of the Treasury and the Secretary of Labor will be directed to formulate to the maximum extent feasible, a single annual form with a single filing date which must be filed with the IRS every year by pension plans. Of course, different types of forms can be prepared for different types of retirement plans. However, pension plans will generally be required to file only one form annually with the federal government. A copy of this form would then be made available to the Department of Labor. Separate annual forms by the IRS, Labor Department and the Pension Benefit Guaranty Corporation are generally unnecessary and impose an unfair time and cost burden on businesses and unions throughout the nation.

"Pension Simplification Bills"
Page 2

3. Summary Plan Description -- As recommended by the Commission on Federal Paperwork, Section 104(a)(1)(C) of ERISA would be amended to eliminate the requirement that a five year summary plan description be filed with the Department of Labor. A December, 1976 report of the Paperwork Commission stated --

> "Employers must provide a summary plan description to each employee every five years. ERISA Section 104(a)(1)(C) requires the administrator of a plan to file with the Secretary of Labor a copy of the summary plan description at the same time that it is furnished to participants and beneficiaries.
>
> "The purpose of this provision of the statute was to permit the DOL to review and compare the summaries with the complete plan descriptions to assure their completeness, accuracy, understandability, etc. Such reviews are costly, duplicative, and practically impossible to perform, considering time and budget constraints.
>
> "Because DOL receives a copy of the complete plan description and any amendments thereto, it is totally duplicative to forward copies of the five year summary plan descriptions to the agency. Discussions with DOL personnel indicate that they do not use such filings, and that the costs of storage could be avoided."

4. Notice of Plan Amendments -- As recommended by the Commission on Federal Paperwork, Section 104(a)(1)(D) would be amended to permit notices of amendments to be filed in connection with the annual report rather than as a separate report which currently is required within sixty days of a plan change. The December, 1976 report of the Commission of Federal Paperwork stated --

> "In view of the fact that employees are notified of changes in their plans, that an annual report containing the same information also must be filed with DOL and IRS, and that there is no spedific use for the data in the amended EBS-1, it is believed that a notice of amendment filed with the annual report should replace filing of an EBS-1 sixty days after each amendment. This would not change the requirement to notify participants of plan changes, nor would it have any effect on the employer's decision to seek a determination of tax status from the IRS."

5. Annual Reports -- The long "laundry list" of specific information which must be included in annual reports of pension plans pursuant to Section 103 of ERISA would be repealed. Section 103 of ERISA is a six page detailed list of reporting requirements, some of which are not necessary for all plans. Instead, the Secretaries of Labor and Treasury would be given discretion to require only such information as is needed to protect the rights of pension plan participants and beneficiaries.

(S. 3193) Cyclical and Simplified Annual Pension Report

1. Tax-qualified pension plans would be required to obtain so-called determination letters from the Internal Revenue Service at the time a plan is created. Most plans already obtain this letter and all plans must file a form with the federal government when the plan is established anyway. Thus, this proposal would not result in any additional reporting.

2. Form EBS-1 which is submitted to the Labor Department would be consolidated with the initial qualification forms that are submitted to IRS. This would reduce duplicate paperwork at the time a plan is established without denying the federal government information necessary to enforce ERISA.

3. The annual report (Form 5500) which must be filed with the federal government every year under ERISA would only have to be filed every five years. In other years, plans would file a simplified annual report which could be incorporated with the plan sponsor's tax return.

4. The full annual reports would be filed on a staggered basis with only 20 percent of the plans filing in any one year.

5. The Departments of Labor and Treasury would be directed to formulate a booklet or guide to assist small businessmen in complying with ERISA.

(S. 2992) Pension Accounting

S. 2992 would direct the Secretary to promulgate uniform standards for reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions.

The presentation of actuarial and accounting information is often so confusing that the information can be worthless. There is so much latitude in the way pension calculations are performed that companies can come up with virtually any level of contributions and liabilities they choose.

(S. 3140) Option For A Combination Keogh-IRA Plan

This bill would give smaller businessmen the option to create a greatly simplified retirement plan with very little paperwork or red tape. The bill would enable employers to establish a pension plan which combines the best features of the so-called Keogh or H.R. 10 plans for the self-employed with the best features of the individual retirement account (IRA). Under the proposal for a simplified pension plan, businessmen would make contributions up to the annual $7,500 Keogh limitation but these contributions would be made directly into separate individual retirement accounts for each employee. The minimum Keogh standards would apply.

This combination Keogh-IRA plan would be advantageous to both employers and employees. The businessman would not have to establish a separate trust fund for the company pension plan since the annual contributions will go directly into individual retirement accounts for the employees. This would substantially reduce paperwork and red tape. Employees would benefit from "portability" under this proposal since the employee could take his individual retirement account with him upon a change of jobs.

Generally, the plan would operate in the same manner as a qualified defined contribution Keogh or H.R. 10 plan except that contributions would be made directly to the separate employee IRA's. The employer would have to provide coverage for all eligible employees. The maximum deductible contribution for the employer or employee would be the lesser of 15 percent of earned income or $7,500.

The existing standards for vesting, participation, nondiscrimination, and social security integration that apply to Keogh plans would also apply to "Simplified Pension Plans". For example, employees with 3 years of service must be allowed to participate in the plan. Immediate vesting would be required. The plan could not discriminate in favor of officers or highly compensated employees.

In addition, under my proposal, if the employer's pension contribution for an employee does not exceed the $1,500 IRA limitation the employee could make up the difference.

Under the proposal, an employer could adopt an IRS prepared model simplified pension plan, copies of which would be filed with the IRS and distributed to the employees together with a copy of the IRA agreement. Individually designed plans could also obtain IRS approval. Existing reporting and disclosure standards would apply. However, the plan should be sufficiently simple that under existing regulations, a copy of the plan could be used as a summary plan description bank statements (or similar documents furnished by an insurance company) should satisfy all applicable requirements regarding disclosure to participants of their interests in the plan. The employer would be required to file very simplified reports with IRS to support his deduction for plan contributions and the qualification of the simplified plan and no accounting for plan assets would be required.

Senator WILLIAMS. Thank you, Senator Bentsen.
Senator Javits.

STATEMENT OF HON. JACOB K. JAVITS, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator JAVITS. Mr. Chairman, I join the Chair in welcoming Lloyd Bentsen of Texas and thanking him publicly again, as I have so many times before, for his enterprise and cooperation which helped us to bring about ERISA.

We must not ever overlook the forest for the trees. The fact is that ERISA is a great triumph of the private enterprise system, and it seeks only to regulate where the private enterprise system cannot regulate itself effectively. I therefore thoroughly agree with Senator Bentsen that the more that we leave to the competitive operations of the system, the better off will be the millions of workers who are benefited.

Also, Mr. Chairman, I wish to declare myself here and now as completely opposed to any effort which has been suggested to scrap the private pension system and to merge it into one colossal Federal retirement system. I could not think of anything worse, anything more regressive or counterproductive. We have many problems with the private retirement system, but we had many more before ERISA. And we know the trouble that Social Security has gotten into, and we certainly do not want that to happen to private pension plans.

The private pension plan, in my judgment, offers the best hope for the decent and adequate retirement of the American worker, when combined with Social Security, as indeed it is today.

Mr. Chairman, I also believe that the President's establishment of a Commission on Pension Policy to develop national policies for retirement, survivor and disability programs is a very good idea, and I compliment the President on it.

I believe that the work of this Commission will accelerate the growth of a consensus necessary to establish a coordinated national retirement income policy.

I am also hopeful that various other studies which have been launched on the development of such a policy are also diligently pursued.

The Chairman and I, who have had such a tremendously gratifying personal collaboration in so many matters concerning workers and their employers, have suggested a single retirement income agency. We have proposed in our bill an Employee Benefits Commission to administer ERISA.

We believe this Commission would be best. It is quite similar to what the Administration has already done in the energy field, where a multiplicity of administrative units were consolidated to implement a single vital national policy.

I think that the President's message on the ERISA reorganization plan, which Senator Bentsen has referred to, is a good first step. I value, however, just as much as that first step, the commitment of the Administration that it will make a long-term proposal by April 30, 1980.

I hope that in this proposal we will see the public interest overriding bureaucratic considerations.

The bills which are before the subcommittees today are designed to strengthen the private pension system, and that is the ball I hope we will keep our eye on and the ball that Senator Williams and I felt we were serving up when we introduced our bill.

I thoroughly agree with the reduction of excessive paperwork and the elimination or modification of technical rules which are unnecessarily restrictive.

I never have believed, as a longtime business lawyer long before I was a Senator or an Army officer, that we could catch the fellow with the last $2. It costs $4, $6, $8 or $10 in order to do that. But I do believe that we can, because we do have the whole world of experience at our command, develop means by which the pragmatic business considerations of efficiency and effectiveness guide what paperwork and technical rules we need to administer this program.

Senator Williams has already spoken about our bill expanding the joint and survivor annuity protection. To me, it is unconscionable that an employee can work for years, be fully vested, and yet lose any benefit for his or her surviving spouse if the plan participant dies before the plan's early retirement age. The present rules are inadequate on that subject, and I believe a vested benefit should be just what it says, vested and nonforfeitable even if the worker dies at a young age.

I realize this may have an effect on what distributions can be made under pension plans. It is something of a lottery. But I think it is too much of a lottery if the spouse is cut out of any benefit.

Also, our bill contains proposals on a tax deduction for employee contributions, a tax credit for improved plans with faster vesting, and a study of the possibility of some gearing of pensions to the cost of living.

Finally, may I pay tribute to Senator Bentsen and the subcommittee which you head. This is the way we ought to go. We ought to have many more joint hearings.

One of the things that has put us in low repute with the public is that we preach about efficiency to others, but when it comes to trying some of it ourselves, we are wanting.

I thoroughly welcome your cooperation, and I will dedicate myself, and I know that my colleagues on the Human Resources Committee feel the same way, to fast and effective action absent any bureaucratic problems.

Mr. Chairman, I ask that my prepared opening statement be included in the hearing record.

Senator WILLIAMS. It will be placed in the record.

[The opening statement of Senator Javits follows:]

OPENING STATEMENT OF SENATOR JAVITS

Senator JAVITS. Some critics of the private pension system have suggested scrapping private pension plans and merging them into one colossal Federal retirement system. I believe such a move would be a terrible mistake which would harm retirees and the Nation as a whole. To be sure, there are problems with the private retirement system. But to establish one Federal retirement system with Social Security as its cornerstone would be jumping from the frying pan into the fire. Anyone familiar with the recently highlighted financing problems of Social Security and its lack of advance funding should know that the private pension system with its billions of dollars of rapidly growing trust funds looks healthy indeed when compared with Social Security.

In my view, what we need is a national retirement income policy which will coordinate the various elements of the retirement income continuum. Private pension plans should be coordinated with Social Security, not merged into it.

Last September in Chicago, I called for the active development of a national policy on retirement income. I am pleased to say that since that time I have perceived a consensus building for this position. On July 12, the President established by Executive order a Presidential Commission on Pension Policy "to develop national policies for retirement, survivor, and disability programs." This Commission will study private, Federal, State, and local pension programs. I believe the work of this Commission will accelerate the growth of a consensus that a coordinated national retirement income policy must be developed and implemented.

I am also hopeful that the various studies which have been launched will conclude that the best way to implement such a national policy is to establish a single retirement income agency. Chairman Williams and I have proposed in S. 3017 that an Employee Benefits Commission be established to administer ERISA. Such a commission would combine most of the jurisdiction and personnel of the existing ERISA agencies and would become the key administrative mechanism for implementing a coherent retirement income policy. Our proposal for a single agency is very similar to what the administration has already done in the energy field; that is, to consolidate a multiplicity of administrative units into one and to charge that consolidated entity with the implementation of an important national policy. A national energy policy is very important, to be sure, but as the population ages, I predict that a national policy on retirement income will become equally important.

In this regard, I would mention that the administration's recent ERISA reorganization plan is a small, first step toward better administration of the pension law. But as the plan sponsors admit, the reorganization plan is only a temporary measure which is to be followed by a long-term solution to be proposed by the Administration before April 30, 1980. I eagerly await the Administration's long-term proposal, and I hope that concern for the national good and the welfare of retirees and their beneficiaries will override shortsighted concerns about bureaucratic jurisdiction or the logistics of implementation.

The overriding concern behind the bills being considered by the subcommittees today is to strengthen the private pension plans. I think every Senator participating in these hearings wants to assure that the private pension system becomes a more substantial part of our retirement income system. In S. 3017, Chairman Williams and I have advocated the reduction of unwarranted hindrances to pension plan growth, including excessive paperwork and certain technical rules which may be overly restrictive. We have also advocated new ideas for expanding pension plan coverage such as the special master plan and the tax credit for new small plans.

But just as important as these proposals are the provisions in S. 3017 which increase rights and protections of plan participants. A pension system which provides inadequate benefits and protections for workers will never become a substantial part of our retirement income system. Consequently, Chairman Williams and I have proposed expansion of ERISA's joint and survivor annuity protection. I think it is absolutely unconscionable that an employee can work many years and be fully vested yet lose any benefit for his or her surviving spouse if the participant dies before the plan's early retirement age. The present rules are inadequate and must be changed. A vested benefit should be just that—vested and nonforfeitable—even if a worker dies at a young age. I consider this proposed change to be essential.

Chairman Williams and I have also advocated a tax deduction for employee contributions to pension plans, a tax credit for improved plans with faster vesting, and a Labor Department study of the feasibility of requiring cost-of-living increases.

We have, in addition, proposed the development of solvency standards for multiple employer trusts and the prohibition of any decrease of disability benefits under welfare plans because of Social Security increases.

The fact that today's hearings are jointly sponsored by the Senate's Labor and Tax Committees is eloquent testimony to the seriousness of our intention to act. We have much work to do in the next year, and I look forward to cooperating with the Finance Committee in trying to improve and strengthen the private retirement system.

With the chairman's permission, I would like to include in the hearing record my May 1 floor statement when S. 3017 was introduced.

Thank you, Mr. Chairman.

Senator WILLIAMS. Thank you, Senator Javits.

[The May 1 floor statements of Senator Williams and Senator Javits on the introduction of S. 3017, the bill itself, and a section-by-section analysis follow:]

Congressional Record

United States of America

PROCEEDINGS AND DEBATES OF THE 95th CONGRESS, SECOND SESSION

Vol. 124 WASHINGTON, MONDAY, MAY 1, 1978 No. 61

Senate

INTRODUCTION OF BILLS AND JOINT RESOLUTIONS

The following bills and joint resolutions were introduced, read the first time and, by unanimous consent, the second time, and referred as indicated:

By Mr WILLIAMS (for himself and Mr. JAVITS).

S 3017 A bill to amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 for the purpose of simplifying, clarifying, and improving Federal law relating to the regulation of employee benefit plans, to foster the establishment and maintenance of plans, and for other purposes, to the Committee on Finance and the Committee on Human Resources, jointly, by unanimous consent.

ERISA IMPROVEMENTS ACT OF 1978

Mr. WILLIAMS Mr. President, today I am introducing the ERISA Improvements Act of 1978

My bill amends the Employee Retirement Income Security Act of 1974 (ERISA) and certain provisions of the Internal Revenue Code of 1954 in order to foster and encourage the establishment and maintenance of private sector employee benefit plans, promote improvements in those plans, and streamline the Government's regulatory activities over them.

In the 3½ years since ERISA's enactment, I have closely observed its implementation by the Labor Department, Internal Revenue Service, and Pension Benefit Guaranty Corporation, and its effects on employee benefit plans and their participants In the main, I am convinced that ERISA is a sound law and that its effects have been salutory.

The bill I introduce today will improve upon the regulatory framework Congress established in 1974, resolve certain problems that have arisen since ERISA's enactment, and spur the growth and improvement of private pension and welfare plans.

AGENCY JURISDICTION

Under ERISA, three Federal agencies are involved in regulating private employee benefit plans This has resulted in confusion and delay for the public, and in duplication and overlap by the agencies Furthermore, the division of agency responsibilities has hindered the development of a coherent Federal policy respecting the role of the private sector in providing retirement income.

My bill provides for the consolidation in one new agency, a five-member Employee Benefits Commission, of all the responsibilities under ERISA and most of the responsibilities under the Internal Revenue Code relating to the regulation of most private sector employee benefit plans

I am convinced that the present and future role of private employee benefit plans in supplying retirement income and health care coverage, and in generating investment capital, is so important that it demands the full-time attention of a separate agency. But it is also clear that private employee benefit plans and their regulation are matters having important labor relations and tax revenue implications

Accordingly, both the Chairman and the Vice Chairman of the new Employee Benefits Commission will have roles that embody close and continuing links to the Departments of Labor and the Treasury. The Commission Chairman will be a special liaison to the Secretary of Labor, will regularly apprise the Secretary of the Commission's activity, and will be expected to apprise the Commission of the views of the Secretary of Labor regarding the relationships between labor law, labor relations, collective bargaining, and employee benefit plans.

The Vice Chairman of the Commission will perform a similar function respecting the Secretary of the Treasury, and will also be expected to apprise the Commission of the views of the Secretary of the Treasury regarding tax policy and interpretation of the Internal Revenue Code as it relates to employee benefit plans.

The new Commission's primary enforcement mechanisms will be its civil, equitable relief authority and its power to certify a retirement plan as being eligible or ineligible for favorable tax treatment on a prospective basis. The draconian nature of the retroactive disqualification penalty, in my opinion, far outweighs its usefulness as an enforcement device. It is, and should be recognized as, an undesirable holdover from the days before ERISA when no other effective compliance tool was available. So my bill provides that retroactive disqualification may be imposed only where the failure of the plan to meet applicable standards is willful.

In addition to avoiding the adverse impact on innocent employees that is inherent in retroactive disqualification, this and other changes my bill makes should greatly diminish the need for most retirement plan sponsors to obtain a favorable determination letter every time a plan is established or amended, and paperwork and costs will be reduced accordingly.

ERISA TITLE I CHANGES

Numerous changes in title I of ERISA are made by the ERISA Improvements Act of 1978. While preserving ERISA's present conceptual framework, the bill simplifies and clarifies many provisions.

REPORTING AND DISCLOSURE

In the reporting and disclosure area, for example, the summary annual report has been eliminated. In my judgment, the cost of preparing, printing and distributing this document every year clearly outweighs its usefulness. All plan participants will, of course, continue to have ready access to a copy of the complete annual return/report (form 5500) that must be filed each year by the plan.

Other changes are made to avoid disruptive and costly duplications of professional services and to further reduce paperwork burdens.

MINIMUM STANDARDS

Certain revisions in the minimum participation and vesting rules have been made to clarify or otherwise change the application of these rules to multiemployer plans. Certain other changes have been made to codify interpretations of the administering agencies. For example, it has been made clear that a plan may make amendments to conform to final regulations which have interpreted a statutory minimum standard provision differently than did a predecessory temporary regulation.

Also, subject to certain safeguard conditions, the permissibility of elapsed time systems for measuring service is made clear.

A major change has been made in the joint and survivor rules. Under the present provisions, a nightmare tangle of regulations has created complexity and costs for plans and has even caused some plans to discontinue use of the annuity form of benefit. In these cases, the rules of ERISA, as implemented by the regulations, have had precisely the opposite effect as was intended. The new joint and survivor annuity provision is simpler and gives greater assurances that surviving spouses of deceased plan participants will receive retirement income.

FIDUCIARY RESPONSIBILITY

Several significant changes have been made in the fiduciary provisions.

For example, to reduce and clarify the scope of ERISA's prohibited transaction provisions, my bill makes several changes in the definition of party in interest.

Also, the scope of the cofiduciary responsibility rules has been narrowed slightly to reflect the realities of business organization. The present rule places a responsibility on institutional and other large fiduciaries which cannot be met without elaborate, expensive, and burdensome reporting and communication rules.

A new exemption from the prohibited transaction rules has been added to remove doubt about the permissibility under those rules of transfers of assets between plans pursuant to reciprocity arrangements.

PREEMPTION

Changes are made in ERISA's preemption provision to clarify congressional policy in certain areas that have been highlighted since ERISA was enacted. In an abrupt change of a position of more than 40 years' standing, the Securities and Exchange Commission has begun to interpret the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 as being applicable to what has been termed the "interest" of an employee in certain types of employee benefit plans.

In my view, Mr President, this application of these securities acts provisions creates an intolerable situation for most employee benefit plans. Federal regulation of these plans is the subject of ERISA, the Internal Revenue Code and, for collectively bargained plans, the Labor-Management Relations Act. It was in these laws (and, before ERISA, in the Welfare and Pension Plans Disclosure Act) that Congress directed its attention to the regulation of private sector plans, to the rights of employees under these plans, and to the relationship between employees, their plans and the plan sponsors.

From the time of the ERISA oversight hearings that were held by the Labor Subcommittee of my Human Resources Committee in October of 1977 until January of this year, I engaged in a continuing dialog with officials of the Securities and Exchange Commission, attempting to understand the rationale for the SEC's position, and, at the same time, trying to see whether the SEC understood the policy implications of its new position.

What I have learned and observed during this time has not been encouraging. In short, I see no practical way to reconcile the present position of the SEC with the regulatory system for private sector employee benefit plans that was so carefully worked out by the Congress. Instead, I see the specter of yet another agency applying yet another body of law to private employee benefit plans, occurring not as the result of congressional action taken after careful deliberation but as the result of agency and private interpretations of law.

And I see the possibility of potentially enormous liabilities imposed on plans and plan sponsors due to claims relating to events that occurred in the past, at a time when it was justifiably believed that the Securities Acts did not apply.

In this regard, I note the Supreme Court of the United States has recently addressed a very similar retroactive liability issue. In *City of Los Angeles, et al. v. Manhart, et al.*, No. 76-1810 (April 25, 1978), the court considered the impact on pension plans of an interpretation of title VII of the 1964 Civil Rights Act, recognized that "conscientious and intelligent administrators of pension funds" might well have interpreted the law differently than the court was now interpreting it, and reversed lower court rulings which had granted retroactive relief against the retirement plan in question. In an especially pertinent footnote to its opinion, the court took special notice of the importance placed by the Congress, in ERISA, on "making only gradual and prospective changes in the rules that govern pension plans."

To remove any doubt about congressional intent in this area, the ERISA preemption provision would be revised by my bill to ~~ensure~~ that the Federal Securities Acts and similar State laws will not be applied in the future to the interest of an employee in an employee benefit plan which is subject to ERISA, and the civil enforcement section of ERISA would be revised to ~~ensure~~ that no employee benefit plan and no sponsor, fiduciary, and so forth, of such a plan shall be subjected to liability of any sort due to a claim that the interest of an employee in the plan is a security.

To preclude the imposition of retroactive liabilities, another change would remove from the jurisdiction of the Federal courts any past, present, or future claim in which it is or has been asserted that the interest of an employee in an employee benefit plan is a security.

The only exception to these rules is for plans in which participation is wholly voluntary and which are profit-sharing, stock bonus and similar-type plans designed (and permitted under ERISA) to invest heavily in securities issued by the employer who maintains the plan.

TAX LAW CHANGES

It is my view that private retirement plans are and must continue to be a critical component in America's system of providing retirement income. Yet, even after 25 years of spectacular growth of these plans in the years following the Second World War, private pension plans in 1974 covered only about half of the private sector, non-agricultural work force. Since ERISA's enactment in 1974, growth of the private system has slowed, and the past 3½ years have been a time of an increased incidence of terminations, and a decreased incidence of new plan starts, accompanied, however, by steady growth of the size of the work force.

I myself believe that there are several causes for the recent failure of private retirement plans to sustain their earlier rate of growth. The requirements of ERISA (and the changes made by ERISA in the Internal Revenue Code) are unquestionably responsible to some extent. ERISA's minimum standards, paperwork, and other compliance costs have raised the price of plan maintenance for virtually all plans.

Many plan sponsors have been able to meet these burdens and costs without undue strain. In the main, these are larger, corporate employers which have within their organizations the financial, professional, and technical resources that are requisite to the establishment, maintenance, and sound funding of an employee benefit plan that meets Federal standards.

For small employers, and especially for very small employers, however, the adjustments have been more difficult, the burdens heavier, and the added costs more difficult to bear.

Finally, particularly for the very small employers, the availability of individual retirement accounts has been a factor in the termination of some plans or in the decision not to establish a plan.

But the changes made by ERISA alone clearly are not solely responsible for the slowing of the rate of growth of private pension plans. The past few years have been a time of economic uncertainty, bringing, as it always does, a certain reluctance on the part of managers to make new, long-term, commitments. Also, statistics on private pension plan coverage show that, by 1974, most employees working for larger employers were covered by already existing plans.

The large remaining gaps in coverage exist largely among employees working for smaller employers. Even if ERISA had not been enacted, the rate of growth of the private pension system probably would have slowed anyway because the tax, economic, and other incentives (such as collective bargaining) that spur pension plan establishment and growth are less powerful respecting many small employers.

The slowing of the rate of growth is, in any event, very disturbing. And it may be calamitous in light of demographic trends which indicate a future increase in the proportion of the population that consists of retirees compared to the proportion of the population that consists of active workers. These trends, which consist largely of the maturing of the baby boom of the late 1940's and 1950's, the present low birth rates, the ever-increasing longevity figures, and the increased use of optional early retirement, may not all persist. Or, they may be offset by other trends, such as larger than predicted numbers of women entering the work force. But it is more likely that we are entering on a period, that is likely to last for a good many years, which has been described as "the graying of America." Indeed, the battle cry of youth during the 1960's, "don't trust anyone over 30!" may well be echoed in 1990 by, "don't trust anyone under 60!"

The likelihood, then, is that our society must be prepared in the coming years to supply adequate retirement income to an enlarged proportion of the population. Regarding the private sector work force, that income can be supplied in one or more of three ways: Private, individual savings, social security; and private pension plans.

Private, individual savings are not sufficient to provide retirement income in most cases because most individuals will not or cannot set aside sufficient amounts over their working careers and because private savings are often drawn upon in times of need before retirement.

Respecting social security, three things seem very apparent. First, it is unlikely that social security benefits will ever provide more than a floor of retirement income. Second, even if the recently enacted social security financing increases are maintained, it is unlikely that the system will ever be advanced-funded in any meaningful sense; it is and is likely to remain an intergenerational income transfer mechanism. Finally, any reserves that the social security system may accumulate are invested in Treasury paper and are not available as are private pension assets as broadly applicable investment capital.

If we are to meet increased retirement income needs, the best and most painless way to do it is by expanding coverage of our private sector retirement plans. We need to increase the number of plans and the number of employees covered under them.

We cannot achieve 100 percent coverage and we should not attempt to do so, because some proportion of the "working" population has so tenuous an attachment to the workforce that the costs of coverage would far outweigh the benefits that might be provided. But we can make significant inroads towards covering the 50 percent or so of the private, non-agricultural workforce that is not now covered by private plans.

To the extent we do so, we will not only assure adequate levels of retirement income, we will also make available additional billions of dollars of investment capital.

Therefore, in addition to the simplifying and clarifying changes I have proposed, many of which should lower plan costs, the ERISA Improvements Act of 1978 would bring about three significant changes in the Federal tax laws to foster and encourage the establishment and maintenance of private pension benefits plans.

TAX CREDITS FOR PLAN ESTABLISHMENT AND PLAN IMPROVEMENT

First, a tax credit, which could be taken by a plan sponsor in addition to the present deduction for contributions, is proposed for the establishment of new plans that meet ERISA and Internal Revenue Code standards. This credit, which would phase out over a period of years, would be available only to smaller employers. I am proposing that this credit be an amount equal to 5 percent of the deductions allowed to an employer for the first year of plan maintenance, 3 percent for the second and third years, and 1 percent for the fourth and fifth years.

Also, a credit is proposed for the sponsor of any plan which satisfies certain requirements that will be established by the Employee Benefits Commission. A plan meeting these requirements will be known as an "improved plan."

In general, an improved plan will be one which has substantially earlier participation and substantially faster vesting rules than the ERISA minimums, or which offers an equivalently better benefit structure, as determined by the Commission. The additional credit available for each plan year during which the plan is maintained in its improved form will be 5 percent of the amount of allowable deductions for contributions made to the plan for that year.

DEDUCTIONS FOR EMPLOYEE CONTRIBUTIONS TO TAX-QUALIFIED PLANS

Under present law, a person who is not an active participant in a tax-qualified retirement plan may contribute to an individual retirement account (IRA) and take a deduction for the lesser of $1,500 or 15 percent of compensation. Investment earnings of the account are not taxable and taxation occurs when the individual retires and begins to draw out of the account. The IRA was designed to permit individuals not covered by employer-sponsored plans to obtain the same tax advantages as are available to employees covered by tax-qualified pension plans. Viewed from that perspective alone, the IRA is not objection able.
But there are several problems associated with IRA's.

Because an IRA may be established by an owner of a business, the IRA has in some cases been used as a substitute for a tax-qualified pension plan, depriving employees of the protections offered by the Internal Revenue Code rules prohibiting discrimination in favor of the highly compensated. Also, because IRAs are available only to persons who are not active participants in tax-qualified plans, IRA's may not be used by employees who are involuntarily covered by their employers' plans but who do not continue employment with one employer long enough to vest.

There are a number of ways to deal with these problems. I believe the best way is to offer a tax deduction for employee contributions to tax-qualified plans. As with employee contributions under present law, all such contributions would be 100 percent vested when made, and, if an employee should terminate service with an employer before retirement age, the employee could "cash out" of the plan and roll his contributions over to the plan of his new employer or into an IRA.

Thus, the employee covered by a plan having low benefit levels could supplement the employer's contributions with his or her own 100 percent vested contributions. The transient employee could do the same thing and, if service were terminated before vesting in the employer contributions, the terminating employee could withdraw the entire account balance derived from his or her own contributions and roll the balance over into an IRA or into the plan of the new employer.

Under my proposal, a deduction would be available for employee contributions to tax-qualified plans for up to the lesser of 10 percent of compensation or $1,000, reduced by 20 percent of the amount by which adjusted gross income exceeds $30,000. All tax-qualified plans would have to accept employee contributions, and treat them as individual accounts, but only in amounts up to $1,000 per employee per year. Thus, the employee earning annual compensation of $8,000 could deduct $800 for an $800 contribution; $10,000 could deduct $1,000 for a $1,000 contribution; from $10,000 to $30,000 could deduct $1,000 for a contribution of $1,000 and $32,000 could deduct $600 for a contribution of from $600 to $1 000

To preclude the use of IRA's as a substitute for nondiscriminatory, tax-qualified plans, I am proposing that owner-employees, such as sole proprietors and partners, and corporate employees who occupy analogous positions, not be permitted to utilize IRA's for themselves. Linked to my other proposals, this change should not be objectionable, and it will further stimulate the establishment of tax-qualified plans.

SPECIAL MASTER AND PROTOTYPE PLANS

For many years, master and prototype plans have been utilized by smaller employers as a way to provide a retirement program for themselves and their employees which does not involve the employer in complicated plan design and investment problems.

My special master plan proposal is designed to permit an employer to provide retirement income for himself and his employees, under a plan which meets or exceeds Internal Revenue Code and ERISA standards, with virtually none of the burdens presently associated with plan installation and maintenance. Under this proposal, the designer of the special master plan would be a person capable of providing both administrative and investment services respecting a retirement plan. These "master sponsors," who could be, for example, insurance companies, banks, or investment companies, would submit one or more special master plans or prototype plans to the Employee Benefits Commission for approval

The Commission would approve only those plans which, in design and operation, meet the applicable requirements of ERISA (including the new rules relating to special master plans) and the Internal Revenue Code Once approval is obtained, the master sponsor will make the special master plan available to employers To keep complexity at a minimum, special master plans will have to be defined contribution plans

Under a special master plan, the adopting "employer sponsor's" sole affirmative obligation under the substantive rules of ERISA will be to make such contributions and payments, and furnish such work force data and other information, as are required under the terms of the plan

In all other respects, the applicable responsibilities of Federal law relating to plan sponsorship will be assumed by the master sponsor. So, for example, the master sponsor will be responsible for required disclosure to participants and filings of annual and other reports with the Commission, for compliance with ERISA's fiduciary responsibilities, and for handling benefits claims.

The Employee Benefits Commission will promulgate regulations to insure that no special master plan is made available for adoption by employers unless the plan, in design and operation, will satisfy the applicable requirements of ERISA and the Internal Revenue Code. Among other things, this will eliminate the need for adopting employers to seek advance determination letters.

To facilitate the adoption and operation of these special master and prototype plans, certain changes, applicable only to such plans, have been made respecting ERISA's prohibited transaction provisions, and reporting and disclosure requirements. Also certain safeguard mechanisms are present, and the Employee Benefits Commission is, among other things, directed to study the feasibility of extending the special master plan concept to defined benefit plans and to report to the Congress on its findings.

Special master plans will be eligible for the new tax credits I have proposed.

I believe that my special master plan proposal is workable, economically feasible from the standpoint of both investment managers and employers, and will offer greatly expanded opportunities for the creation of new, sound retirement plans covering large numbers of employees

Mr. President, although the ERISA Improvements Act of 1978 is broad in scope and incorporates certain new concepts, it is not intended to be comprehensive and it does not address all of the problems I have observed over the past 43 months. Because the Congress will receive a comprehensive report from the Pension Benefit Guaranty Corporation (PBGC) on or before July 1 of this year regarding the problems of multiemployer plan termination insurance under title IV of ERISA, and because I believe that report will contain implications respecting the single employer insurance program as well, I have deliberately not addressed certain title IV problems of which I am aware I will develop appropriate proposals in these areas, if necessary after I have assessed the PBGC report.

Also, I have never been satisfied about our inability in 1974 to develop a feasible portability program, and I am working now on a portability proposal which I hope to have ready in the near future

In addition, Mr. President, my bill is designed to stimulate public discussion and debate respecting the ways our society presently supplies income to retirees and the various ways we may do so in the future

Especially as regards the future, it is my view that we face a choice that must be made soon We can shrug off the looming problem of the need to supply increased amounts of retirement income and do nothing to encourage growth of private retirement plans. The likely result of that choice will be to place enormous demands on general revenues and FICA taxes

Or we can act now to ease the problems associated with private pension plan creation and maintenance and to foster more and better plans The simplifying and clarifying ERISA amendments, consolidation of agency responsibilities, special master plan concept, and Tax Code changes embodied in the ERISA Improvements Act of 1978 represent a set of ideas to implement this choice, which I believe is the one we must make

In this regard, the specific amounts of the tax credits and employee deduction proposed in my bill may be too high or too low, and technical changes may be desirable to assure equitable application and avoid tax abuse. I look forward to comments from the public and from my colleagues on the Finance Committee, with which the Human Resources Committee shares jurisdiction respecting private pensions plans, on these and other aspects of my legislation.

Mr. President, in a short time I will announce hearings to be conducted by the Labor Subcommittee of the Committee on Human Resources respecting the ERISA Improvements Act of 1978. I am looking forward to those hearings as an opportunity to learn the views of interested persons regarding this legislation and the important issues of retirement income security it addresses.

I ask unanimous consent, Mr. President, that the full text of the ERISA Improvements Act of 1978 and its accompanying section-by-section analysis be included in the Record at the conclusion of our remarks, and that the ERISA Improvements Act of 1978 be referred jointly to the Committee on Human Resources and the Committee on Finance.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. JAVITS Mr. President, the bill I am introducing today with Senator WILLIAMS is an important measure with long-term implications for this Nation. I view this bill, the ERISA Improvements Act of 1978, as the next major step toward the development of a national retirement income policy.

My involvement in retirement income matters goes back many years. My first thrust into the private pension area occurred over a decade ago when I introduced the first pension reform bill. My persistent efforts to protect employee benefit plan participants and beneficiaries reached fruition in 1974 when, in partnership with Senator WILLIAMS, the Employee Retirement Income Security Act of 1974 (ERISA) was enacted into law

I feel very strongly about ERISA and about the enormous good it has achieved American workers can now rest assured that they have firmly established legal rights with respect to their benefit plans and that the promises of employers to pay pension or welfare benefits are binding, legal commitments with assurance of payment. No longer will employers be able to extract long years of continuous service from an employee and avoid paying a promised pension at retirement time solely because of a 20-year vesting rule, for example If an employer's defined benefit pension plan terminates, the participants and beneficiaries will not lose their guaranteed benefits because Federal termination insurance will pay their benefits

Convinced as I am of the essential merit of the ERISA program, I am not blind to the fact that there are certain problems with the law. With so mammoth and complex a statute, I would have been surprised if some problems had not arisen in its implementation.

The bill I am introducing today is intended in part to deal with the problems which have arisen with ERISA. The bill makes changes in the areas of reporting and disclosure, minimum standards, funding, fiduciary responsibility, and enforcement—which includes the overruling of the Daniel decision. The general purpose of these amendments is to make ERISA easier to live with for those who are charged with running employee benefit plans. I should add, however, that essential participant protections are not impaired by these changes.

To further ease the burden which ERISA has caused for some, my bill eliminates the tripartite administration of ERISA by establishing a new regulatory agency. This new entity, the Employee Benefits Commission, will take over all of the present ERISA-related responsibilities of the Labor Department and the Pension Benefit Guaranty Corporation, and most of such duties of the Internal Revenue Service Establishment of this new Commission will solve the dual jurisdiction problem and will result in better policy coordination and enforcement. Most importantly, it will become, over the long run, the key mechanism for the development and implementation of a national retirement income policy.

By making ERISA easier to live with, these amendments should encourage employers to maintain their existing plans and to establish new plans. I believe, however, that further encouragements and incentives are necessary in order to expand the numbers of workers covered by private pension plans.

A recent Social Security Administration study indicates that in 1975 only 46.2 percent of all wage and salary workers were covered by retirement plans. This percentage represents 30.3 million wage and salary employees. Although these figures compare favorably to those of 1950 in which only 22.5 percent or 9.8 million such employees were covered by private retirement plans, they make painfully clear that too many workers are still not covered by private retirement plans. As the study notes, in recent years the trend has been more toward providing broadened protections to workers already covered than toward expanding coverage to greater numbers of new groups of workers.

My bill takes a number of bold new steps to encourage increased coverage of workers by private pension plans. First, it permits financial institutions such as banks, insurance companies, and investment companies to establish special master plans, participation in which will be available to all employers.

The duties of an employer sponsor under a special master plan will be limited to making timely contributions and furnishing necessary workforce data. The financial institution will be responsible for complying with the other requirements of ERISA and the tax code, including handling paperwork, dealing with Federal agencies, processing claims, and managing plan assets. An employer who wants to provide pension coverage for his employees but who is deterred from so doing by the imposition of legal duties will be able to join a special master plan.

Second, my bill grants tax credits for five years to small employers who establish new qualified pension plans. The credit will be equal to 5 percent of the deduction allowed for the first year of plan maintenance, 3 percent for the second and third years, and 1 percent for the fourth and fifth years. This tax incentive is available only to small employers because it is thought that major growth in coverage will be achieved only if small employers adopt plans.

Third, in order to reduce the incentive for employers to set up IRA's for themselves and to neglect the retirement needs of their employees, deductions for contributions to IRA's will be made unavailable only for owner-employees, corporate officers and 10 percent or more shareholders. This change in no way affects the rights of all other employees to set up IRA's.

In addition to expanding coverage of the workforce by retirement plans, my bill also aims at increasing the rights and benefits of those employees covered by employee benefit plans. In order to assist workers who are in low-benefit pension plans or who change jobs frequently, my bill permits a tax deduction for employee contributions to qualified pension plans. The maximum amount of the annual deduction will be the lesser of 10 percent of compensation or $1,000, reduced by 20 percent of the amount by which the adjusted gross income exceeds $30,000.

The bill also provides a tax credit for any employer who establishes an "improved plan." Such a plan must have significantly earlier participation and significantly more rapid vesting rules than ERISA's minimum standards or must offer some other equivalently, significant improvement as determined by the Commission. The amount of the credit, which will be available for each year the improved plan is maintained, will be 5 percent of the annual allowable deduction for contributions to the plan.

To further increase benefits of employees and their beneficiaries who are covered by plans (and also to reduce burdensome compliance rules) I am proposing an improvement in the present joint and survivor annuity requirements. Under present law, the spouse of a 45-year old worker with a fully vested benefit based on 20 years of service could, under the terms of a plan, fail to receive any benefit if the working spouse dies.

To overcome this shortcoming, my bill requires with respect to a 50 percent or more vested participant who dies before the annuity starting date that a plan provide a survivor's annuity for the participant's spouse which begins on the annuity starting date. A plan will be permitted to pay benefits actuarially equivalent to such survivor's annuity earlier than the annuity starting date, for example, in the form of a death benefit. A pension plan which does not provide an annuity form of benefit will be required with respect to such an employee to provide for a lump sum distribution of the account balance to the surviving spouse not later than 60 days after the end of the plan year in which the participant died.

With respect to cost of living increases, which can be extremely expensive to provide, my bill requires a Federal 2-year study of the feasibility of requiring pension plans to provide cost of living adjustments to benefits payable under such plans.

Although not increasing benefits of employees under welfare plans, a provision in my bill does provide greater protection for participants in certain uninsured welfare benefit plans whose participants have no commonality of interest respecting terms or conditions of employment other than their participation in such plan. This section requires that such uninsured welfare plans shall be subject to such solvency and reserve standards as the new Commission shall require by regulation. This requirement is aimed at the use of self-funded multiple employer trusts (MET's) by small employers to provide welfare benefits for employees. A number of these MET's have gone bankrupt, leaving millions of dollars of unpaid claims. The establishment of Federal solvency standards will improve the present situation and partially fill a regulatory void which has developed because of ERISA's preemption of State statutes regulating welfare plans.

Another provision of the bill which provides greater protection of participants in employee benefit plans proscribes any decrease of disability benefits being paid under a welfare plan because of an increase in the benefit levels or the wage base under the Social Security Act. The bill also forbids a pension plan from reducing benefits being paid to a vested participant who has separated from service because of any payment made by the employer as the result of a workers compensation award.

Mr. President, before turning in greater detail to the provisions of my bill, I want to note that this measure is not exhaustive and all-inclusive. There are many matters which have not been addressed at this time and which deserve legislative attention. For example, ERISA title IV matters relating to the plan termination insurance program have not been addressed because we are waiting for the recommendations of the Pension Benefit Guaranty Corporation which are due on July 1. A portability proposal has not been advanced because further work is necessary to develop a workable program.

My bill should also not be considered the final word on the subjects which have been addressed. I am open to constructive recommendations regarding the proposals I have made and will do my utmost to consider all sides as we work toward a fair and just resolution of the issues before us.

NEW AGENCY

From a long-term perspective, one of the most important aspects of my bill is the creation of a new, centralized agency to administer ERISA. This new agency, the Employee Benefits Commission (EBC), will exercise all of the ERISA-related powers of the Department of Labor and the Pension Benefit Guaranty Corporation and most of such powers of the Department of the Treasury. The EBC will start its operations 1 year after enactment of this legislation.

I have long advocated the centralized administration of ERISA. The current splintering of jurisdictions between three agencies was the unfortunate result of political compromise. I thought it was a mistake when ERISA was passed in 1974, and after 3½ years of experience, I am more firmly convinced than ever that it was a mistake. I believe that we in the Congress must put aside secondary concerns of committee jurisdiction and have the courage to do what is best for the Nation. And there is little doubt in my mind that a centralized and rationalized administration of ERISA will be in the best interests of this country.

The consolidation of ERISA functions will solve the current dual jurisdiction problem which has been so prominently illustrated in the prohibited transaction area. The centralization of functions will also result in better ERISA policy development which will transcend the limited institutional interests of the existing agencies. And of course, from the point of view of plan participants and sponsors, one-stop shopping will reduce confusion and costs.

But, Mr. President, there is an even more important reason for the establishment of a centralized pension agency. Starting in about the year 2000, this country will probably be facing an unprecedented demand for retirement income. Based upon present demographic trends including low fertility rates, low mortality rates and the aging of the post war baby boom, there will probably be early in the next century an inordinately large number of older people and comparatively few younger workers. If we do not make sure that adequate resources are built up now to provide retirement income in the future, we may not be able to provide adequately for all of our older citizens. Younger workers will resist shouldering greater tax burdens to provide for their more numerous elders, and intergenerational conflict will result, similar to but more severe than the present turmoil over increased social security taxes.

A centralized pension agency will be an essential tool for developing a national retirement income policy which will deal with the slowly ticking, retirement income time bomb. The agency which I have proposed in this bill deals only with private employee benefit plans and does not have jurisdiction over other elements of the retirement income continuous like Federal, State, and local pension systems or the social security system. As more attention is focused on these matters, it may be appropriate to propose such expanded jurisdiction in the future. For the present, however, I believe the establishment of the Employee Benefits Commission is a necessary first step in developing an administrative mechanism which will aid in formulating a national policy on retirement income and the related matters of capital formation and employee stock ownership.

Mr. President, the Commission which I am proposing will have five full-time members, two of whom will have ties with existing executive departments. The Chairman of the Commission will also be a special liaison officer to the Secretary of Labor and will be nominated by the President from a list of nominees prepared by the Secretary of Labor. The

Chairman, like the four other members of the Commission, will be subject to Senate confirmation. The Commission's executive director and general counsel will be appointed by the Chairman.

The Vice Chairman of the Commission will be a special liaison officer to the Secretary of the Treasury and will be nominated by the President from a list prepared by the Treasury Secretary.

The other three Commission members will be nominated by the President from a list prepared by both the Secretaries of Labor and Treasury. The purpose for creating ties between the Commission and the two existing agencies is to assure that in carrying out its development of policy on employee benefits, the Commission will give due consideration to pertinent labor law and tax law considerations. I also believe that the maintenance of ties to the existing agencies is necessary for political reasons.

The Commission will administer ERISA title I (reporting and disclosure, minimum standards, funding, fiduciary responsibility, and enforcement) and title IV (plan termination insurance). It will also administer Internal Revenue Code sections 401 (tax qualification), 410 (participation), 411 (vesting and accruals), 412 (funding), 413 (collectively bargained plans), 414 (definitions and special rules), 6057 (annual registration) and 6058 (annual return) insofar as these sections relate to plans covered by ERISA. The Commission will have the power to certify to the Treasury Secretary that an ERISA-covered plan satisfies the code's section 401 conditions for tax qualification. The Commission will also have authority to certify to the Treasury Secretary that an "improved plan" which meets standards exceeding ERISA's minimum standards is eligible for a special tax credit.

My bill also eliminates the automatic excise taxes imposed for funding deficiencies (code section 4971) and prohibited transactions (code section 4975) with respect to plans covered by ERISA. It also provides that retroactive disqualification may be imposed only when the failure of a plan to meet code section 401's standards is the result of intentional failure or willful neglect. This last amendment should reduce the need to apply for new determination letters each time a plan is established or amended.

REPORTING AND DISCLOSURE

My bill's most far-reaching change in ERISA's reporting and disclosure sections is to grant the new Commission authority to exempt any employee benefit plan from any of the existing paperwork requirements or to modify any of these requirements. In order to grant an exemption or a waiver, the Commission must find that the change is appropriate and necessary in the public interest and consistent with the purposes of title I of ERISA.

This new authority will give the Commission needed flexibility in tailoring reporting and disclosure requirements to particular situations. The Commission will be able to exercise its discretion to reduce unnecessary paperwork which adds to the cost of plan administration and may not be essential to protecting the interests of participants and beneficiaries. It should be added, however, that this section is not intended to permit the wholesale abrogation of ERISA's requirements. The existing rules were imposed with specific purposes in mind and should not be waived or modified without good reason.

Consonant with the policy of tailoring paperwork requirements to particular situations, my bill requires the development of reporting forms and requirements which to the maximum extent feasible take into account the different types and sizes of plans. What may be appropriate for a large plan to report may be unnecessary with respect to a small plan.

My bill also eliminates a number of requirements which appear not to be cost-justified. The summary annual report, which must be distributed to participants each year and which must disclose, among other things, the plan's assets and liabilities as well as its annual receipts and disbursements, is eliminated because it is too costly in light of the information it provides. Participants who are interested in the fiscal condition of their plans can request a copy of the full annual report which must be provided by the plan administrator. To assure that this right is practically available, the bill provides that an administrator can charge no more than $10 for a copy of the full annual report.

If an employee is interested in the amount of his own accrued benefit, he can request such information from the administrator who, under newly combined ERISA sections 105 and 209, must provide such information. An administrator who fails to do so shall be liable to the requesting participant for up to $100 per day from the date of such failure.

The bill eliminates the requirement that an updated summary plan description be furnished every 5 years if amendments have been made. An administrator will simply be required to provide every 10th year a summary plan description which must be updated by integrating all plan amendments into the description. I believe it is important that there be some periodic reissuance of this important document whether or not amendments have been made.

For tax qualified plans covered by ERISA, my bill requires the consolidation of the plan description (EBS-1) and the determination letter application forms (forms 5300, 5301, and 5303). These forms require the reporting of essentially duplicative information, and should be merged into one document or series of documents.

Upon the separation from service or incurrence of a 1-year break in service by an employee, a plan administrator will be required to automatically disclose to the former participant his accrued benefit only if this benefit is vested. There is little point in requiring an administrator to bear the cost of notifying a former employee that he has no vested accrued benefit. It is intended, however, that such an employee will have the right to request information on his accrued benefit, whether vested or not, before the occurrence of a 1-year break in service.

My bill also attempts to cut down on unnecessary fees paid by plans to accountants and actuaries who may be, in some instances, doing duplicative work in preparing parts of a plan's annual report. The bill requires accountants to rely on the correctness of any actuarial matter certified to by an enrolled actuary and requires enrolled actuaries to rely on the correctness of any accounting matter as to which a qualified public accountant has expressed an opinion.

The bill also cuts down on apparently unnecessary auditing by accountants of the assets and liabilities of common or collective trusts, separate accounts or separate trusts of financial institutions such as banks or insurance companies which are regulated and subject to periodic examination by State or Federal agencies. Participants, of course, receive greater protection from a full audit which covers assets in such pooled trusts or accounts, but the cost of doing such an audit may not be justified where the institution is already subject to periodic examination by a governmental agency.

MINIMUM STANDARDS AND FUNDING

My amendments to parts 2 and 3 of ERISA's title I attempt both to overcome some of the difficulties which plans have experienced with the minimum standards and funding rules and to expand certain participant protections.

In order to facilitate portability and reciprocity among collectively bargained plans, the bill prevents ERISA's title I rules from thwarting the transfer of contributions from a pension or welfare plan (away plan) to a similar plan in which the employee had previously become a participant (home plan). The transfer must be pursuant to a written agreement between the plans, and the Commission may establish conditions, variances, and exemptions to encourage such transfer arrangements. An appropriate prohibited transaction exemption is granted to avoid uncertainty regarding such transfers of contributions.

My bill also provides that rather than using the employment commencement date for measuring a year of service for purposes of eligibility, a plan may use the first day of the plan year for such purposes as long as rights and benefits under ERISA's part 2 are determined on the basis of all of an employee's service regardless of the date on which the employee commenced participation in the plan. The intent of this provision is to relieve plans of the extra recordkeeping and reporting and disclosure burdens which arise when service must be measured from a different date for each employee. The new rule will permit a plan to distribute a summary plan description, for example, within 90 days after the end of the plan year (assuming completion of a year of service) rather than 90 days after each participant completes an eligibility year of service. The trade off for permitting plans to use the plan year for this purpose is that vesting and benefit accruals, for example, will be determined on the basis of all an employee's service before as well as after his commencement of participation in the plan.

Under the bill, a multiemployer plan will be able to provide that a participant's accrued benefit upon his separation from the service is the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates or by employment in different bargaining units. For purposes of the 3 percent accrual method or the fractional method, the accrued benefit may be determined by projecting the normal retirement benefit to which a participant would be entitled if he continued to accrue benefits at the average of the rates applicable to his period of actual participation.

The intent of this section is to tie a participant's benefit accruals for a given year of service to the maximum retirement benefit in effect during that year. If in year 1979 the maximum monthly benefit for 30 years of service is $200 per month and that benefit is increased to $300 per month for year 1980, under the proposed rule a participant in a 3 percent accrual plan will be entitled to an accrual of $6 in 1979 and $9 in 1980. If the employer separated from the service in 1981, his accrued benefit would be determined by adding the different rates of benefit accrual for t .e different periods of participation.

The bill also amends the multiemployer suspension of benefit rules upon reemployment. Multiemployer plans will be permitted to suspend the payment of benefits while an employee is reemployed in the same industry, trade or craft, and the same geographic area covered by the plan, as when such benefits commenced. The rule eliminates "industry" as an element separate from "trade or craft" to avoid problems which have arisen in the application of the existing rule.

Under the proposed rule, if a carpenter who worked in covered employment in a furniture factory retired and later returned to covered employment in housing construction in the same area, the plan could suspend benefit payments while the worker was reemployed. Under the existing rule, the plan may not be able to do so because the carpenter arguably was not reemployed in the same industry. The bill also permits the plan to impose a financial penalty on pensioners who fail to report their reemployment as required by a plan and also to prevent the periodic payment and suspension of benefits to employees who have not retired but who continue to work on an irregular basis.

Under the bill, the funding method may take account, and for plan years beginning after December 31, 1980, shall take account of all plan provisions, including provisions which have not yet affected participants as to entitlement to, or accrual of, benefits. If such a provision is not implemented as of the time specified when the provision was adopted the funding standard account shall be appropriately adjusted in accordance with Commission regulations. The intent of this provision is to permit a plan which is having a funding shortfall to make a future benefit reduction but to take account of that reduction for present funding purposes. The Commission regulations with respect to the failure to implement such a provision are expected to deal with any possible funding abuses in this regard.

Two sections of this minimum standards package will expand the protections of plan participants and beneficiaries. The first of these expands the present joint and survivor annuity protection. With respect to a 50 percent or more vested participant who dies before the annuity starting date, a plan will have to provide a survivor's annuity for the participant's spouse which begins on the annuity starting date. Such an actuarially equivalent benefit could be in the form of a death benefit. A pension plan which does not provide an annuity benefit would be required to provide with respect to a participant just described a lump sum distribution of the account balance to the participant's surviving spouse not later than 60 days after the end of the plan year in which the participant died. The implementation of these changes would eliminate the complications caused by the present rules on electing joint and survivor coverage at the early retirement age.

The second minimum standards section in my bill which will help participants prohibits any decrease of disability benefits paid under a welfare plan because of an increase in the social security benefit level or wage base. A pension plan is also prohibited from reducing benefits being paid to a vested participant who has separated from service because of any employer payment as a result of a workers compensation award.

Other minimum standards amendments include: Clarification that 125 days of service in any maritime industry shall be the equivalent of 1,000 hours of service; permitting plans which complied with temporary regulations to alter their provisions so as to comply with final regulations; and explicitly permitting the use of the elapsed time method for measuring service.

The definition of "multiemployer plan" is amended to mean a plan which is collectively bargained and which has 10 or more contributing employers. A plan having more than one but fewer than 10 contributory employers will also be a multiemployer plan if the Commission determines that it is consistent with ERISA to so treat the plan.

FIDUCIARY RESPONSIBILITY

An important fiduciary change benefiting participants is made with respect to uninsured welfare plans whose participants have no commonality of interest respecting terms or conditions of employment other than their participation in such plan. My bill imposes on such uninsured welfare plans those solvency and reserve standards which the Commission shall require by regulation. ERISA contains funding standards for pension plans, but contains no analogous provisions for such welfare plans. This absence of solvency standards for such welfare plans is compounded by ERISA's preemption of State statutes which may impose standards on such plans.

The legal vacuum which exists has permitted the unregulated growth of self-funded multiple employer trusts (MET's), two of which went bankrupt in California leaving at least $7 million in unpaid claims and leaving 40,000 participants without coverage. I believe it is essential that this situation be corrected as soon as possible.

In this regard, my bill will assist in determining whether MET's are ERISA employee benefit plans, by defining the term "employees' beneficiary association," which appears in the definition of "employee organization." An employee's beneficiary association is an association in which employees participate as members and in which eligibility for membership is based on a commonality of interest with respect to the members' employment relationship.

My bill requires employers who are obligated to contribute under the terms of a collectively bargained plan to make such contributions in accordance with the terms of the plan. The Commission will not be permitted to bring an action to enforce such employer duty, but a fiduciary who brings a successful action under this new section on behalf of a plan shall be entitled to recover from the defendant reasonable attorney's fees and costs of the action. The imposition of this new statutory duty will particularly help multiemployer plans collect delinquent employer contributions.

The scope of the party-in-interest definition is narrowed so that the breadth of ERISA's prohibited transaction provisions will be somewhat reduced. The service provider, employer, employee organization, and employee-officer-director elements of the definition are narrowed. Clarifying changes are made with respect to the fiduciary, relative, and joint venturer parts of the party in interest definition.

A modification is made in the cofiduciary liability rule which holds one fiduciary responsible for a breach of a duty by a second fiduciary if the first fiduciary knows of the breach and does not make reasonable efforts to remedy it. In large financial institutions, for example, it is very difficult to assure that such knowledge by one employee is communicated to the appropriate employee of that institution who could take appropriate action. Consequently, the amendment provides that with respect to a fiduciary who is not a natural person, "knowledge" means knowledge actually communicated (or knowledge which, in the normal course of business, should have been communicated) to the fiduciary's employee who is authorized to carry out the fiduciary's responsibilities regarding the matter to which the knowledge relates.

In order to make more types of insurance available to plans, the bill provides with respect to policies which insure benefits, including, but not limited to guaranteed benefit policies, that plan assets shall include such policies, but not the insurer's general account assets.

My bill also permits plans maintained by more than one employer to return an employer contribution within 1 year after the plan administrator knows that the contribution was made by a mistake of fact. The present rule requires the return of the mistaken contribution within 1 year after the payment of such contribution.

ADMINISTRATION AND ENFORCEMENT

One of the most troubling matters addressed by this bill is the Seventh Circuit's decision in *Daniel v. International Brotherhood of Teamsters*, 561 F. 2d 1123 (7th Cir., 1977), cert. granted 46 LW 3526 (Feb. 21, 1978). Daniel held that participation in a collectively bargained, compulsory, noncontributory pension plan involves the sale of a security to the employee-participant, subject to the antifraud disclosure requirements of the Securities Exchange Act of 1934. Because of the potentially disastrous effects Daniel may have on employee benefit plans, the bill will change the law in this area. However, I do reserve the right to seek to amend this provision, perhaps using as a point of departure the application of the antifraud provisions in cases where pension plans have already terminated.

The bill utilizes three means to negate Daniel. First, it provides that no person shall be subject to liability as the result of an action alleging that an employee's interest in an employee benefit plan is a security under Federal or State securities laws. Second, it removes jurisdiction from the Federal courts to decide any action instituted prior to, on, or after the date of enactment in which it is alleged that an employee's interest in such a plan is a security. Third, it provides prospectively that an employee's interest in an employee benefit plan shall not be a security under the 1933 and 1934 Federal securities acts and any State securities laws, and that ERISA supercedes such statutes in this regard. The only exception to the foregoing rules is for eligible individual account plans in which participation is voluntary.

I have mixed emotions about overruling Daniel. On the one hand, Mr. Daniel was the victim of an unfair break in service rule, and the securities laws, according to the Seventh Circuit, provide him with a remedy for the wrong he alleges. On the other hand, the application of the securities laws to interests in employee benefit plans creates the potential for the imposition of large unforeseen liabilities, the termination of certain pension plans, the imposition of disclosure requirements which duplicate those of ERISA, and the addition of another body of law and another regulatory agency to an already crowded legal landscape. A recent Labor Department study estimates potential Daniel liabilities under various hypothetical alternatives to range from $3.5 to $39.6 billion. These potential liabilities do not include legal fees and other costs of litigation, which might be very substantial. On balance, I must reluctantly conclude that Daniel should be overruled.

I must note that this bill does not deal with the many questions which exist with respect to the scope of ERISA's preemption provision. The matter is multifaceted, to say the least, and I believe further study is necessary to determine what the desirable breadth of Federal preemption should be.

A Federal study is mandated by my bill of the feasibility of requiring pension plans to provide cost-of-living adjustments to benefits payable under such plans. I favor some form of required cost-of-living adjustment to protect retirees' benefits from erosion by inflation. The high cost of such provisions, however, has convinced me that an in-depth study is required on how this objective can be achieved without imposing unacceptable economic burdens on pension plans and their sponsors.

My bill also designates one of the existing employer seats on the Labor Department Advisory Council as a small employer position. I believe this is necessary to assure that the problems of small employers receive adequate attention.

TAX CODE CHANGES

As I previously mentioned in discussing the new Commission, this Nation is facing a potentially tremendous future demand for retirement income, because of a progressively aging population. One important way to meet this coming demand is to foster the establishment of more private pension plans. In 1975 only 46.2 percent of all wage and salary workers were covered by retirement plans, so there is much room for improvement in pension plan coverage.

My bill seeks to encourage greater growth in coverage by, among other things, making two changes in the tax code. The first grants tax credits for 5 years to small employers who establish new qualified pension plans (new plan credit). A credit equal to 5 percent of the employer's deduction will be permitted for the first taxable year during which such plan is maintained. The credit will phase down to 3 percent for the second and third years of plan maintenance and to 1 percent for the fourth and fifth years. It will not be available in the sixth year. In determining the amount of the credit, any portion of the employer's deduction which is attributable to the transfer to or under the plan of employer securities will be disregarded.

The new plan credit, which is not available to employers who terminated their plans at any time after January 1, 1978, is intended to help small employers meet the costs of starting a plan. It is available only to small employers, because growth in coverage is likely to occur among this group of employers.

A second amendment to the tax code is intended to reduce the role IRA's play in causing employers, particularly small employers, to provide for their own retirement while neglecting to provide for their employees' retirements. The bill provides that a deduction for contributions to IRA's will not be available to owner-employees described in section 401 (c)(3) of the tax code, corporate officers and 10 percent or more shareholders. This provision in no way affects the availability of IRA's to other employees.

My bill also proposes tax incentives to bring about greater rights and benefits for those employees covered by qualified plans. To assist workers who are in low-benefit pension plans or who change jobs frequently and, therefore, never vest, a tax deduction is provided for employee contributions to such plans. The maximum deduction will be the lesser of 10 percent of compensation or $1,000, reduced by 20 percent of the amount by which adjusted gross income exceeds $30,000. All tax qualified plans will be required to accept employee contributions of up to $1,000 per calendar year per employee. All employee contributions will be 100 percent vested and will be held in separate accounts.

I view my proposal of an employee deduction for contributions to qualified pension plans as an important step toward the development of a consistent tax policy for employee contributions to fringe benefit plans and tax favored deferred compensation arrangements. The tax treatment of "cafeteria" plans, cash, and deferred profit-sharing plans, nonqualified deferred compensation arrangements, and 403(b) annuities should be considered together with my proposal for a tax-deductible employee contribution to qualified pension plans.

In order to encourage the establishment of plan provisions superior to ERISA's minimum standards, a tax credit is granted to employers who establish "improved plans" (improved plan credit). Such a plan must have significantly earlier participation and more rapid vesting rules than ERISA's minimums or must offer an equivalently significant improvement as determined by the Commission. The improved plan credit will be equal to 5 percent of the annual allowable deduction for the employers' contribution to the plan. This credit will not be available to H.R. 10 plans.

My bill also makes two changes in Code section 402(e) dealing with lump sum distributions. These amendments are intended to solve problems which multi-employer plans have had with the administration of this section.

SPECIAL MASTER PLAN

To encourage further the growth of pension plan sponsorship, my bill makes possible the establishment of "special master plans." Under such plans, employers, particularly small employers, will be able to join plans sponsored by financial institutions such as banks, insurance companies, and investment companies and have a minimal number of responsibilities with respect to such plans. The financial institutions, for a fee, will be responsible for meeting most of the obligations imposed by ERISA on plan administrators.

The employer who joins a special master plan will be responsible to transmit to the financial institution timely contribution and workforce data as may be required by the terms of the plan. The employer's plan, which is established by his signing of the special master plan joinder agreement, will automatically be tax qualified upon the signing of the joinder agreement if the special master plan is qualified.

Other responsibilities imposed by ERISA and the tax code will be placed on the financial institution sponsoring the special plan. The institution will be the plan administrator and named fiduciary for each employer's plan. The institution will handle reporting and disclosure matters, communication with the Federal agencies, claims by participants, and asset management. It is expected that the efficiencies of scale will permit the institutions to perform these functions much more cheaply and efficiently than a small employer.

My bill will enhance these efficiencies of scale by permitting the financial institution to file one annual report reflecting the assets of the special master plan as long as the report makes clear the proportion of special plan assets attributable to each participating employer's plan. My bill also permits the institution to prepare one plan description and one summary plan description for the special plan as long as a description of the variations from the common provisions are included.

Certain changes to ERISA's prohibited transaction provisions are made to facilitate the adopting of such special plans and the providing of services to such plans by investment managers. In addition, appropriate limits are placed on the responsibilities of the sponsoring institutions so that, for example, an institution will not be required to ascertain whether information required to be furnished by the employer is accurate or complete.

If an employer fails to meet his obligations under the special plan by, for example, failing to make timely contributions, he shall, in accordance with the terms of the plan, be deemed the plan administrator and shall consequently be responsible for performing functions previously handled by the financial institution.

The special master plan permitted by my bill will be of the defined contribution type. Because of the added complexity associated with defined benefit plans, the new Commission is directed to report back to Congress within 36 months on the feasibility of permitting defined benefit special master plans.

Mr. President, the special master plan concept contained in this bill is a variant of an idea I put forward in my ERISA speech of last August. In that floor statement, I stated that it may be advisable to establish federally sponsored master plans so that small employers will be encouraged to provide retirement benefits for their employees. The proposal in this bill is an attempt to accomplish through the private sector what I envisioned the Federal Government doing. I am optimistic that the financial institutions will be interested in marketing the new special master plans and that greater pension plan coverage among small employers can be achieved, particularly when the new tax credit for establishing plans is added to the equation. I encourage the financial institutions who may be interested in sponsoring such special plans to recommend how the providing of these plans can be facilitated.

If, for some reason, the special plan concept is not successful, a federally sponsored plan may be the only means left to encourage greater plan coverage.

CONCLUSION

In conclusion, Mr. President, the bill that is being introduced today embodies many of the ideas or variants thereof which I have been discussing publicly since last August. The bill will benefit plan participants and beneficiaries and will make ERISA easier to live with for those who run employee benefit plans. It will expand pension plan coverage and will start the development of the administrative tools this Nation needs to formulate a coordinated, national retirement income policy.

The basic policy of my bill is to strengthen the private pension system. Contrary to recent suggestions by a high administration official that private pensions might be scrapped in favor of an expanded social security system, I firmly believe that the private pension system should be revitalized and expanded. Private pensions have become an inherent element of our free enterprise system and serve bona fide needs of that system.

There are, of course, inequities in our present retirement income arrangement, but I believe these can be overcome better through coordination of the existing sources of retirement income. The answer is to coordinate these separate sources, not to merge them into one giant Federal program. I am firmly committed to the continuing health and growth of the private pension system, and I am opposed to the nationalization of the private pension system.

S. 3017

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

SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "ERISA Improvements Act of 1978".

(b) TABLE OF CONTENTS.—

SEC. 3. TECHNICAL AND CONFORMING CHANGES.

The Secretary of the Treasury and the Secretary of Labor shall, as soon as practicable but in any event not later than 90 days after the date of the enactment of this Act, submit to the Congress a draft of any technical and conforming changes in the Internal Revenue Code of 1954, and the Employee Retirement Income Security Act of 1974, respectively, which are necessary to reflect throughout such Code and Act the changes in the substantive provisions of law made by this Act.

TITLE I—CONSOLIDATION OF FEDERAL AGENCY RESPONSIBILITIES FOR EMPLOYEE BENEFIT PLANS

SUBTITLE A—FINDINGS, DECLARATION OF POLICY

SEC. 101 FINDINGS AND DECLARATION OF POLICY.

(a) The Congress finds that the free flow of commerce and the implementation of the provisions of the Employee Retirement Income Security Act of 1974 and the provisions of subchapters D and F of chapter 1 of the Internal Revenue Code of 1954 (insofar as they relate to such Act) have been restricted and hampered by administrative difficulties encountered by the Labor Department, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation, that the implementation of such provisions and the free flow of commerce have been further hampered and restricted by assertions of applicability of Federal and State securities and other laws to certain employee benefit plans, that the paperwork burdens and compliance costs resulting from such Act and Code provisions and affecting employee benefit plans and persons sponsoring such plans can be reduced in certain respects without jeopardizing the interests of employees in such plans and in the integrity of the assets of such plans, and that present and future needs for retirement income can best be met by strengthening and improving private employee pension benefit plans and that it is in the national interest to do so.

(b) It is hereby declared to be the policy of this Act to consolidate the administration of the Employee Retirement Income Security Act of 1974 and certain provisions of the Internal Revenue Code of 1954 as relate to plans which are subject to such Act in a single agency; to clarify prospectively the extent to which Federal and State securities and other laws may affect employee benefit plans which are subject to such Act and to protect certain persons and plans and hold them harmless from liability due to certain types of past, present or future allegations under such Federal or State securities laws, to provide new incentives to foster the establishment and maintenance of private employee pension benefit plans; and to further improve such plans by clarifying, simplifying and otherwise improving such Act and the provisions of such Code.

SUBTITLE B—EMPLOYEE BENEFITS COMMISSION

SEC 121 SPECIAL LIAISON OFFICERS FOR LABOR AND TREASURY DEPARTMENTS.

(a) LABOR DEPARTMENT OFFICER.—There is established within the office of the Secretary of Labor, the position of special liaison officer to the Employee Benefits Commission. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of Labor and shall serve for a term of years in accordance with the provisions of section 122(b). The special liaison officer shall serve as chairman of the Employee Benefits Commission and shall report regularly to the Secretary of Labor on the activities of the Commission.

(b) TREASURY DEPARTMENT OFFICER.—There is established within the office of the Secretary of Treasury the position of special liaison officer to the Employee Benefits Commission. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of the Treasury and shall serve for a term of years in accordance with the provisions of section 122(b). The special liaison officer for the Treasury shall serve as vice-chairman of the Employee Benefits Commission and shall report regularly to the Secretary of Treasury on the activities of the Commission.

SEC 122. EMPLOYEE BENEFITS COMMISSION.

(a) ESTABLISHMENT.—There is established, as an independent agency within the executive branch of the Government, the Employee Benefits Commission. The Commission is composed of—

(1) the special liaison officer for the Secretary of Labor appointed under subsection (a) of section 121,

(2) the special liaison officer for the Secretary of the Treasury appointed under subsection (b) of section 121, and

(3) 3 additional members appointed by the President, by and with the advice and consent of the Senate, selected from a list of nominees submitted jointly by the Secretary of Labor and the Secretary of the Treasury.

(b) TERMS OF OFFICE.—

(1) NUMBER OF YEARS.—Members of the Commission shall serve for terms of 6 years, except—

(A) the special liaison officer for the Secretary of the Treasury first appointed after the date of enactment of this Act shall serve for a term of 3 years, and

(B) of the three members of the Commission initially appointed under paragraph (3) of subsection (a), one shall serve for a term of 2 years, one shall serve for a term of 4 years, and one shall serve for a term of 6 years.

(2) SERVICE BEYOND EXPIRATION DATE.—A member of the Commission may serve as a member of the Commission after the expiration of his term until a successor has taken office as a member of the Commission.

(3) VACANCY APPOINTMENTS.—An individual appointed to fill a vacancy occurring other than by the expiration of a term of office shall be appointed only for the unexpired term of the member such individual succeeds.

(4) POLITICAL AFFILIATION.—Not more than three members of the Commission may be affiliated with the same political party.

(c) COMPENSATION.—Members of the Commission shall receive compensation equivalent to the compensation paid at level III of the Executive Schedule.

(d) FUNCTIONS.—The Commission shall—

(1) formulate a policy respecting Federal laws which now or may hereafter relate to employee benefit plans described in section 3(3) of the Employee Retirement Income Security Act of 1974.

(2) administer and enforce titles I and IV of such Act, and

(3) administer and seek to obtain compliance with sections 401, 410, 411, 412, 413, 414, 6057, and 6058 of the Internal Revenue Code of 1954 insofar as such sections relate to employee benefit plans (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974) described in section 4(a) of such Act and not exempt under section 4(b) of such Act.

(e) RULES, ETC.—The Commission shall prepare written rules for the conduct of its activities, shall have an official seal which shall be judicially noticed, and shall have its principal office in or near the District of Columbia (but it may meet or exercise any of its powers anywhere in the United States).

(f) ADMINISTRATIVE AUTHORITY.—

(1) STAFF DIRECTOR; GENERAL COUNSEL.—The Commission shall have a staff director and a general counsel who shall be appointed by the Chairman. The staff director and the general counsel shall be paid at a rate not in excess of the rate in effect for level IV of the Executive Schedule. With the approval of the Chairman, the staff tirector may—

(A) appoint and fix the compensation of such additional personnel as he considers necessary, and

(B) procure temporary and intermittent services to the same extent as authorized by section 3109(b) of title 5, United States Code

(2) USE OF OTHER AGENCIES' RESOURCES.—In carrying out its responsibilities, the Commission may avail itself of the assistance, including personnel and facilities, of other agencies and departments of the United States Government. The heads of such other agencies and departments may make available to the Commission such personnel, facilities, and other assistance, with or without reimbursement, as the Commission may request.

SEC 123 POWERS OF COMMISSION.

(a) IN GENERAL.—The Commission has powers expressly granted to the Secretary of Labor and the Pension Benefit Guaranty Corporation under the Employee Retirement Income Security Act of 1974 and, in addition, has the power—

(1) to require, by special or general orders, any person to submit in writing such reports and answers to questions as the Commission may prescribe, and such submission shall be made within such reasonable period of time and under oath or otherwise as the Commission may require;

(2) to administer oaths or affirmations;

(3) to require by subpoena, signed by the chairman or the vice chairman, the attendance and testimony of witnesses and the production of all documentary evidence relating to the execution of its duties;

(4) In any proceeding or investigation, to order testimony to be taken by deposition before any person who is designated by the Commission and has the power to administer oaths and, in such instances, to compel testimony and the production of evidence in the same manner as authorized under paragraph (3);

(5) to pay witnesses the same fees and mileage as are paid in like circumstances in the courts of the United States;

(6) to initiate (through civil actions for injunctive, declaratory, or other appropriate relief), defend, or appeal from a decision in, any civil action in the name of the Commission for the purpose of enforcing the provisions of titles I and IV of the Employee Retirement Income Security Act of 1974, through its general counsel;

(7) to develop such prescribed forms and to make, amend, and repeal such rules, pursuant to the provisions of chapter 5 of title 5, United States Code, as are necessary to carry out the provisions of this Act and of titles I and IV of the Employee Retirement Income Security Act of 1974;

(8) to conduct investigations and hearings, to encourage voluntary compliance, and to report apparent criminal law violations to the appropriate law enforcement authorities; and

(9) to certify to the Secretary of the Treasury that an employee benefit plan described in section 122(d)(3) of this Act—

(A) satisfies or does not satisfy (or has or has not satisfied) the requirements of sections 401, 410, 411, 412, 413, 414, 6057, or 6058 of the Internal Revenue Code of 1954, or

(B) satisfies or does not satisfy (or has or has not satisfied) the requirements of sections 44C and 44D of the Internal Revenue Code of 1954.

(b) ENFORCEMENT OF ORDERS OF THE COMMISSION.—Any United States district court within the jurisdiction of which any inquiry is carried on may, upon petition by the Commission in case of refusal to obey a subpoena or order of the Commission issued under subsection (a), issue an order requiring compliance therewith. Any failure to obey the order of the court may be punished by the court as contempt.

(c) TRANSFER OF FUNCTIONS.—All functions of the Secretary of Labor under the Employee Retirement Income Security Act of 1974 are transferred to, and shall be carried out by, the Commission. All functions of the Pension Benefit Guaranty Corporation under such Act are transferred to, and shall be carried out by, the Commission. All functions of the Secretary of the Treasury under sections 401, 410, 411, 412, 413, 414, 6057, and 6058 of the Internal Revenue Code of 1954, insofar as such sections relate to employee benefit plans described in section 122(d)(3) of this Act, are transferred to, and shall be carried out by, the Commission.

(d) TRANSFER PROVISIONS.—

(1) PERSONNEL, ETC.—All personnel, liabilities, contracts, property, and records determined by the Director of the Office of Management and Budget to be employed, held, or used primarily in connection with the functions of the Secretary of Labor under the Employee Retirement Income Security Act of 1974, of the Pension Benefit Guaranty Corporation under such Act, and of the Secretary of the Treasury under sections 401, 410, 411, 412, 413, 414, 6057, and 6058 of the Internal Revenue Code of 1954, insofar as such sections relate to employee benefit plans described in section 122(d)(3) of this Act, are transferred to the Commission.

(2) TRANSFER OF PERSONNEL.—

(A) Except as provided in subparagraph (B), personnel engaged in functions transferred under paragraph (1) shall be transferred in accordance with applicable laws and regulations relating to the transfer of functions.

(B) The transfer of personnel pursuant to paragraph (1) shall be made without reduction in classification or compensation for one year after such transfer.

(3) PROCEDURAL EFFECTS OF TRANSFER.—

(A) All laws and regulations relating to the functions transferred under this Act shall, insofar as such laws and regulations are applicable and not amended by this Act, remain in full force and effect. All order, determinations, rules, and opinions made, issued, or granted under such laws by the Secretary of Labor, the Pension Benefit Guaranty Corporation, or by the Secretary of the Treasury, which are in effect at the time of the transfer provided by paragraph (1), and which are consistent with the amendments made by this Act, shall continue in effect to the same extent as if such transfer had not occurred.

(B) The provisions of this Act shall not affect any proceeding pending before the Secretary of Labor, the Pension Benefit Guaranty Corporation, or the Secretary of the Treasury on the date of enactment of this Act.

(C) No suit, action, or other proceeding commenced by or against the Secretary of Labor, the Pension Benefit Guaranty Corporation, or the Secretary of the Treasury shall abate by reason of the transfer made under paragraph (1). The court before which such suit, action, or other proceeding is pending may, on motion or supplemental petition filed at any time within 12 months after the date of enactment of this Act, allow such suit, action, or other proceeding to be maintained against the Commission if the party making the motion or filing the petition shows a necessity for the survival of the suit, action, or other proceeding to obtain a settlement of the question involved.

SEC. 124. CERTIFICATION OF CERTAIN IMPROVED PLANS.

(a) GENERAL RULE.—The Commission shall, upon application made by an employer who maintains a qualified employer retirement plan (as defined in section 221 (c)(3)(A) through (E) of the Internal Revenue Code of 1954), certify such plan to the Secretary of the Treasury as an improved plan for purposes of the credit allowed by section 44D of the Internal Revenue Code of 1954 if, for the plan year for which certification is requested—

(1) the Commission determines that there has been a substantial improvement in the employee benefits under the plan as compared with the preceding plan year, and

(2) rights of employees under the terms of the plan exceed the minimum requirements described in part 2 of title I of the Employee Retirement Income Security Act of 1974.

(b) MINIMUM IMPROVEMENT STANDARDS.—The Commission shall not certify any plan as an improved plan under subsection (a) unless, under the plan—

(1) the age and service requirements for participation in such plan permit significantly earlier participation than must be permitted under the age and service requirements of section 202 of the Employee Retirement Income Security Act of 1974, and

(2) the rate at which a participant's right to his normal retirement benefit becomes nonforfeitable is significantly more rapid than the least rapid rate permitted under section 203 of such Act, or

(3) the Commission determines that there is some other significant improvement in a participant's benefits and rights under the plan which is at least equivalent to an improvement which would satisfy the requirements of paragraphs (1) and (2).

SEC. 125. TERMINATION OF TREASURY DEPARTMENT'S JURISDICTION OVER CERTAIN ASPECTS OF CERTAIN PLANS, AGENCY COOPERATION.

(a) TERMINATION OF TREASURY JURISDICTION.—Except as provided in subsections (b) and (c), the Secretary of the Treasury shall not administer, seek to obtain compliance with, or otherwise exercise responsibility or power respecting sections 401, 410, 411, 412, 413, 414, 6057, 6058, 4971, and 4975 of the Internal Revenue Code of 1954 insofar as such sections relate to an employee benefit plan (as defined in section 3 (3) of the Employee Retirement Income Security Act of 1974) described in section 4 (a) of such Act and not exempt under section 4 (b) of such Act.

(b) CERTIFICATIONS BY COMMISSION.—Certifications made by the Employee Benefits Commission to the Secretary of the Treasury pursuant to section 123 (a) (3) of this Act shall be treated by the Secretary as if he had made such certifications himself.

(c) COOPERATION.—Pursuant to procedures they shall jointly formulate and establish, the Employee Benefits Commission, the Secretary of Labor, and the Secretary of the Treasury shall make arrangements for—

(1) notification by the respective Secretaries to the Commission regarding information which concerns the Commission's functions under section 122(d), and

(2) notification by the Commission to the Secretaries regarding information which concerns their respective functions under laws relating to employee benefit plans.

SEC. 126. EFFECTIVE DATE AND REPEAL.

This title shall take effect one year after the date of enactment of this Act. Subtitle A of title III of the Employee Retirement Income Security Act of 1974 is repealed on such effective date.

TITLE II—AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

SUBTITLE A—DECLARATION OF POLICY; DEFINITIONS

SEC. 201. DECLARATION OF POLICY, DEFINITIONS.

(a) DECLARATION OF POLICY.—Section 2 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(d) It is hereby further declared to be the policy of this Act to foster the establishment and maintenance of employee benefit plans sponsored by employers, employee organizations, or both.".

(b) Section 3 of the Employee Retirement Income Security Act of 1974 is amended by—

(1) redesignating paragraph (4) as paragraph (4)(A) and by adding at the end thereof the following new subparagraph:

"(B) For purposes of this paragraph, the term 'employees' beneficiary association' shall mean an association in which employees participate as members and in which eligibility for membership is based on a commonality of interest with respect to the members' employment relationships.".

(2) striking out subparagraphs (A), (B), (C), (D), (E), and (F) of paragraph (14) and inserting in lieu thereof, respectively, the following subparagraphs:

"(A) any fiduciary, counsel, or employee of such plan,

"(B) a person providing professional services to such plan, or a person providing nonprofessional services on a continuous basis to such plan,

"(C) an employer any of whose employees are covered by such plan, if the employees of such employer constitute five percent or more of all employees covered by the plan;

"(D) an employee organization any of whose members are covered by such plan, if the members of such employee organization constitute five percent or more of all employees covered by the plan;

"(E) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) of a person described in subparagraph (C), (D), (E), or (G), or

"(F) a 10 percent or more (in capital or profits) partner, or joint venturer with, a person described in subparagraph (C), (D), (E), or (G).";

(3) inserting in paragraph (15) "brother, sister," immediately before "spouse,";

(4) striking out "The" in paragraph (20) and inserting in lieu thereof "Except as otherwise provided in section 514 (d) (2), the".

(5) (A) striking out clauses (i), (ii), and (iii) of subparagraph (A) of paragraph (37) and inserting in lieu thereof the following:

"(i) which is maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer,

"(ii) to which ten or more employers contribute, or to which more than one and fewer than ten employers contribute if the Secretary finds that treating such a plan as a multiemployer plan would be consistent with the purposes of this Act, and",

(B) redesignating clauses (iv) and (v) of paragraph (37)(A) as clauses (iii) and (iv), respectively, and

(C) striking out subparagraph (B) of paragraph (37) and inserting in lieu thereof the following new subparagraph:

"(B) For purposes of this paragraph, all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a) of the Internal Revenue Code of 1954, determined without regard to section 1563(e)(3)(C) of such Code) shall be deemed to be one employer.".

SUBTITLE B—SIMPLIFYING AND CLARIFYING AMENDMENTS

PART 1—REPORTING AND DISCLOSURE

SEC. 221. DISCLOSURE OF ACCRUED BENEFITS.

Section 105 of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"REPORTING OF PARTICIPANT'S BENEFIT RIGHTS

"SEC. 105. (a)(1) Each administrator of an employee pension benefit plan shall furnish to any plan participant or beneficiary who so requests in writing a statement indicating, on the basis of the latest available information—

"(A) the total benefits accrued, and

"(B) the nonforfeitable pension benefits, if any, which have accrued, or the earliest date on which benefits will become nonforfeitable.

"(2) In no case shall a participant or beneficiary be entitled under this subsection to receive more than one report described in paragraph (1) during any one twelve-month period.

"(3) If an administrator furnishes an annual statement which contains the information required by this subsection, the furnishing of such annual statement shall satisfy the requirements of this subsection.

"(4) This subsection shall apply to a plan to which more than one unaffiliated employer is required to contribute only to the extent provided by regulations prescribed by the Commission.

"(b)(1) Each administrator of an employee pension benefit plan shall report, in such manner and at such time as may be provided in regulations prescribed by the Commission, to each plan participant who during a plan year—

"(A)(i) terminates his service with the employer, or

"(ii) has a 1-year break in service, and

"(B) is entitled to a deferred vested benefit under the plan as of the end of such plan year, and

"(C) with respect to whom retirement benefits are not paid under the plan during such plan year.

The report required under this subsection shall inform the employee of the nature, amount, and form of the deferred vested benefit to which such participant is entitled, and such other information as the Commission may require.

"(2) Not more than one report shall be required under paragraph (A)(ii) with respect to consecutive one year breaks in service.

"(c)(1) Except as provided by paragraph (2) of this subsection, each employer shall, in accordance with regulations prescribed by the Commission, maintain records with respect to each of his employees sufficient to determine the benefits due or which may become due to such employees. The employer shall furnish the plan administrator information necessary for the administrator to make the reports required by subsections (a) and (b).

"(2) If more than one employer adopts a plan, each such employer shall, in accordance with regulations prescribed by the Commission, furnish to the plan administrator information necessary for the administrator to maintain the records and make the reports required by subsections (a) and (b). Such an administrator shall maintain the records and, to the extent provided under regulations prescribed by the Commission, make the reports, required by subsections (a) and (b).

"(3) If any person who is required under this section (other than under subsection (a)(1)) to furnish information or to maintain records fails to comply with such requirements, he shall pay to the plan a penalty of $10 for each employee with respect to whom such failure occurs, unless it is shown that such failure is due to reasonable cause.".

SEC. 222. EXEMPTION FOR REPORTING AND DISCLOSURE REQUIREMENTS.

(a) IN GENERAL.—Section 110 of such Act is amended to read as follows:

"EXEMPTIONS AND MODIFICATIONS

"SEC. 110. The Secretary may by regulation exempt any employee benefit plan or person, or any class of employee benefit plans or persons conditionally or unconditionally from any requirement of this part or may modify any such requirement if he determines that such exemption or modification is—

"(1) appropriate and necessary in the public interest, and

"(2) consistent with the purposes of this title.".

(b) CONFORMING CHANGES.—Section 104(a) of such Act is amended—

(1) by striking out paragraphs (2) and (3), and by redesignating paragraphs (4) and (5) as (2) and (3), respectively, and

(2) by striking out "paragraph (4)" in paragraph (3) (as redesignated) and inserting in lieu thereof "paragraph (2)".

SEC. 223. ELIMINATION OF SUMMARY ANNUAL REPORT.

Section 104(b) is amended—

(1) by striking out paragraph (4) and redesignating paragraph (4) as (3), and

(2) by inserting before the period at the end of the last sentence of such paragraph a comma and the following: "but the charge for furnishing a copy of the latest annual report may not exceed $10".

SEC. 224. CONSOLIDATION OF FORMS.

Not later than eighteen months after enactment of this Act, the Commission shall, with respect to employee benefit plans described in section 122(d)(3) of this Act, prescribe a single form (or a single series of forms) which shall be used to satisfy the requirements of section 103(a)(3) of the Employee Retirement Income Security Act of 1974 and such additional reporting requirements as the Commission deems necessary for the reporting of information presently reported on Internal Revenue Service Forms 5500, 5501, and 5502.

SEC. 225. IMPROVEMENT OF REPORTING REQUIREMENTS.

In order to avoid the reporting of unnecessary information, the Commission shall develop reporting forms and requirements for employee benefit plans described in section 122(d)(3) of this Act which, to the maximust extent feasible and consistent with the purposes of this Act and the Employee Retirement Income Security Act of 1974, take into account the different types and sizes of employee benefit plans. Not later than 18 months after the date of enactment of this Act, the Commission shall report to the Congress on the actions taken and proposed to be taken to implement this directive. Not later than 24 months after the enactment of this section, the Commission shall submit to the Congress its final written report on the implementation of this section.

SEC. 226. OPINIONS OF ACTUARIES AND ACCOUNTANTS.

Section 103(a) of the Employee Retirement Income Security Act of 1974 is amended—

(1) by inserting ", except to the extent required by subparagraph (B)," in paragraph (3)(A) after "Such examination shall be conducted in accordance with generally accepted auditing standards,",

(2) by striking out "may" in paragraph (3)(B) and inserting in lieu thereof "shall",

(3) by striking out "if he so states his reliance" in such paragraph,

(4) by striking out "may" in paragraph (4)(D) and inserting in lieu thereof "shall" and

(5) by striking out "if he so states his reliance" in such paragraph.

SEC. 227. UPDATE OF SUMMARY PLAN DESCRIPTION.

Section 104(b)(1) of the Employee Retirement Income Security Act of 1974 is amended to read as follows

"(1) The administrator shall furnish to each participant, and each beneficiary receiving benefits under the plan, a copy of the summary plan description, and all modifications and changes referred to in section 102(a)(1) –

"(A) within 90 days after he becomes a participant, or (in the case of a beneficiary) within 90 days after he first receives benefits, or

"(B) if later, within 120 days after the plan becomes subject to this part.

Not less frequently than every tenth year after the plan becomes subject to this part, the administrator shall furnish to each participant and to each beneficiary receiving benefits under the plan, the summary plan description described in section 102 which shall be updated by the integration into the summary plan description of all plan amendments, if any, made within such 10-year period. If there is a modification or change described in section 102(a)(1), a summary description of such modification or change shall be furnished not later than 210 days after the end of the plan year in which the change is adopted to each participant and to each beneficiary who is receiving benefits under the plan.".

SEC. 228. SCOPE OF ACCOUNTANT'S OPINION.

Section 103(a)(3)(C) of the Employee Retirement Income Security Act of 1974 is amended by striking out "need" and inserting in lieu thereof "shall".

SEC. 229. EFFECTIVE DATES.

The amendments made by sections 222 and 227 shall be effective, and the amendments made by sections 221, 226, and 228 shall apply with respect to plan years beginning on and after the date of enactment of this Act. Sections 224 and 225 shall be effective 12 months after such enactment date. The amendments made by section 221 shall be effective 18 months after such enactment date.

PART 3—MINING STANDARDS

SEC. 231. RECIPROCAL AGREEMENTS.

Section 209 of the Employee Retirement Income Security Act of 1974 is amended to read as follows

"RECIPROCAL AGREEMENTS

"SEC. 209. Notwithstanding any other provision of this title, the contributions made with respect to the employment of an employee pursuant to a collective bargaining agreement and payable to a pension or welfare plan maintained pursuant to that agreement (hereinafter in this section referred to as the 'away plan') may be transferred to a similar pension or welfare plan established pursuant to another collective bargaining agreement under which the employee had previously become a participant (hereinafter referred to in this section as the 'home plan') if such transfer is pursuant to a written agreement between the administrator of the away plan and the administrator of the home plan. In any case where contributions received with respect to the employment of an employee are transferred from an away plan to a home plan in accordance with this section, such employment shall be considered as employment under the jurisdiction of the home plan for purposes of computing the accrued benefit and vesting of such employee, but the employer who contributed to the away plan on behalf of such employee shall not be deemed to be an employer maintaining the home plan solely because of such transferred contributions. The Secretary may by regulation establish additional conditions, and such variances and exemptions as are consistent with the purposes of this Act, in order to facilitate such transfer arrangements in the interest of portability and to protect the pension and welfare benefits of employees who become employed under two or more collective bargaining agreements associated with different pension or welfare plans.".

SEC. 232. DETERMINING PARTICIPATION ON A PLAN YEAR BASIS.

The second sentence of section 202(a)(3)(A) of the Employee Retirement Income Security Act of 1974 is amended by inserting "(i)" after "first day of a plan year" and by inserting after "date his employment commenced" the following "or (ii) in the case of a plan where rights and benefits under this part are determined on the basis of all of an employee's service without regard to the date on which the employee's participation in the plan commenced".

SEC. 233. SPECIAL RULE FOR 125 DAYS OF SERVICE IN THE CASE OF A MARITIME INDUSTRY.

Section 204(b)(3)(F) of the Employee Retirement Income Security Act of 1974 is amended by striking out "a 1 year of participation" and inserting in lieu thereof the following "1,000 hours of employment".

SEC. 234. SUMMATION OF DIFFERENT BENEFIT ACCRUAL RATES.

Section 210(a) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new paragraph:

"(4) a multiemployer plan may provide that the accrued benefit to which a participant is entitled upon his separation from the service is—

"(A)(i) the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates, or

"(ii) the sum of different rates of benefit accrual for different periods of participation, as defined by employment in different bargaining units, and

"(B) determined for purposes of subparagraphs (A) and (C) of subsection 204(b)(1), by projecting the normal retirement benefit to which a participant would be entitled if he continued to accrue benefits at the average of the rates applicable to his period of actual participation.".

SEC. 235. SUSPENSION OF BENEFITS BECAUSE OF REEMPLOYMENT.

Section 203(a)(3)(B) of the Employee Retirement Income Security Act of 1974 is amended—

(1) by striking out "in the same trade" in clause (ii) and inserting in lieu thereof ", trade,", and

(2) by striking out "'employed'" in the last sentence and inserting in lieu thereof the following "which may, with respect to clause (ii), include self-employment. The permissible period of benefit suspension shall include a period determined pursuant to regulations promulgated by the Commission in addition to the months in which the employment occurs to the extent necessary to prevent the periodic payment and suspension of pension benefits to workers who have not retired but who continue to work on an irregular basis. The imposition of a financial penalty on a pensioner who fails to report his employment as required by the rules of a plan shall not be deemed a violation of the vesting requirements of this section. The amount of the financial penalty permitted by the preceding sentence shall be determined pursuant to regulations promulgated by the Commission but in no event shall the penalty exceed an amount equal to one year's benefit

SEC. 236. AMENDMENTS TO CONFORM PLANS TO FINAL REGULATIONS.

Section 204 of the Employee Retirement Income Security Act of 1974 is amended by redesignating subsection (h) as (i) and inserting after subsection (g) the following new subsection:

"(h) Any plan amendments adopted prior to January 1, 1980, which comply with final regulations issued under this Act shall not be deemed to violate any provision of this title by reason of the fact that such amendment changes or revises any amendment adopted after September 2, 1974, and prior to issuance of such final regulations, unless such amendment has the effect of decreasing vested rights or accrued benefits under such plan as in existence on September 2, 1974.".

SEC. 237. REDUCTIONS IN RETIREMENT OR DISABILITY BENEFITS.

Section 206 (b) of the Employee Retirement Income Security Act of 1974 is amended—

(1) by inserting after "plan" in paragraph (1) the following "or is receiving disability benefits under a welfare plan",

(2) by inserting immediately after "this Act" the following: "(or, in the case of a participation or beneficiary who is receiving disability benefits under a welfare plan, the date of enactment of the ERISA Improvements Act)", and

(3) by adding at the end thereof the following new sentence: "A pension plan may not reduce pension benefits being received by a participant or beneficiary or pension benefits in which a participant who is separated from the service has a nonforfeitable right by reason of any payment made to the participant or beneficiary by the employer maintaining the plan as the result of an award made under a workers compensation law.".

SEC. 238. JOINT AND SURVIVOR ANNUITY.

(a) Section 205 of the Employee Retirement Income Security Act of 1974 is amended—

(1) by inserting "(1)" after "(a)" in subsection (a), and by adding at the end of such subsection the following new paragraph:

"(2) If a pension plan does not provide for the payment of benefits in the form of an annuity, with respect to any participant who under the plan has a nonforfeitable right to not less than 50 percent of his accrued benefit derived from employer contributions and who dies before receiving such precentage of his benefit which is nonforfeitable, such plan shall provide that the participant's account balance shall be distributed in the form of a lump sum to the participant's surviving spouse not later than 60 days after the end of the plan year in which the participant died.",

(2) by striking out subsection (b) and inserting in lieu thereof the following:

"(b)(1) A plan which provides for the payment of benefits in the form of an annuity shall not be treated as satisfying the requirements of this section unless, with respect to any participant who under the plan has a nonforfeitable right to not less than 50 percent of his accrued benefit derived from employer contributions and who dies before the annuity starting date, the plan provides a survivor's annuity for the participant's spouse—

"(A) which begins on the annuity starting date (determined as if the participant had lived until his earliest retirement age, or his actual date of death if later, and had retired on such date prior to his death), if the spouse is living on such date, and

"(B) the payments under which are not less than the payments which would have been made under the survivor's annuity to which such spouse would have been entitled if the participant had terminated employment on his date of death, had survived and retired on such annuity starting date, and had died on the day following such date

"(2) A plan shall not be treated as not satisfying the requirements of subsection (a) and paragraph (1) if the plan provides for the payment of benefits actuarially equivalent to the survivor's annuity required by paragraph (1) to a surviving spouse beginning not later than the annuity starting date specified in paragraph (1).",

(3) by striking out subsection (c) and subsection (h) and by redesignating subsections (d), (e), (f), and (g) as (c), (d), (e), and (f), respectively,

(4) by striking out "(whether or not an election has been made under subsection (c))" in subsection (c) (as redesignated under paragraph (3)), and

(5) by striking out "subsection (c) or (e)" in subsection (e) (as redesignated under paragraph (3)) and inserting in lieu thereof "subsection (d)".

(b) Effective Date.—The amendments made by this section shall apply with respect to plan years beginning on or after the date which is 24 months after the date of enactment of this Act

SEC. 239. ELAPSED TIME

Section 211 of the Employees Retirement Income Security Act of 1974 is amended by inserting immediately after subsection (e) the following new subsection:

"(f) Notwithstanding anything to the contrary in this part, the Secretary may prescribe by regulation one or more systems of measuring service for purposes of sections 202, 203, and 204 which are based upon measurement of the elapsed time of an employee's service. Any such regulations shall include safeguards to assure that employees whose service is measured in terms of elapsed time are in the aggregate, not disadvantaged by the use of such system of measurement when compared to employees whose service is measured in the manner prescribed in sections 202, 203, and 204.".

PART 3—FUNDING

SEC. 251. FUNDING TO TAKE ACCOUNT OF FUTURE AMENDMENTS.

Section 302 (c) (1) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following: "The funding method may take account, and for any plan year beginning after December 31, 1980, shall take account, of all provisions of the plan, including provisions which have not yet affected any participant as to entitlement to, or accrual of, benefits. In the event any such provisions is not implemented at the time specified when the provision was adopted, the funding standard account shall be appropriately adjusted in accordance with regulations prescribed by the Secretary. A provisions adopted but contingent on a future event shall be deemed not to be in effect as a provision of the plan prior to the occurrence of that event.".

PART 4—FIDUCIARY RESPONSIBILITY

SEC. 261 GENERAL ASSET ACCOUNT.

Section 401(b) of the Employee Retirement Income Security Act of 1974 is amended by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) In the case of a plan the benefits of which are insured, the assets of the plan shall include the policy under which the benefits are insured but shall not, solely by reason of the issuance of such policy, include the assets of the insurer issuing the policy except to the extent that such assets are maintained by the insurer in one or more separate accounts and do not constitute surplus in any such account. For purposes of this paragraph, the term 'insurer' means an insurance company, insurance service, or insurance organization, qualified to conduct business in a State.".

SEC 262 OBLIGATION OF EMPLOYER TO PAY CONTRIBUTIONS.

(a) Section 403 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(d) Every employer who is obligated under the terms of a collectively bargained plan (or under the terms of a collective bargaining agreement related to such plan) to make periodic contributions to the plan shall, to the extent not inconsistent with law, make such contributions in accordance with the terms and conditions of such plan or such agreement.

SEC. 263. REFUND OF MISTAKEN CONTRIBUTIONS.

Section 403(c)(2)(A) of the Employee Retirement Income Security Act of 1974 is amended by inserting before the period at the end thereof the following "or, in the case of a plan maintained by more than one employer, within one year after the plan administrator knows that the contribution was made by a mistake of fact.".

SEC. 264. CO-FIDUCIARY RESPONSIBILITY

Section 405 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(e)(1) In the case of a fiduciary other than an individual, the term 'knowledge' in subsection (a)(3) shall mean knowledge actualy communicated (or knowledge which, in the normal course of business, should have been communicated) to the fiduciary's officer or employee who is authorized to carry out the fiduciary's responsibilities, obligations, or duties (or who in fact carries out such responsibilities, obligations or duties) regarding the matter to which the knowledge relates.

"(2) In the case of an employer who is a fiduciary and who fails to satisfy the requirement of section 403(d), subsections (a) (2) and (3) shall not apply to any cofiduciary of such employer respecting such failure".

SEC 265 EXEMPTION FOR RECIPROCITY ARRANGEMENT

Section 408(b) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new paragraph:

"(10) Any transfer of contributions between plans pursuant to section 208, if a plan to which the contributions are transferred pay not more than a reasonable charge for any administrative expenses reasonably incurred by a plan transferring such contributions".

SEC. 266. SOLVENCY STANDARDS FOR CERTAIN UNINSURED WELFARE PLANS.

(a) IN GENERAL.—Part 4 of subtitle B of title I of the Employee Retirement Income Security Act of 1974 is amended by redesignating section 413 and 414 as 414 and 415, respectively, and by inserting after section 412 the following new section:

"CERTAIN UNINSURED WELFARE PLANS

"SEC. 413. (a) Every uninsured welfare plan described in subsection (b) shall be subject to such solvency and reserve standards as the Secretary shall require by regulation.

"(b) The term 'uninsured welfare plan' means a welfare plan (or portion of a welfare plan) under which the benefits are not funded by insurance under a policy issued by an insurer (as defined in section 401(b)(2)) and the participants of which have no commonality of interest respecting terms or conditions of employment other than their participation in such plan.

"(c) Regulations promulgated by the Secretary under this section shall take effect not later than 18 months after the date of enactment of the ERISA Improvements Act.".

(b) CLERICAL AMENDMENTS.—The table of contents for such Act is amended by redesignating the items relating to sections 413 and 414 as relating to sections 414 and 415, and by inserting after the item relating to section 412 the following new item:

"SEC. 413. Uninsured welfare plans".

PART 5—ADMINISTRATION AND ENFORCEMENT

SEC. 271 REMEDIES.

Section 502 of the Employee Retirement Income Security Act of 1974 is amended by—

(1) striking out "105(c)" in subsection (a)(4) and inserting in lieu thereof "105".

(2) striking out subsection (b) and inserting in lieu thereof the following

"(b) The Commission shall not bring an action to enforce section 403(c)";

(3) striking out subsection (g) and inserting in lieu thereof the following

"(g)(1) Except as provided in paragraph (2), in any action under this title by a participant, beneficiary, or fiduciary, the court in its discretion may allow a reasonable attorney's fee and costs of the action to either party

"(2) In any action under this title by a fiduciary on behalf of a plan to enforce the provisions of section 403(d) and in which a judgment in favor of the plan is awarded, the court shall allow a reasonable attorney's fee and costs of the action, to be paid by the defendant.";

(4) striking out subsection (i) and redesignating subsections (j) and (k) as subsections (i) and (j), respectively; and

(5) inserting a new subsection (k), to read as follows

"(k)(1) Notwithstanding any provision of law to the contrary, in the case of an employee benefit plan other than an eligible individual account plan (as defined in section 407(d)(3) of this Act) in which participation is voluntary under the terms of the plan—

"(A) no person or employee benefit plan shall be subject to liability or punishment, civil or criminal, or be required to reimburse or pay money or any other thing of value, as the direct or indirect result of a cause of action explicitly or implicitly alleging that the interest of an employee in such a plan is, or ought to be characterized as or deemed to be, a security within the meaning of the Security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934, or any law of any State which regulates securities, and

"(B) no court of the United States shall have jurisdiction of an action or proceeding at law or in equity, whether instituted prior to or on or after the date of enactment of the ERISA Improvements Act of 1978, to the extent such action or proceeding involves a cause of action explicitly or implicitly alleging that the interest of an employee in such a plan is, or ought to be characterized as or deemed to be, a security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934, or any law of any State which regulates securities

"(2) For purposes of this subsection and section 514(d)(2), participation is not voluntary under the terms of a plan—

"(A) if, as an incident of employment with the employer or employers maintaining the plan or as an incident of membership in one or more employee organizations, the members of which are covered under the plan, and upon satisfaction of the plan's age and service requirements, if any, an employee becomes a participant in the plan, and

"(B) even if a provision of the plan permits an employee, subject to approval by the plan administrator, to waive participation in the plan.".

SEC 272 ADVISORY COUNCIL.

Paragraph (3) of section 512(a) of the Employee Retirement Income Security Act of 1974 is amended by striking out "(at least one of whom shall be representative of employers maintaining or contributing to multiemployer plans)" and inserting in lieu thereof the following: "(one of whom shall be representative of employers maintaining or contributing to multiemployer plans and one of whom shall be representative of employers maintaining small plans)".

SEC. 273 IMPACT OF INFLATION ON RETIREMENT BENEFITS.

Section 513 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(d) The Secretary shall conduct a study of the feasibility of requiring employee pension benefit plans to provide cost-of-living adjustments to benefits payable under such plans. The Secretary shall compile data and analyze the effect inflation is having and may be expected to have on retirement benefits provided by private pension plans. The Secretary shall submit the study required by this subsection to the Congress no later than 24 months after the date of enactment of the ERISA Improvements Act.".

SEC. 274. PREEMPTION.

Section 514 of the Employee Retirement Income Security Act of 1974 is amended by—

(1) striking out "subparagraph (B)," in subsection (b)(2)(A) and inserting in lieu thereof "subparagraph (B) and subsection (d)(2),";

(2) striking out "nothing" where it appears in subsection (d) and inserting in lieu thereof "(1) Except as provided in paragraphs (2) and (3), nothing"; and

(3) adding at the end of subsection (d) the following new paragraphs:

"(2) Notwithstanding any provision of law to the contrary, the interest of an employee in an employee benefit plan described in section 4(a) and not exempt under section 4(b) is not, and shall not be characterized as or deemed to be, a security within the meaning of the Securities Act of 1933, the Securities and Exchange Act of 1934, or any law of any State which regulates securities, unless such plan is an eligible individual account plan (as defined in section 407(c)(3) of this Act) in which participation is voluntary under the terms of the plan.

"(3) Notwithstanding any provision of law to the contrary, an interest or participation—

"(A) in a single or collective trust maintained by a bank or in a separate account maintained by an insurer, and

"(B) issued to an employee benefit plan or plans described in section 4(a) and not exempt under section 4(b).

is not, and shall not be characterized as or deemed to be, a security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934, or any law of any State which regulates securities, and such a single or collective trust or separate account is not, and shall not be characterized as or deemed to be, an investment company within the meaning of the Investment Company Act of 1940 or any law of any State which regulates investment companies. For purposes of this paragraph, the term 'insurer' shall have the meaning given in section 401(b)(2)".

TITLE III—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

SEC. 301. LUMP SUM DISTRIBUTIONS: PLANS TREATED AS SINGLE PLAN.

(a) GENERAL RULE.—Section 402(e)(4)(C) of the Internal Revenue Code of 1954 (relating to aggregation of certain trusts and plans) is amended to read as follows

"(C) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under subparagraph (A)—

"(i) all trusts which are part of a plan shall be treated as a single trust,

"(ii) in the case of a multiemployer plan (as defined in section 3 (37) of the Employee Retirement Income Security Act of 1974), all defined benefit plans maintained by an employer shall be treated as a single plan, and all defined contribution plans maintained by an employer shall be treated as a single plan.

"(iii) in the case of any plan not described in subsection (ii), all pension plans maintained by an employer shall be treated as a single plan, all profit-sharing plans maintained by an employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan, and

"(iv) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of enactment of this Act.

SEC. 302 LUMP DISTRIBUTION; SEPARATION FROM THE SERVICE.

(a) GENERAL RULE.—Section 402(e)(4) of the Internal Revenue Code of 1954 (relating to definitions and special rules) is amended by adding at the end thereof the following new subparagraph:

"(M) SEPARATION FROM THE SERVICE.—For purposes of subparagraph (A), in the case of any multiemployer plan (as defined in section 3 (37) of the Employee Retirement Income Security Act of 1974), a separation from the service shall be deemed to have occurred in the case of any employee if such employee has not worked in service covered by the plan for a period of 6 consecutive months after severing his employment relationship with any employer maintaining the plan.".

(b) Effective Date.—The amendment made by this section shall apply with respect to plan years beginning after the date of enactment of this Act.

Sec. 303. Deduction for Certain Employee Contributions to Qualified Retirement Plans.

(a) In General.—Part VII of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to additional itemized deductions for individuals) is amended by redesignating section 221 as 222, and by inserting immediately after section 220 the following new section:

"Sec. 221 Certain Employee Contributions to Qualified Retirement Plans

"(a) General Rule.—In the case of an individual who—

"(1) has not attained age 70½ before the close of the taxable year, and

"(2) is an active participant in a qualified employer retirement plan,

there is allowed as a deduction an amount equal to the sum of the amounts contributed by the individual as an employee to or under such plan for the taxable year.

"(b) Maximum Amount of Deduction—

"(1) In general.—The amount allowable as a deduction under subsection (a) to any individual for the taxable year shall not exceed the lesser of—

"(A) an amount equal to 10 percent of the compensation includible in the individual's gross income for such taxable year, or

"(B) $1,000.

"(2) Reduction of deduction based on adjusted gross income.—The amount of the deduction allowable under subsection (a) for a taxable year after the application of paragraphs (1) and (3) shall be reduced by 20 percent of the amount by which the adjusted gross income of the taxpayer exceeds $30,000 ($15,000 in the case of a married individual making a separate return).

"(c) Definitions, Special Rules.—

"(1) Recontributed amounts.—No deduction shall be allowed under this section with respect to a rollover contribution described in section 402(a)(5), 403(a)(4), 408(d)(3), or 409(b)(3)(C).

"(2) Amounts contributed under endowment contract.—In the case of an endowment contract described in section 405(b), no deduction shall be allowed under this section for that portion of the amounts paid under the contract for the taxable year which are properly allocable, under regulations prescribed by the Secretary, to the cost of life insurance.

"(3) Qualified employer retirement plan.—The term 'qualified employer retirement plan' means—

"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan described in section 403(a),

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

"(D) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing,

"(E) any plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b) (whether or not such individual's rights in such contract are nonforfeitable), and

"(F) a group retirement trust maintained by a labor organization described in section 501(c)(5) which is financed exclusively by assessments of employees who are members of such labor organization, which was established prior to January 1, 1974, and in which the assessments paid to the trust by any participant are 100 percent nonforfeitable.

"(4) Compensation.—For purposes of this section, the term 'compensation' includes earned income as defined in section 401(c)(2).

"(5) Married individuals.—In the case of an individual who is married (as determined under section 143(a)), the maximum deduction under subsection (b) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

"(6) Time when contributions deemed made.—For purposes of this section, a taxpayer shall be deemed to have made a contribution to or under a qualified employer retirement plan on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than 45 days after the end of such taxable year".

(b) Clerical Amendment.— The table of sections for such subpart is amended by striking out the last item and inserting in lieu thereof the following:

"Sec. 221. Certain employee contributions to qualified retirement plans.

"Sec. 222. Cross references.".

(c) Conforming Amendment.—Paragraph 10 of section 62 of such Code (relating to retirement savings) is amended—

(1) by striking out "and" and inserting in lieu thereof a comma, and

(2) by inserting "the deduction allowed by section 221 (relating to deduction for certain employee contributions to qualified retirement plans)" before the period at the end of such paragraph.

(d) Acceptance of Employee Contributions.—Section 401 of such code (relating to qualified pension, profitsharing, and stock bonus plans) is amended by redesignating subsection (k) as (l), and by inserting after subsection (j) the following new subsection:

"(k) Employee Contributions.—A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part accepts employee contributions for which a deduction is allowable under section 221 (as determined without regard to the limitation of subsection (b)(1) of such section) of up to $1,000 per calendar year per employee and treats such contributions as separate accounts.".

(d) Effective Date.—The amendments made by this section shall apply with respect to taxable years and plan years beginning after December 31, 1978.

Sec. 304. Credit for the Establishment of Qualified Plans by Small Employers.

(a) In General.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended by inserting immediately before section 45 the following new section.

"Sec 44C Establishment of New Small Business Employer Retirement Plans

"(a) General Rule.—In the case of a small business employer who maintains or makes contributions to or under a qualified employer retirement plan, there is allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to a percentage (determined under subsection (b)) of the amount allowable for the taxable year to such employer as a deduction under section 404.

"(b) Determination of Percentage.—The percentage applicable under subsection (a) for a taxable year is—

"(1) 5 percent for the first taxable year for which a deduction under section 404 is allowable to the taxpayer

"(2) 3 percent for each of the succeeding 2 taxable years, and

"(3) 1 percent for each of the 2 taxable years succeeding the 2 taxable years referred to in paragraph (2).

"(c) Definitions; Special Rules.—For purposes of this section—

"(1) Qualified employer retirement plan.—The term 'qualified employer retirement plan' has the meaning given to such term by section 221(c)(3)(A) through (E).

"(2) Small business employer.—The term 'small business employer' means an employer (within the meaning of section 404) which is a small business (as determined by the Administrator of the Small Business Administration under section 112 of the Small Business Act (15 U.S.C. 632))

"(3) Disregard for amounts attributable to employer securities.— In determining the amount of the credit allowable under subsection (a) for any taxable year any portion of the deduction allowed for such year which is attributable to the transfer to or under the plan of employer securities (as defined in section 407(d)(1) of the Employee Retirement Income Security Act of 1974) shall be disregarded.

"(d) Application With Other Sections.—The amount of the deduction allowable under section 404 for any taxable year shall not be reduced because of the allowance of a credit under this section for the taxable year. The credit allowable under subsection (a) for any taxable year shall not be allowed if the taxpayer claims the credit allowable by section 44D for the taxable year

"(e) Terminations.—No credit is allowable under subsection (a) in the case of an employer who terminates a qualified employer retirement plan (or successor to such an employer) at any time after January 1, 1978.".

(b) Clerical Amendment.—The table of sections for such subpart is amended by inserting immediately before the item relating to section 45 the following new item

"Sec. 44C. Establishment of new small business employer' retirement plans.".

(c) Effective Date.—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1978.

Sec. 305. Credit for the Improvement of Qualified Retirement Plans.

(a) In General.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended by inserting immediately before section 45 the following new section:

"Sec. 44D. Improved Qualified Employer Retirement Plan Credit

"(a) General Rule.—In the case of an employer who maintains an improved qualified employer retirement plan (other than such a plan which is described in section 401 (d)), there is allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 5 percent of the amount allowable for the taxable year to such employer as a deduction under section 404.

"(b) Limitation Based on Tax Liability; Carryover of Excess Credit —

"(1) Limitation. The amount of the credit allowed under subsection (a) for the taxable year shall not exceed the liability of the taxpayer for tax under this chapter for the taxable year.

"(2) Carryover of excess amount.—If the amount of the credit determined under subsection (a) for the taxable year exceeds the amount of the limitation imposed by paragraph (1) for such taxable year (hereinafter in this paragraph referred to as the 'unused credit year'), such excess shall be a credit carryover to the taxable year following the unused credit year, and, subject to the limitation imposed by paragraph (1), shall be taken into account under subsection (a) in such following taxable year.

"(c) Definition of Improved Qualified Employer Retirement Plan.—For purposes of this section, the term 'improved qualified employer retirement plan' means a qualified employer retirement plan (as defined in section 221(c)(3) (A) through (E)) which is certified by the Employee Benefits Commission as an improved plan under section 124 of the ERISA Improvements Act.

"(d) Application With Other Sections.—The amount of the deduction allowable under section 404 for any taxable year shall not be reduced because of the allowance of a credit under this section for the taxable year. The credit allowable under subsection (a) for any taxable year shall not be allowed if the taxpayer claims the credit allowable by section 44C for the taxable year.".

(c) Clerical Amendment.—The table of sections for such subpart is amended by inserting immediately before the item relating to section 45 the following new item:

"Sec 44D. Improved qualified employer retirement plan credit.".

(c) Effective Date.—The amendments made by this section shall apply with respect to taxable years and plan years beginning after December 31, 1978.

Sec. 306. Denial of IRA, Etc., Benefits to Owner-Employees; Corporate Officers and Shareholders.

(A) In General.—

(1) Retirement savings.—Subsection (b) of section 219 of the Internal Revenue Code of 1954 (relating to limitations and restrictions) is amended by inserting after paragraph (6) of such subsection the following new paragraph:

"(7) No deduction is allowed under subsection (a) in the case of an owner-employee (as defined in section 401(c)(3)) or an officer or 10 percent or more stockholder directly or indirectly of a corporation."

(2) Retirement savings for married individuals.—Subsection (b) of section 220 of such Code (relating to limitations and restrictions) is amended by inserting after paragraph (7) the following new paragraph:

"(8) No deduction is allowed under subsection (a) in the case of an owner-employee (as defined in section 401 (c)(3)) or an officer or 10 percent or more stockholder directly or indirectly of a corporation.".

(b) Effective Date.—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1978.

Sec. 307. Retroactive Disqualification of Plans.

In the administration of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954, the Secretary of the Treasury shall not treat an employee benefit plan described in section 123 (d) (3) of the ERISA Improvements Act of 1978 as not meeting the requirements of such part for any taxable year or plan year preceding the year in which the Employee Benefits Commission determines that the plan does not meet such requirements unless the Commission has also determined that the failure to meet such requirements in such preceding year was a result of intentional failure or willful neglect on the part of the person or persons maintaining the plan.

TITLE IV—SPECIAL MASTER AND PROTOTYPE PLANS

Sec 401 Special Master and Prototype Plans

(a) In General.—Subtitle B of title I of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new part:

"Part 6—Special Master and Prototype Plans

"special master and prototype plans

"Sec. 601. (a) For purposes of this section—

"(1) 'special master plan' means a master or prototype individual account employee pension benefit plan which has been approved by the Commission in accordance with subsection (d), all of the assets of which are controlled by one or more investment managers.

"(2) 'investment manager' means an investment manager described in section 3(38)(A) and (B) (without regard to the parenthetical clause) and in the case of an investment adviser to a regulated investment company (as defined in section 851 of the Internal Revenue Code of 1954), shall include the principal underwriter of such investment adviser.

"(3) 'master sponsor' means an investment manager who is the sponsor of a special master plan, and

"(4) 'employer sponsor' means an employer any of whose employees are covered under a special master plan, an association of such employers, or an employee organization, any members of which are covered under such a plan.

"(b) Notwithstanding any other provisions of this Act or the Internal Revenue Code of 1954 to the contrary, in the case of a special master plan—

"(1) except as provided in subsection (e), the responsibilities, duties, and obligations of an employer sponsor under parts 1, 2, 3, and 4 of this title shall be limited to making such timely contributions and payments, and furnishing such timely, complete, and accurate information, as may be required under the terms of the plan; and

"(2) the requirements of sections 401 and 410, 411, 412, 413, and 414 of the Internal Revenue Code of 1954 which are applicable to the plan of the employer sponsor shall be deemed to be initially satisfied as of the date the employer sponsor and master sponsor execute the special master plan joinder.

"(c) Notwithstanding any other provisions of this title or the Internal Revenue Code of 1954 to the contrary, in the case of a special master plan—

"(1) except as provided in subsection (e), the master sponsor shall be the administrator and named fiduciary of each employer sponsor's plan for the purposes of this title;

"(2) the requirements of section 102(b), if otherwise satisfied, will not be violated if—

"(A) the plan description includes plan provisions common to the plans of all employer sponsors adopting the special master plan, together with a description of each type of variation from such common provisions that is permitted under the terms of approval by the commission, and an identification, by name of employer sponsor, employer sponsor identification number, name of plan, and plan identification number, of the employer sponsors who have adopted each such type of variation, and

"(B) the summary plan description of each employer sponsor's plan describes provisions common to the plans of all employer sponsors adopting the special master plan, together with a description of any provisions of such employer sponsor's plan which vary from such common provisions, with appropriate cross-references;

"(3) the requirements of section 103, if otherwise satisfied, will not be violated merely because data in the annual report reflect the aggregate assets of the special master plan, if the annual report also includes an identification, by name of employer sponsor, employer sponsor identification number, name of plan, and plan identification number, of the percentage of total special master plan assets attributable to each employer sponsor's plan;

"(4)(A) the exemption described in section 408(b)(2) shall be applied as if any investment manager sponsoring a special master plan and any investment manager providing services to such a plan were a party in interest respecting such plan for a reason other than by virtue of such investment manager's being a fiduciary, and

"(B) the term 'bank or similar financial institution' in section 408(b)(6) shall be deemed to mean any investment manager who is a master sponsor, and the term 'sound banking and financial practice' in such section shall, in the case of an investment manager other than a bank, be deemed to mean 'sound fiduciary practice';

"(5) no master sponsor shall have a responsibility, obligation, or duty under sections 404 or 405—

"(A) to ascertain whether information required to be furnished to the master sponsor by an employer sponsor pursuant to the terms of a special master plan is accurate or complete, or

"(B) due to the failure of an employer sponsor to satisfy the requirements of subsection (b)(1)) and

"(6) the special master plan shall be deemed to be the employee benefit plan referred to in section 502, and the term 'person' in section 504 shall not be deemed to exclude any investment manager, master sponsor or employer sponsor described in subsection (a).

"(d)(1) The Commission shall prescribe such regulations, and furnish such rulings, opinions, forms, and other types of guidance as are necessary to implement this section. To the greatest extent consistent with the purposes of this Act, such regulations and other types of guidance shall be designed to facilitate the establishment of special master plans and their adoption by employer sponsors.

"(2) The Commission shall approve a special master plan only if it determines that the plan of an adopting employer sponsor, in design and in operation, will satisfy the requirements of this section, other applicable requirements of this Act, and the requirements of section 401 of the Internal Revenue Code of 1954 (to the extent that such Act and Code are not inconsistent with this section).

"(3) Approval of special master plans and amendments to such plans shall be accomplished by a process carried out in the national office of the Commission, until such time as the Commission may establish procedures for field office approval under which uniformity of treatment by field offices is assured.

"(4) Upon approval by the Commission of a special master plan, or of any amendment to such a plan for which approval is required, a special master plan certificate shall be issued to the master sponsor by the Commission. Except as provided in paragraph (5), for a period of 60 months from the date of adoption of the plan by an employer sponsor or from the effective date of an amendment for which approval is required, a duly notarized copy of such certificate shall be prima facie evidence in any administrative or judicial proceeding that the terms of the plan meet the requirements of this section, this title, and the requirements of sections 401, 410, 411, 412, 413 and 414 of the Internal Revenue Code of 1954.

"(5) The Commission, after notice and hearing, shall revoke the certificate described in paragraph (4)—

"(A) respecting the plan of any employer sponsor, if the Commission finds that there has been a failure on the part of the employer sponsor to observe the terms of the plan and that such failure has been detrimental to the rights of any plan participant under the terms of the plan or this title, and

"(B) respecting the special master plan, if the Commission finds that there has been a failure to observe the terms of the plan or the provisions of this section on the part of the master sponsor and that such failure has been detrimental to the rights of plan participants under the terms of the plan or this title.

"(6) Upon the request of a master sponsor, the certificate issued by the Commission upon the approval of a special master plan, or upon the approval of an amendment to such a plan for which approval is required, shall specify those plan amendments or types of amendments for which, in the discretion of the Commission, approval need not be obtained.

"(7) The Commission shall study the feasibility of permitting defined benefit special master plans and shall report to the Congress regarding such study not later than 36 months after the effective date of this section.

"(e) Any employer sponsor who fails to make such timely contributions and payments or who fails to furnish such timely, complete and accurate information as may be required under the terms of a special master plan shall, in accordance with the terms of such plan, be deemed to be the plan administrator of the plan (to the extent the plan covers the employees of such employer sponsor), as of the time, not earlier than the date of such failure, specified in such plan, and as of such specified date the master sponsor shall cease to be the administrator and named fiduciary of such employer sponsor's plan.".

(b) The table of contents for the Employee Retirement Income Security Act of 1974 is amended by inserting immediately after the item relating to section 514 the following:

"Part 6—Special Master and Prototype Plans

"Sec. 601 Special master and prototype plans.".

(c) The amendments made by this section shall take effect 18 months after the date of enactment of this Act.

The ERISA Improvements Act of 1978
Section by Section Analysis

Sec. 1 Short title and table of contents.

This section designates the Act as the ERISA Improvements Act of 1978, and sets out the table of contents.

Sec. 2. Technical and conforming changes.

The Secretaries of Labor and the Treasury are directed to submit to the Congress within not more than 90 days after enactment of the ERISA Improvements Act of 1978, a draft of technical and conforming changes to the Employee Retirement Income Security Act and the Internal Revenue Code of 1954 necessary to reflect in ERISA and the Code the changes in substantive provisions of law made by the ERISA Improvements Act of 1978.

TITLE I—CONSOLIDATION OF FEDERAL AGENCY RESPONSIBILITIES FOR EMPLOYEE BENEFIT PLANS

Subtitle A—Findings; Declaration of Policy

Sec 101 Findings and declaration of policy

This section states the Congressional findings which underlie the ERISA Improvements Act and the policy of the Act.

Sec. 121 Special liaison officers.

These provisions establish new positions in the offices of the Secretary of Labor and the Secretary of the Treasury. They provide for a special liaison officer to the Secretary of Labor, and that this official shall also be Chairman of the Employee Benefits Commission established by section 122. The special liaison officer will be nominated by the President from a list of nominees prepared by the Secretary of Labor, and shall be subject to Senate confirmation.

Similarly the special liaison officer to the Secretary of the Treasury will be the new Commission's vice chairman, will be nominated by the President from a list of nominees prepared by the Secretary of the Treasury, and will be subject to Senate confirmation.

These provisions will ensure that the Employee Benefits Commission will have close, high-level, and continuing links to the Departments of Labor and of the Treasury, so that the views of those Departments respecting labor law and policy and tax law and policy, respectively, regarding employee benefit plans will be known and considered by the Commission as it carries out its responsibilities, and so that the two Secretaries will be continuously apprised of the Commission's policymaking.

Sec. 122. Employee benefits commission.

This section establishes a new Employee Benefits Commission and describes its structure. In addition to the chairman and vice-chairman, the Commission will have three other members who will be nominated by the President and subject to Senate confirmation. The President will make his selections from a list of nominees prepared jointly by the Secretary of Labor and the Secretary of the Treasury. Commission members will serve staggered terms of six years.

The functions of the Commission will be to administer and enforce titles I and IV of ERISA, and to administer and effect compliance with sections 401, 410 through 414, 6057 and 6058 of the Internal Revenue Code insofar as those sections relate to employee benefit plans covered under ERISA. In addition, the Commission will develop policy respecting all Federal laws which relate to all employee benefit plans.

Sec 123. Powers of the commission.

A full range of powers necessary for the Commission to carry out its responsibilities is included in this section. Among other things, the Commission is given the power to certify to the Secretary of the Treasury that a plan subject to ERISA satisfies or does not satisfy the Internal Revenue Code requirements for tax qualification. Also, the Commission will be empowered to certify to the Secretary of the Treasury regarding whether a plan satisfies the proposed Internal Revenue Code rules respecting the eligibility of an employer for the special tax credits (described in title III of the Act).

This section also contains provisions dealing with the transfer of functions, personnel, records, etc. from the Departments of Labor and of the Treasury, and from the Pension Benefit Guaranty Corporation, to the Employee Benefits Commission, and with the effect of such transfers on regulations, rulings, opinions, etc., and on pending litigation.

Sec. 124. Certification of improved plans.

This section and section 306 describe a new procedure and rules under which retirement plans meeting certain standards which exceed the minimum participation, vesting and related standards described in part 2 of ERISA may be certified by the

Commission as eligible for one of the special tax credits described in title III of the Act.

Under the provisions of section 124, the Commission is directed to certify as an improved plan (the employer sponsor of which will be eligible for the improved plan tax credit described in section 2061), a plan which has been substantially improved compared to the immediately preceding plan year and under which rights of employees under the terms of the plan significantly exceed the minimum standards provisions of part 2 of title I of ERISA (relating to participation, vesting benefit accrual, etc.) Certain criteria are established to guide the Commission in its determinations.

Sec. 125. Termination of Treasury Department jurisdiction, agency cooperation

This section provides that the Secretary of the Treasury shall not administer the tax qualification functions that have been transferred to the Employee Benefits Commission, insofar as plans subject to ERISA are concerned

It also provides that certifications made by the Commission to the Secretary of the Treasury (relating to plan satisfaction of the Internal Revenue Code rules respecting tax qualification, employee deductions and tax credits) shall be treated by the Secretary as if he had made them himself

Finally, section 125 requires that the Commission and the Secretaries of Labor and of the Treasury make arrangements for notification by the Secretaries to the Commission regarding information that relates to the Commission's functions, and for the Commission to similarly notify the respective Secretaries regarding information that concerns their continuing functions under laws relating to employee benefit plans.

Sec. 126 Effective date and repeal

The effective date of the provisions of title I will be one year after enactment. Subtitle A of title III of ERISA, relating to coordination between the Secretaries of Labor and the Treasury, is repealed as of this effective date

TITLE II—AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

SUBTITLE A—DECLARATION OF POLICY AND CLARIFYING DEFINITIONS

Sec 201 Declaration of policy and definitions.

This section amends section 2 of ERISA to declare that a policy of ERISA is to foster the establishment and maintenance of employee benefit plans sponsored by employers and employee organizations.

Also, section 201 makes a number of changes in the definitions contained in section 3 of ERISA

A definition of the term "employees' beneficiary association" is added to section 3(4) of ERISA in order to clarify that such an association is one in which employees participate as members and in which eligibility for membership is based on a commonality of interest with respect to the members' employment relationship. The purpose of introducing this definition is to assist the Commission and the courts in determining whether so-called "multiple employer interests" are employee benefit plans subject to ERISA.

The term "party in interest" in section 3(14) of ERISA is clarified (by removing the parenthetical clause in subparagraph (A)), and is narrowed in several respects to remove from party in interest status those persons who are highly unlikely to be in a position to influence the actions of a plan or of plan officials.

The term "relative" in section 3(15) of ERISA is changed to include brothers and sisters. The omission of these relatives has proven to be inconsistent with the purposes of ERISA.

The definition of "security" has been revised to avoid any possible confusion respecting the changes made by sections 271 and 274 of the ERISA Improvements Act of 1979

The definition of "multiemployer plan" has been substantially revised. A plan will be a multiemployer plan under ERISA if it is collectively bargained and has 10 or more contributing employers. A collectively bargained plan having more than one but fewer than 10 contributing employers will also be a multiemployer plan if the Employee Benefits Commission finds that it would be consistent with the purposes of ERISA to so treat it.

SUBTITLE B—SIMPLIFYING AND CLARIFYING AMENDMENTS

PART 1—REPORTING AND DISCLOSURE

Sec. 221 Disclosure of benefit information.

This section combines and slightly modifies present sections 105 and 209 It requires plan administrators not more than once per year to furnish participants who so request in writing a statement of the total benefits accrued, and the vested benefits, if any, or the earliest date on which benefits will become nonforfeitable. Administrators may satisfy this duty by furnishing annual statements containing appropriate information.

This section also requires administrators to communicate the nature, amount and form of the vested accrued benefit to participants who terminate service or incur a one-year break in service, and to whom retirement benefits are not paid during the plan year.

Employers are required to maintain appropriate records prescribed by the Commission so that benefits can be determined. If more than one employer adopts a plan, each employer must furnish the administrator information necessary for the maintenance of appropriate records.

A monetary penalty is imposed on any person who is required to furnish information or to maintain records and who fails to do so. The penalty on the responsible person is the payment to the plan of $10 for each employee with respect to whom such failure occurs, except that the penalty for an administrator who fails to comply with a request for a statement of benefit accruals shall be liable to the participant who made the request, under the terms of ERISA section 502(c), for a civil penalty up to $100 per day from the date of such failure.

Sec. 222. Exemptions.

This section amends ERISA section 110 so that the Secretary may exempt any employee benefit plan or person or any class of plans or persons conditionally or unconditionally from any of the reporting and disclosure requirements of part 1 of title I or may modify any such requirement. To grant an exemption or modification, the Secretary must find that such alteration is appropriate and necessary in the public interest and consistent with the purposes of title I of ERISA.

Sec. 223. Elimination of summary annual report.

This provision eliminates the requirement that an administrator must furnish a summary annual report to each participant and each beneficiary receiving benefits under the plan. In order to facilitate the availability of the full annual report, a limit of $10 is placed on the fee which can be charged by an administrator for a copy of the full annual report.

Sec. 224. Consolidation of forms.

Under this section, the Commission is required not later than 18 months after the date of enactment to combine the plan description (EBS-1) and the determination letter application forms (form 5300 series) This merging of forms will be applicable only to tax-qualified employee benefit plans subject to the Commission's authority

Sec 225. Improvement of reporting requirements.

In order to avoid the reporting of unnecessary information, the Commission is required to develop reporting forms and requirements which to the maximum extent feasible take into account the different types and sizes of plans. The Commission is required to report back to the Congress on its progress in this regard 18 months and again 24 months after the enactment of this section.

Sec. 226. Opinions of actuaries and accountants.

In order to eliminate unnecessary duplication of efforts by actuaries and accountants under ERISA's annual reporting requirements, an enrolled actuary is required to rely on the correctness of accounting matters as to which a qualified public accountant has expressed an opinion. Correspondingly, a qualified public accountant is required to rely on the correctness of any actuarial matter certified to by an enrolled actuary

Sec. 227 Update of summary plan description.

This section modifies the present requirement that an administrator furnish an updated summary plan description every five years if amendments have been made and a summary plan description every 10 years, whether or not amendments have been made.

The new requirement is that an administrator must furnish to each participant not less frequently than every tenth year a summary plan description which shall be updated by the integration into the document of all plan amendments, if any.

Sec. 228. Scope of accountant's opinion.

With respect to the accountant's opinion which is included in a plan's annual report, this section provides that the accountant shall not express an opinion regarding statements of assets and liabilities of common or collective trusts maintained by a bank or similar institution or of a separate account maintained by an insurance carrier or of a separate trust maintained by a bank as trustee. The statement with respect to which the accountant shall not express an opinion must be prepared by a bank or similar institution or insurance carrier regulated and subject to periodic examination by a State or Federal agency and be certified by the financial institution as accurate.

Sec. 229. Effective date.

This section establishes various effective dates for the provisions of sections 221-228.

PART 2—MINIMUM STANDARDS

Sec. 231 Reciprocal agreements.

In order to promote portability and reciprocity, this section provides that ERISA's existing rules shall not interfere with the transfer of contributions from a collectively bargained pension or welfare plan (away plan) to a similar plan in which the employee previously participated (home plan). Such transfer must be pursuant to a written agreement between the away plan and the home plan. The Secretary may by regulation establish additional conditions, and such variances and exemptions as are consistent with the purposes of ERISA, in order to facilitate such transfer arrangements

Sec. 232. Determining participation on a plan year basis.

Present law requires that the 12-month computation period for determining years of service for purposes of becoming a participant in a plan generally starts on the date on which the employee's employment commences.

The amendment provides that the computation period may start on the first day of a plan year in the case of a plan where vesting and accrual rights, for example, are determined on the basis of all of an employee's service without regard to the date on which the employee's participation in the plan commenced.

Sec. 233 Maritime industry—125 days.

Under ERISA, 125 days of service in any maritime industry is treated as a year of participation for benefit accrual purposes.

The amendment clarifies the service requirements in the maritime industry for accrual purposes. It states that 125 days of service in any maritime industry shall be the equivalent of 1,000 hours of service, and codifies an interpretation already made by the Secretary of Labor

Sec 234. Summation of different benefit accrual rates.

This amendment permits a multiemployer plan to provide that the accrued benefit to which a participant is entitled upon his separation from the service is the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates or by employment in different bargaining units

The accrued benefit may be determined for purposes of the three percent accrual method or the fractional method by projecting the normal retirement benefit to which a participant would be entitled if he continued to accrue benefits at the average of the rates applicable to his period of actual participation.

Sec. 235 Suspension of benefits because of reemployment.

ERISA permits a multiemployer plan to suspend benefit payments while an employee is employed in the same industry, in the same trade or craft, and the same geographic area covered by the plan, as when such benefits commenced.

The amendment reduces the three element test to two elements, namely reemployment in the same industry, trade or craft, and the same geographic area as when benefits commenced. The amendment also applies the suspension rule to self-employment.

In addition, it is provided that the permissible period of benefit suspension shall include a period determined pursuant to Commission regulations in addition to the months in which employment occurs to the extent necessary to prevent the periodic payment and suspension of benefits to employees who have not retired but who continue to work on an irregular basis.

The amendment permits the plan to impose a financial penalty on a person who fails to report his reemployment as required by the plan. The amount of the penalty shall be determined pursuant to Commission regulations but in no event shall exceed an amount equal to one year's benefit.

Sec. 236. Amendments to conform plans to final regulations.

This section provides that any plan amendments adopted prior to January 1, 1980 which comply with final regulations shall not violate ERISA's title I because such an amendment alters an amendment adopted after ERISA was signed into law and prior to the issuance of such final regulations. Such amendments adopted prior to January 1, 1980, though, may not decrease vested rights or accrued benefits in existence on the date ERISA was signed into law

Sec. 237 Reduction in retirement or disability benefits.

ERISA provides that if a participant is receiving benefits under a pension plan, or is separated from the service and has a vested benefit, a plan may not decrease benefits by reason of any benefit increase under Social Security or the Railroad Retirement Act of 1937, or any increase in the Social Security wage base

The amendment provides that the same rule applies to a participant receiving disability benefits under a welfare plan as of the date of enactment of such amendment.

This section also provides that a pension plan may not reduce pension benefits which are being paid to a participant or in which a participant who is separated from the service has a vested right as the result of a workers compensation award.

Sec 238 Joint and survivor annuity

Under ERISA, a plan which provides benefit payments in the form of an annuity, must provide such payments in a form having the effect of a qualified joint and survivor annuity If a plan provides for the payment of benefits before the normal retirement age, the plan is not required to provide annuity payments in a form having the effect of a qualified joint and survivor annuity during the period beginning on the participation commencement date and ending on the later of (1) the date the employee reaches the earliest retirement age or (2) the first day of the 120th month beginning before the date on which the employee reaches normal retirement age From the later of these two dates to the date on which the employee reaches normal retirement age, a plan must permit a participant to elect joint and survivor annuity coverage

The amendment expands joint and survivor annuity coverage by requiring with respect to a participant who has not less than a 50 percent vested benefit and who dies before the annuity starting date that the plan provide a survivor's annuity for the participant's spouse wh' h begins on the annuity starting date A plan will be permitted to pay benefits actuarially equivalent to such survivor's annuity earlier than the annuity starting date

A pension plan which does not provide for the payment of benefits in the form of an annuity shall, with respect to a participant who has not less than a 50 percent vested benefit and who dies before receiving such benefit, provide that the participant's account balance be distributed in the form of a lump sum to the surviving spouse not later than 60 days after the end of the plan year in which the participant died.

These changes in the joint and survivor annuity shall apply with respect to plan years beginning two years after the date of enactment of this section

Sec 239 Elapsed time.

This provision permits the Secretary to prescribe by regulation a one or more systems of measuring service for participation, vesting and accrued purposes which is based upon measurement of the elapsed time of an employee's service Such regulations shall include safeguards to ensure that employees are not, in the aggregate, disadvantaged by the use of elapsed time measurement.

PART 3—FUNDING

Sec 251 Funding to take account of future amendments

This amendment provides that the funding method may take account, and for plan years beginning after December 31, 1980 shall take account of all plan provisions, including provisions which have not yet affected participants as to entitlement to, or accrual of benefits The funding method may thus take into account a future benefit reduction.

In the event any such provision is not implemented as of the time specified when the provision was adopted, the funding standard account shall be appropriately adjusted in accordance with Commission regulations. A provision adopted but contingent on a future event shall be deemed not to be in effect as a provision of the plan prior to the occurrence of that event.

PART 4—FIDUCIARY RESPONSIBILITY

Sec 261 General asset account.

ERISA provides that in the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall include such policy, but shall not, solely by reason of the issuance of such policy, include any assets of the insurer

This amendment broadens this provision by providing that in the case of a plan the benefits of which are insured, the plan assets shall include the insurance policy but shall not, solely by reason of the issuance of such policy, include the assets of the insurer except to the extent such assets are maintained by the insurer in one or more separate accounts and do not constitute surplus in any such account.

Sec 262 Obligation of employer to contribute.

Under this new section, every employer who is obligated under a collectively bargained plan (or under a collective bargaining agreement related to such a plan) to contribute periodically to such a plan is required, in accordance with applicable law, to make the agreed-upon contributions.

Sec 263. Refund of mistaken contributions.

ERISA section 403 provides that plan assets shall never inure to the benefit of any employer except as permitted under statutory exceptions, which include the permissible return of a contribution within one year after the payment of such contribution by a mistake of fact.

This amendment permits a multiemployer plan to return an employer contribution within one year after the plan administrator knows that the contribution was made by a mistake of fact.

Sec. 264. Cofiduciary responsibility

ERISA section 405 presently provides that a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan if he has "knowledge" of a breach of such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach

This amendment provides that in the case of a fiduciary who is not an individual, the term "knowledge" shall mean knowledge actually communicated (or knowledge which, in the normal course of business, should have been communicated) to the fiduciary's officer or employee who is authorized to carry out the fiduciary's responsibilities (or who does so in fact) regarding the matter to which the knowledge relates

This amendment also limits the responsibility of any cofiduciary respecting the failure of an employer who is a fiduciary to make contributions to a collectively bargained plan.

Sec 265 Exemption for reciprocity arrangements.

In order to avoid confusion [illegible] uncertainty regarding the permissibility of transfers of contributions from one collectively bargained plan to another, this section adds to section 408(b) of ERISA a prohibited transaction exemption, with appropriate safeguards, regarding transfers of contributions between such plans pursuant to section 131.

Sec. 266 Solvency standards for insured welfare plans.

This section requires that every uninsured welfare plan which is a multiple employer trust (MET) shall be subject to such solvency and reserve standards as the Secretary shall require by regulation. Such regulations shall become effective not later than 18 months after the date of enactment of the ERISA Improvements Act of 1978.

PART 5—ADMINISTRATION AND ENFORCEMENT

Sec 271 Remedies

This section makes several changes in section 502 of ERISA.

Subsection (a) of section 502 is revised to conform with the changes made by section 221 of this Act.

Subsection (b) is revised to conform to the changes made by title I of this Act, and to preclude the Employee Benefits Commission from initiating suits to collect contributions owing to a plan.

Subsection (g) is amended to provide that where a judgment has been awarded in an action to collect contributions owing to a plan, the court shall allow a reasonable attorney's fee and costs of the action, to be paid by the defendant.

Subsection (i) is deleted to conform to changes made by title I of this .

Subsections (j) and (k) are redesignated as subsections (i) and (j), respectively, and a new subsection (k) is added to provide that, concerning any employee benefit plan other than an eligible individual account plan in which participation is voluntary, no person or employee benefit plan shall be subject to liability of any sort as the direct or indirect result of a cause of action explicitly or implicitly alleging that the interest of an employee in such a plan is a security under Federal or State securities laws. With respect to such plans, no court of the United States shall have jurisdiction of an action, whether instituted prior to or on or after the date of enactment of this section, to the extent that it is alleged that the interest of an employee in such a plan is a security under Federal or State securities laws.

New subsection (k) also makes it clear that participation is not voluntary under the terms of a plan if, as an incident of employment or as an incident of membership in an employee organization the members of which are covered under the plan and upon satisfaction of the plan's participation requirements, an employee becomes a participant in the plan, notwithstanding the existence of a plan provision permitting an employee, subject to approval by the plan administrator, to waive participation in the plan.

Sec. 272. Advisory council.

This amendment changes ERISA section 512 to provide that one of the members representing employers on the Advisory Council on Employee Welfare and Pension Benefit Plans shall be a representative of employers maintaining small plans.

Sec 273 Impact of inflation on retirement benefits.

This section amends section 513 of ERISA to direct the Secretary to conduct a study of the feasibility of requiring pension plans to provide cost of living adjustments to benefits payable under such plans. The Secretary (Commission) is required to submit this study to the Congress no later than 24 months after the date of enactment of this section.

Sec. 274. Preemption.

This amendment revises section 514 to clarify the applicability of other Federal and State laws to plans which are subject to ERISA. First, it provides that ERISA supersedes Federal and State securities laws to the extent that such laws might be applied to the interest of an employee in an employee benefit plan. This change makes it clear that the interest of an employee in an employee benefit plan described in section 4(a) and not exempt under section 4(b) of ERISA is not a security within the meaning of Federal or State securities laws unless such plan is an eligible individual account plan in which participation is voluntary.

Second, this section also makes it clear that the interest or participation of an employee benefit plan subject to ERISA in a single or collective trust maintained by a bank or in a separate account maintained by an insurance company is not to be considered a security within the meaning of Federal or State securities laws, and that such single or collective trusts and separate accounts are not to be considered investment companies for purposes of Federal and State laws.

TITLE III—INTERNAL REVENUE CODE AMENDMENTS

Sec. 301 Lump sum distributions, plans treated as single plan.

This provision amends section 402 of the Internal Revenue Code of 1954 to provide that in the case of a multiemployer plan, defined benefit plans shall be considered separately from defined contribution plans for purposes of determining the balance to the credit of an employee under the lump sum and distribution rules.

Sec 302 Lump sum distributions, separation from the service

This section amends section 402 of the Internal Revenue Code to permit a multiemployer plan to deem an employee who has not worked in service covered under the plan for six months as having separated from the service for purposes of the lump sum distribution rules.

Sec 303 Deduction for employee contributions to qualified plans.

This section amends the Internal Revenue Code to permit a deduction from taxable income for contributions made by employees to qualified retirement plans. The deduction is similar in many respects to the deduction that is presently permitted for contributions to Individual Retirement Accounts, but the deductible amounts are lower to take employer contributions into account. In general, the maximum deduction permitted is the lesser of 10 percent of compensation or $1,000 However, the allowable deduction is reduced by 20 percent of the amount by which adjusted gross income exceeds $20,000.

Under these provisions, every qualified retirement plan will be required to accept employee contributions, and several special conditions are included to avoid undue complications and paperwork.

First, all plans will treat the employee contributions as individual accounts.

Second, there will be no setoff against employee contributions and therefore no need to engage in complicated calculations under a defined benefit plan to determine the value of the employer's contribution respecting each contributing participant.

Third, the maximum annual contribution

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that any plan will be required to accept from any employee will be $1,000.

Sec. 304. Credit for establishment of small plans.

This section adds to the Internal Revenue Code a new section providing a tax credit for small employers who establish retirement plans that meet ERISA's requirements. The credit, which would be available in addition to the deduction for allowable employer contributions, would be based on a percentage of these contributions and would phase downward over a period of five years from the year in which the employer establishes the plan. The allowable credit would be 5 percent for the first year of plan maintenance, 3 percent for each of the following two years, and 1 percent for each of the next two years.

The credit would not be available for a small employer establishing a plan which is a successor plan to a plan previously maintained by the employer and terminated any time after December 31, 1977.

Sec. 305 Credit for the improvement of qualified plans.

This section would amend the Internal Revenue Code to provide a tax credit of 5 percent of an employer's allowable deduction for contributions to a qualified plan (other than an H.R. 10 plan) for any year in which the Employee Benefits Commission determines, under section 134 of the Act, that the plan is an improved plan.

Sec. 306. Denial of IRA benefits to owner-employees.

This section amends the Internal Revenue Code to prohibit employees (sole proprietors, 10 percent or more partners, and officers or 10 percent or more corporate shareholders) from establishing Individual Retirement Accounts for themselves.

Sec. 307. Retroactive disqualification of plans.

This section prohibits the retroactive disqualification of a plan which is subject to ERISA unless the Employee Benefits Commission determines that the past failure to meet the qualification standards was a result of intentional failure or willful neglect on the part of the plan sponsor.

TITLE IV—SPECIAL MASTER OR PROTOTYPE PLANS

Title IV of the bill adds a new part 6 to title I of ERISA to encourage the creation of a new type of master or prototype plan, called a "special master plan," which could be adopted by employers who wish to provide sound retirement income programs for themselves and their employees, without being subjected to the paperwork and other burdens commonly associated with maintenance of a private pension plan.

Section 601(a) defines the terms used in the section and provides that special master plans must be individual account (defined contribution) plans.

Subsection (b) describes the very limited duties under ERISA and the relevant Internal Revenue Code provisions which will be the responsibility of an employer who chooses to adopt a special master plan.

Subsection (c) describes the broader duties under ERISA and the relevant Internal Revenue Code provisions that will be the responsibility of the special master plan sponsor who will be an investment manager, such as an insurance company, bank, investment company, etc. Under these provisions, it is made clear, for example, that the annual return/report required by ERISA and the Internal Revenue Code may reflect the assets of the entire special master plan, so long as the return/report identifies the proportion of special master plan assets attributable to each adopting employers' plan, and that the summary plan description for each adopting employer's plan may describe the standard provisions of the special master plan, so long as it also includes any different or additional provisions which apply to the plan of the adopting employer, and contains appropriate cross-references.

Subsection (d) directs the Employee Benefits Commission to develop regulations and other forms of guidance to facilitate the wide use of special master plans and establishes a mechanism for the approval of such plans. Also, the Commission is directed to study the feasibility of extending the special master plan concept to defined benefit plans.

Subsection (e) provides that upon the failure of an employer to meet his limited responsibilities in connection with the adoption and maintenance of a special master plan, the employer becomes the plan administrator and thereby becomes subject to all of the rules and regulations applicable to plan administrators under ERISA.

Senator WILLIAMS. Before we get to our first witness, I want to insert in the record at this point a statement from Senator Nelson. As a member of both the Human Resources and Finance Committees, he has a strong interest in our proceedings, but was unable to join us today.

[The prepared statement of Senator Nelson follows:]

OPENING STATEMENT

OF

SENATOR GAYLORD NELSON AT JOINT HEARINGS OF THE SUBCOMMITTEE ON PRIVATE PENSION PLANS, SENATE FINANCE COMMITTEE AND THE SUBCOMMITTEE ON EMPLOYEE FRINGE BENEFITS, SENATE COMMITTEE ON HUMAN RESOURCES

August 15 through 17, 1978

Today, the two major Congressional subcommittees concerned with pension legislation -- the Human Resources Subcommittee on Labor and the Finance Subcommittee on Private Pension Plans and Employee Fringe Benefits -- will begin joint hearings on several bills that would amend the Employee Retirement Income Security Act of 1974 (ERISA).

These hearings have been preceeded by detailed and careful preparation among the staff of the two principle legislative committees, as well as the Joint Tax Committee and the Small Business Committee. The importance of this work is indicated by the fact that these would be the first amendments to this statute since its enactment in 1974. It is our hope that these preliminaries can set the stage for constructive changes to the law.

Speaking as Chairman of the Senate Small Business Committee, smaller business is involved with these proceedings because they account for approximately 55% of all private sector employment. Further, the expansion of coverage of the private pension system which would be desirable for all employees must take place, to a considerable extent, in the small business sector.

PRIOR HEARINGS

The Senate Select Committee on Small Business, in conjunction with the Pension Subcommittee, conducted eight days of non-legislative joint hearings during 1976 and 1977. These hearings addressed a range of concerns of small business owners with ERISA paperwork, reporting and compliance, in great depth and detail. Three specific areas were consistently cited by business owners as being in serious need of reform. These included (1) the complex and burdensome reporting; (2) the confusion and delay imposed by dual regulation in some areas; and (3) the unintended side-effects on investment behavior created by ERISA.

The reporting and disclosure requirements imposed by ERISA have created substantial costly paperwork burdens for all pension plans. However, these requirements are particularly onerous for smaller plans, with their more limited resources.

The impact of new ERISA standards and compliance requirements is directly reflected in the statistics on pension plan creations and terminations after ERISA took effect. Testimony during the 1977 hearings showed that there were 16,701 plan terminations during 1976, almost twice the 1975 level and nearly four times the 1974 and 1973 totals, as shown in the following chart. Similarly, initial qualifications of plans was cut in half in the years between 1973 and 1976:

Pension Plan Creations and Terminations Since Enactment of ERISA*

Historical Analysis of Corporate Type Retirement Plan Terminations

	Pension or annuity plans	% of total	Profit-sharing plans	% of total	Stock bonus	Total determination letters issued on terminations
1967	602	46.2	700	53.7	1	1,303
1968	672	46.6	769	53.3	2	1,443
1969	868	50.2	857	49.6	4	1,729
1970	1,142	49.5	1,164	50.5	*	2,306
1971	1,605	48.1	1,730	51.9	*	3,335
1972	1,775	50.0	1,775	50.0	*	3,550
1973	2,222	53.8	1,908	46.2	*	4,130
1974	2,577	56.0	2,027	44.0	*	4,604
1975	4,664	56.3	3,612	43.6	*	8,276
1976	9,100	56.6	6,971	43.4	*	16,071

Historical Analysis of Corporate Type Initial Qualifications of Retirement Plans

	Pension or annuity plans	% of total	Profit-sharing plans	% of total	Stock bonus plans	Total initial qualifications
1967	11,292	55.0	9,205	44.9	25	20,522
1968	12,896	54.2	10,864	45.7	22	23,782
1969	14,692	52.3	13,346	47.6	37	28,075
1970	16,512	50.7	16,062	49.3	*	32,574
1971	18,171	44.7	22,493	55.3	*	40,664
1972	28,265	57.3	21,070	42.7	*	49,335
1973	33,830	56.8	25,775	43.2	*	59,605
1974	32,899	54.9	27,020	45.1	*	59,919
1975	15,321	51.0	14,722	49.0	*	30,043
1976	10,996	42.0	14,824	58.0	*	25,820

*Beginning 1970 stock bonus plans were included with profit-sharing plans.

Basis: Determination letters issued by Internal Revenue Service.

* Source: Twenty-Eighth Annual Report, Select Committee on Small Business, S. Report 95-629, February 1, 1978, page 158, derived from testimony of U.S. Dept. of the Treasury, Joint Hearings on Pension Simplification and Investment Rules, May 10, 1977, p. 49.

This evidence suggests that the existing cumbersome and often unjustified reporting and disclosure requirements may result in an unwillingness on the part of small business to create new pension plans for their employees, and may be causing the terminations of plans which are soundly managed and would otherwise have been able to continue. This is especially troubling when viewed in light of the fact the small business sector should be the area of the greatest expansion in the creation of retirement security plans in view of estimates that half of private sector workers not now covered by retirement plans may work for small business. It must be kept in mind that in most cases, these pension plans are voluntary on the part of the sponsor. To the extent that excess reporting and compliance burdens inhibit new plans and end existing plans, the law is counter-productive. The private sector has been notably successful in attracting discretionary funds into the pension system to build up future retirement income of the labor force, and we should be doing everything we can to help this process along.

REMEDIAL LEGISLATION

One of the legislative proposals arising out of our 1977 hearings was S.1745, my bill that would require the consolidating of reporting to the pension agencies into a single annual report, with common access by all three agencies. In response to the issues raised in these hearings, the participating agencies agreed on the administrative level to implement the single-filing-of-annual-report procedure. The Small Business Committee advocates that Congress adopt the language of S.1745, which would Congressionally mandate this process. This action would serve as a signal to small business owners, who want a simplified pension system, that Congress can create legislation consistent with the dual goals of safe retirement security for employees, without imposing impractical, costly, or disruptive paperwork burdens on employers.

A second proposal in our bill was aimed at drastically reducing the paperwork and time required for obtaining an exemption from the "prohibited transaction" rules under ERISA. Hopefully, the Administration's Reorganization Plan No. 4 on ERISA, which was announced on August 10, 1978 will accomplish this. We are gratified at this effort to eliminate the dual and overlapping authority in the two Departments (Labor and Treasury). The August 10 Reorganization Plan also speaks to issues in other parts of S.1745. It provides a reduction of small business reporting: In place of an annual report to the government, a full report would be submitted every three years, with updating information only in the second year.

A third element of the Reorganization Plan addresses our concern with the periodic reports that must be furnished to all plan participants and beneficiaries, which have been criticized by many business leaders for their length and nature of material requested. Our bill recommended a much simplified format for this reporting and the Reorganization Plan responds to this problem by putting forth a two-page model summary.

The Reorganization Plan can thus be a positive step toward improving the climate for private employers to establish, continue and broaden retirement plans for their employers.

CHANGES IN INVESTMENT POLICY

Another area of continuing concern to the Small Business Committee is the increased investment conservatism of pension fund managers under the new Federal "prudent man rule" legislated by ERISA.

This conservatism has aggravated the already critical problem of capital formation for small businesses, as fiduciaries who fear personal liability for possible "imprudent" investments are less willing to place their funds in any other than the most established "blue chip investments."

Of particular concern to fiduciaries is the decision of a New York Court in the case of The Bank of New York vs. Spitzer, which raised the spectre that trustees and investment managers can be held responsible for one or two unsuccessful investments in a fund that overall has performed well.

In testimony during our 1977 hearings, Attorney Robert Hickey itemized some of the specific legal considerations in this additional conservatism, which could apply if the manager made an investment in a small business which resulted in a loss:*

"Under section 409 of ERISA, the fiduciary is personally liable to the full extent of any losses of the plan resulting from a 'breach' of his duty;

"Under section 502, the fiduciary can be sued in a civil lawsuit to test whether such an investment constituted a 'breach.' This might mean that his organization could incur legal expenses (estimated at between $10 and $40,000 per year for several years) in defending the suit;

"Under section 502(g) reasonable attorneys' fees and costs of such an action can be awarded by a court to either party, so that the trustee might end up paying the expenses of the claimants in the action, even if they did not succeed. At least one court has permitted the imposition of such plaintiff's costs in an unsuccessful suit;

"There is a disinclination in the financial community to provide insurance coverage to such fiduciaries, and 'very few, if any pension fund managers,' have adequate protection from indemnification agreements."

*"Pension Simplification and Investment Rules," Joint Hearings before Subcommittee on Private Pension Plans of Senate Finance Committee, and Select Committee on Small Business, May-July 1977, page 393 et seq.

LABOR DEPARTMENT REGULATIONS ON THE PRUDENT MAN RULE

In response to the attention focused on this area by the hearings, the Labor Department, on April 26, 1978, announced a proposal for new regulations under ERISA which were designed to provide some flexibility to the administrators of the nation's pension plans so that investments of appropriate amounts in smaller businesses and venture capital pools would not be precluded as a legal and practical matter.

Specifically, the regulations would allow for the application of the "total portfolio theory" to pension fund managements. under which investment in small business can be justified in the context of an overall prudent portfolio.

In conjunction with this announcement, the Labor Department invited public comment on the new proposal. The Small Business Committee staff has carefully reviewed each of the four dozen comments on file at the Labor Department. Although many of the commentators made suggestions for improvements or clarifications in the specific language of the regulations, all but three agreed with their intent. Thus, the overwhelming majority felt that a change toward more pension management flexibility was called for. Mr. W. R. Alexander, Executive Vice President for Trust for the First of Denver Bank stated:

> "It is our desire to support the Department of Labor's proposed amendment to Section 2550.404a-1. We feel that this definition of prudence will not only protect the interests of the plan participants, it will allow fiduciaries to develop better performing investment portfolios."

This sentiment, that the new flexibility would improve pension fund performance while still protecting participants' interests, runs throughout the majority of the comments.

Many commentators also felt that the new regulations would contribute toward reversing the trend toward investment conservatism that is hurting capital-hungry small business. Mr. Paul J. Miller's comment, Chairman of the Legislative Committee of the Investment Counsel, expressed this opinion:

> "We welcome the issuance of the proposed regulations as an attempt to offer useful guidance to fiduciaries responsible for investment of employee benefit fund assets subject to ERISA. We in particular applaud the rejection of the view that prudence is determined by looking at each investment separately and the confirmation of the standard of looking primarily at the reasonableness of the portfolio of which the investment is a part, viewed in the light of the overall circumstances, including the objectives and requirements of the plan. This

standard, we believe, is consistent with the approach followed by professional investment managers and provides the manager with the necessary flexibility in selecting individual investments to construct the portfolio, including in it, if deemed appropriate, investments such as the securities of small companies, newly formed companies, or foreign investments."

SMALL BUSINESS COMMITTEE STUDY AS TO THE FORMAT OF THIS CHANGE--

In a related survey, the Small Business Committee personally contacted a broad spectrum of concerned pension people including professional fund managers, attorneys with experience advising fund managers, and officials and former officials from departments and agencies responsible for the implementation of pension laws. A total of 223 individual comments were solicited. The Committee is still in the process of receiving these responses. Upon completion of our review, we will be in a position to make a more definitive recommendation as to the proper course of action in relation to changes in the "prudent man" laws.

One particularly detailed and knowledgeable comment was received from Mr. David T. Livingston, Corporate Director of Research for the Tolly International Corporation, a pension managing and consulting firm.* Mr. Livingston cites a number of areas under ERISA that could also be contributing to the general conservative investment posture in the economy. Specifically, he feels the Section 302 of ERISA, which requires annual determination of funding deficiencies, may be having some adverse effects on investment decision-making:

"Because the funding deficiency is determined annually, there is a growing tendency for trustees, their actuary, and their investment manager to look at investment performance on an annual basis rather than on the basis of a market cycle of three to five years. Clearly this puts equity investments at a disadvantage in the competition for investment capital. Why should employer trustees run the risk of incurring a funding deficiency due to equity losses when all the risk can be removed by sticking with fixed income investments?"

The natural tendency on the part of trustees created by Section 302 to avoid any investments where volatility of return is a factor has a particularly negative effect on small businesses which are by their nature somewhat more volatile. The implication of Mr. Livingston's astute observation -- that

*Letter from David T. Livingston, Ph.D., Corporate Director of Research, Tolley International Corporation to Senate Select Committee on Small Business, dated July 25, 1978.

ERISA may be creating incentives for America's capital managers to invest in the short-run rather than long-run economy, is disturbing and, indeed, is another in a series of powerful signals that ERISA is in serious need of adjustment from the standpoint of their effect upon investment and capital formation.

The comments we have already received indicate that the statutory form for this change should be seriously considered. What can be encouraged at one time by sympathetic regulators can be discouraged at a later time by unsympathetic regulators. And, it is our feeling that a Congressional declaration in this area will have more force in the courts than a departmental pronouncement.

We believe these hearings are important, and will do all we can to make them productive for small and other businesses sponsoring pension plans as well as the participants in those plans.

Senator WILLIAMS. We will start with the testimony on the Department that feels most at home in this room, the Department of Labor, represented this morning by Under Secretary Robert Brown. I see, Secretary Brown, that you are accompanied by all the Department's leading figures in the administration and enforcement of ERISA. So if you want to introduce your associates, please proceed, and we look forward to your statement.

STATEMENT OF HON. ROBERT J. BROWN, UNDER SECRETARY OF LABOR, DEPARTMENT OF LABOR; ACCOMPANIED BY FRANK BURKHARDT, ASSISTANT SECRETARY FOR LABOR MANAGEMENT RELATIONS; IAN D. LANOFF, ADMINISTRATOR, PENSION AND WELFARE BENEFIT PROGRAMS; AND MONICA GALLAGHER, ASSOCIATE SOLICITOR OF LABOR

Secretary BROWN. Let me introduce first of all Assistant Secretary Frank P -khardt, Assistant Secretary for Labor Management Relations. O my left, Ian Lanoff, who is Administrator for Pension and Welfare Benefit programs in the Department of Labor. And on my right, Monica Gallagher, Associate Solicitor.

Mr. Chairman, I am delighted to be here.

I am especially delighted to be here before the principal coauthors of this landmark legislation.

The number of bills proposed before your committee attest to congressional interest in improving the strength of the Nation's private pension and welfare plan system, and reflect the importance you place on ERISA as an integral element of this process.

The Department of Labor shares your views on the importance of ERISA; we recognize that private pension plans, which collectively have approximately $264 billion in assets, represent a major source of retirement income for our Nation's workers and a major source of investment for economic growth. They provide retirement benefits to 39 million participants and health benefits to 45 million individuals.

Much work and thought has gone into the seven bills being considered today. We are in agreement with most of the objectives of those bills.

S. 3017, the "ERISA Improvements Act of 1978" would significantly amend numerous substantive provisions of ERISA, and would also reorganize ERISA's administrative structure. We will submit a report containing a detailed analysis of its provisions.

The remaining six bills provide, for the most part, alternative methods for approaching problems addressed in S. 3017. S. 1383 eliminates from ERISA coverage, and thus from the effective Federal preemption of State statutes, plans maintained for the sole purpose of complying with, among other things, a State health insurance law; S. 250 prohibits employers from maintaining disability compensation plans that provide for plan benefits to be reduced whenever social security disability benefits are increased. S. 2992 would amend ERISA to require the use of uniform accounting standards in computing pension liabilities. S. 3193, S. 901, and S. 1745 all attempt, in one form or another, to simplify paperwork requirements and streamline enforcement.

Today I would like to discuss the proposals contained in these bills in terms of five broad areas: (1) dual jurisdiction, (2) paperwork reduction, (3) the prudence standard, (4) the impact of ERISA on State and Federal laws, and (5) extensions of employee benefit plan coverage and protections.

Last Thursday, the President announced a reorganization proposal to realign relevent ERISA responsibilities between the Departments of Labor and Treasury. We believe that this proposal will provide an immediate, though interim, solution to several problems caused by shared responsibilities under existing law, such as delays experienced in issuing important regulations and in processing requests for exemption from the prohibited transaction provisions. It will also clarify much of the confusion among the public regarding which agency has ultimate responsibility for administering relevant provisions of ERISA. The reorganization will significantly expedite the issuance of exemptions from the prohibited transactions provisions, streamline the development of regulations, and provide to the public a clearer delineation of Labor and IRS responsibilities.

Two of the bills before us today also deal with the dual jurisdiction issues, S. 3017 and S. 901. S. 3017 proposes to eliminate dual jurisdiction by establishing a single agency, the Employee Benefits Commission, responsible for all ERISA related functions currently administered by the Departments of Labor and Treasury and by the Pension Benefit Guaranty Corporation (PBGC). The Commission is intended to provide a single source for the regulation of pension and welfare plans, and to serve as a focal point for establishing national retirement policies.

S. 901 would provide a division of ERISA jurisdiction between the Departments of Labor and Treasury which would also include enforcement functions. The Department of Labor would be solely responsible for reporting and fiduciary provisions while the Treasury Department would have full authority over minimum standards.

We are hopeful that the President's reorganization proposal will effectively deal with many of the problems that these legislative proposals address. Basically, the reorganization proposal provides for the Labor Department to have rulemaking responsibility concerning fiduciary matters, and for the IRS to have the responsibility over participation, vesting and funding standards. The Labor Department would, however, retain authority to approve IRS determinations on minimum standards affecting collectively bargained plans.

The proposal retains shared responsibility between the Labor Department and the IRS where the approach has proven to be effective and desirable. Shared responsibilities continue, for example, with respect to enforcement. In this area, the Department and the IRS have established a mechanism for coordinating compliance activities. Under the program, the Departments will exchange information in order to assist enforcement actions and jointly schedule investigations in order to prevent duplicate efforts. Both the Department and the IRS will benefit from the other agency's expertise and efforts in the compliance area.

The reorganization proposal includes a pledge to evaluate responsibilities under ERISA and to submit by April 30, 1980, legislative proposals for a long-term administrative structure for ERISA. As the Secretary stated last week, the reorganization plan does not foreclose either of the possibilities outlined in these two bills. The agencies' experience under the reorganization proposal, along with the report to the Presidential Commission on Retirement Policy, will provide the administration and the Congress with a basis for assessing the proposal contained in S. 3017 and S. 901.

Since the inception of ERISA there has been much criticism of the amount of paperwork it has generated. While most materials required for submission are necessary for the effective enforcement of the act, this administration has made a concentrated effort to reduce unnecessary ERISA paperwork requirements.

ERISA's reporting and disclosure provisions provide essential information to participants and beneficiaries about the financial health of their plans and about their entitlement to benefits under these plans. These disclosure requirements have gone a long way toward taking the mystery out of benefit qualifications and have opened the financial records of plans to public scrutiny. The law grants the Department certain discretion in applying these provisions; we are endeavoring to use this latitude to promulgate meaningful and sensible standards, while at the same time holding paperwork to the minimum necessary.

Many of the bills introduced to amend ERISA contain proposals to reduce paperwork, including (a) eliminating the summary annual report, (b) providing a standard form for reporting pension fund liabilities, (c) combining the plan description form (EBS-L) with the IRS form 5300, (d) requiring cyclical filing of the annual report, and (e) establishing a single filing of the annual report.

S. 3017 and S. 1745 both propose to eliminate the summary annaul report (SAR). The SAR contains a summary of the plan's annual report and must be distributed to all participants and beneficiaries each year. The Department originally proposed regulations for the SAR on July 29, 1976. These were criticized as requiring the distribution of a document which was both burdensome for plans to prepare and uninformative to participants. In response to these objections, which are reflected in the legislation before you, we expect in the next several weeks to propose a revised regulation that makes the SAR easier to prepare and more meaningful to users by requiring less, but more significant, information.

The new SAR regulation to be proposed will prescribe a pre-designed format for the plan administrator to simply copy information directly from the annual report. This will minimize the burden on plans and will provide participants with a picture of a plan's financial activity and condition; it will also require a statement indicating where additional information can be obtained. We feel that in this form the SAR will enable participants to better understand the financial condition and operation of their plan, and not be burdensome to employers.

S. 3017 and S. 1745 link elimination of the SAR with changes to ERISA's requirements concerning participant benefit statements. The intention is to provide participants with accurate and understandable information on their status under the plan. Indeed, the Department is completing a draft of a proposed regulation on benefit statements which we believe will accomplish these objectives. But we do not believe that participant benefit statements can be entirely substituted for the summary annual report, and therefore both requirements should be retained.

Another concern regarding reporting requirements is the lack of consistency in the methods of calculating pension fund benefit liabilities and the possible duplication of effort by accountants and actuaries involved in preparing these estimates.

S. 2992 proposes the development of uniform actuarial standards, and S. 3017 would require that accountants and actuaries accept each others' analyses. These bills recognize the need to describe pension plan liabilities in an accurate and meaningful way and to relate those liabilities to the financial structure of the sponsor.

We believe that these objectives can be accomplished under present law without imposing new statutory requirements. Toward this end, the Department undertook a review of the requirements for disclosure of pension fund liabilities. This review included extensive discussions with the American Academy of Actuaries and the Financial Accounting Standards Board. The result was the formulation of proposals that will appear in the Federal Register for comment within the next month. They should provide participants and other interested parties with a uniform and clear picture of pension plan obligations, while keeping the costs to plans for providing this information at a reasonable level.

A number of bills address reporting problems involving both the Department and the IRS. The issues raised include ERISA requirements of duplicate filing for the annual report, overlap between the form 5300 and the plan description (Form EBS-1), and a cyclical filing of the annual report. Many of these problems have already been corrected.

In April, 1977, the Department and the IRS signed a memorandum of understanding establishing a single filing date for the annual report as would be required under S. 1745.

Last week the administration announced a proposal to eliminate altogether the requirements that newly established plans file the form EBS-1 and that existing plans file renewals. The suggestion that plan financial reporting be redesigned on a cyclical basis has already received substantial attention and is one of the matters to which we are devoting priority attention at this time.

As the President announced, we have agreed in principle with the IRS to develop a cyclical filing program for certain smaller plans; we envision a program in which full financial reports similar to form 5500 would be required only once every 3 years.

While we are anxious to reduce unnecessary reports for all plans regardless of size, it is essential that we continue to require the reporting of information which is necessary to support the Government's compliance efforts. In this connection we expect to be examining whether a cyclical filing system should be implemented for large plans.

The Department and the IRS intend to develop a compliance oriented form for small plans that will be designed for computerized analysis. This will be based in part on a highly sophisticated statistical technique, the discriminant function (DIF) system, which the agencies will use for ascertaining compliance with certain ERISA standards.

I would like to reiterate that we believe that steps we have taken, and are planning to take, will greatly reduce paperwork. For example, a major set of reductions in reporting requirements were contained in the annual report regulations issued on March 10, 1978. These regulations affect reports beginning with those for the 1977 plan year. Already hundreds of thousands of plans have experienced lower report preparation costs as a result of these new regulations. These regulations were based on Department consultations with administrators representing both large and small plans, service providers, and others knowledgeable in the area who were asked to identify the most costly and least useful annual report requirements of past years.

In reviewing the measures we have taken, it should be clear that not only is ERISA flexible in many respects, but the Department is committed to using that flexibility in order to relieve plans of unnecessary burdens. Therefore, I believe you will find that many of the objectives contained in the legislation before us have either already been, or are presently being, achieved administratively.

Many persons have suggested that ERISA's prudence requirement has limited investment in small business securities. In response to this concern, and because of uncertainty that existed regarding the application of this provision, the Department has issued a proposed regulation concerning the investment of plan assets under the prudence rule.

That proposed regulation makes clear that investment decisions must be viewed in the context of all relevant facts and circumstances and the plan's total investment portfolio. The regulation explains that even though investments in small companies may be riskier than "blue chip" stocks, such investments may be entirely proper under the prudence rule.

I would note that the Small Business Administration in its comments on the Department's proposed regulations regarding the prudence requirement stated:

> We think that this proposed rule, if promulgated as published, will provide an environment in which pension plans and their fiduciaries can provide investment funds to a broader spectrum of companies, including companies which are considered small business.

In addition, a review of investments by pension funds indicates that while the prudence rule may have caused some initial uncertainty, it did not lead to a concentration of investments in "blue chip" securities. S. 1745 attempts to increase investments in small business securities by explicitly providing that an investment is not imprudent solely because it is made in venture capital, or small business organizations.

We believe that the proposed regulation makes clear to plan managers that they can invest in small businesses. We see no need for, and oppose, any weakening of the very important protections provided by the prudence rule.

Another major set of issues involves the relationship between ERISA and State and Federal laws. Three main areas of overlap have arisen: (1) State laws regulating employee benefit plans, (2) Multiple Employer Trusts, and (3) Federal securities laws.

S. 1383 apparently envisages complete exemption of a class of health plans from ERISA coverage. The proposal is apparently a response to a U.S. District Court decision in *Standard Oil of California* v. *Agsalud* that ERISA preemption prevented Hawaii from adopting legislation requiring the establishment of, and regulating health plans in the State.

We are opposed to S. 1383 because it would remove existing ERISA protections with respect to the reporting, disclosure and fiduciary responsibilities of health plans. Federal preemption of State laws was a basic concept in the enactment of ERISA. The Congress established a uniform set of standards that could not be eroded or superseded by State laws. This was intended to prevent a maze of State statutes, some weaker and some stronger than ERISA.

Another preemption problem has been caused by some Multiple Employer Trusts (METs) claiming to be employee benefit plans for the purpose of circumventing regulation by State insurance commissions. A number of these METs have failed, leaving substantial unpaid claims.

Over the last year the Department has attempted to resolve the status of METs under ERISA. We have initiated investigations, entered into litigation, provided interpretations about the coverage of METs on a case-by-case basis, and issued a news release cautioning METs against engaging in certain practices. We believe that these measures will discourage the establishment of METs where the purpose is to avoid State insurance regulation.

S. 3017 contains provisions intended to remedy these abuses by providing that the Secretary may impose solvency standards on METs covered by the law. It also, by defining "employee beneficiary association," limits the number of METs which could qualify as plans. While we have some reservations about the legislative language, we support any effort made to cure the types of abuses engaged in by arrangements claiming to be plans covered under ERISA.

S. 3017 would also affect the decision of the 7th Circuit Court of Appeals in *John Daniel* v. *International Brotherhood of Teamsters.* The Court of Appeals held that the interests of participants in private pension plans are "securities" within the coverage of the antifraud provisions of the securities laws. This decision, which is currently being reviewed by the Supreme Court, would impose a new set of requirements on employee benefit plans and would involve yet another Federal agency in regulating them.

In addition, as it now stands, the *Daniel* decision could impose substantial retrospective liabilities on many pension plans. We estimate that these liabilities could be $8 billion to $40 billion.

We believe that the Congress never intended to have the securities laws cover the interests of participants in involuntary noncontributory employee benefit plans. The Solicitor General has recently submitted a brief on behalf of the United States, signed by the Solicitor of Labor and the General Counsels of the Treasury and the PBGC, supporting reversal of the 7th Circuit's decision. Noting that harmonization of the Securities Acts and ERISA is of direct interest to the

United States, the Solicitor General pointed out that the legislative history of the Securities Acts is conspicuously devoid of any references to pension plans, while, in enacting ERISA, the Congress explicitly sought to foster the growth of such plans and to provide adequate protection to employees dependent upon those plans.

The Solicitor General concluded that an employee's interest in an involuntary, noncontributory defined plan is not a security within the meaning of the Securities Act because employees do not, as they would in the purchase of a security, part with money in the hope of receiving profits, nor are they attracted solely by the prospect of a return on investment.

A major objective of S. 3017 is to extend the coverage, benefits and protections provided through employee benefit plans. This represents a farsighted and responsible concern for the welfare of our working population. As you know, only about half of our Nation's work force is currently covered by private pension plans.

Under present law, a worker may participate in a plan for 20 or 30 years, die at age 50, and the participant's survivor may have no interest in the participant's vested accrued benefits. S. 3017 would prevent this forfeiture of vested benefits if the participant had vested in at least 50 percent of accrued benefits.

The Department is completing a study on the effect of this proposal. Preliminary results thus far indicate this amendment will provide significant benefits to spouses, primarily women, who would otherwise have very limited sources of retirement income.

S. 3017 provides a number of incentives designed to stimulate the growth and improvement of pension plans. To promote the establishment of pension plans by small employers this bill provides new tax incentives, and mandates the development of "special master plans" that would reduce the administrative costs and responsibilities for small companies sponsoring pension plans.

As you are aware, the Department strongly favors having as many workers covered by pension plans as possible. The current gaps in coverage exist largely among employees working for smaller businesses. Thus, we favor the increased efforts to extend pension coverages; however, with respect to whether the proposals are consistent with sound tax policy, we must defer to the Treasury Department.

S. 3017 encourages employers to provide improved pension benefits for workers in plans of all sizes by providing tax credits for employers sponsoring "improved" plans that significantly exceed ERISA standards. It also encourages workers to contribute to their retirement security by permitting tax deductions for employee contributions to pension plans. Both these proposals would extend great benefits to retired workers and their families.

Once again, while we generally favor measures directed at improving benefits to participants, we must defer to the Treasury Department as to the tax consequences of these measures.

In summary, I believe our experience since the enactment of ERISA shows that it has brought about fundamental reform. The challenge before us lies in moving forward to further strengthen and extend the private pension and welfare plan system. I look forward to working with you on this endeavor.

I wish you to know that Secretary Marshall looks forward to working with you. We are very encouraged by the good work the committee has done thus far in submitting these very encouraging bills.

This concludes my remarks, Mr. Chairman.

I will be glad to try to respond to any questions you have.

Thank you.

Senator WILLIAMS. Thank you very much, Secretary Brown.

We applaud you for your efforts in bringing a new order under reorganization to more effective operation of ERISA. The reorganization plan comes up here under law that says it will go into effect unless in 60 days the Congress disagrees.

Secretary BROWN. That is right.

Senator WILLIAMS. This assumes that the Congress will be in session for those 60 days.

Have you looked at the calendar? There is a possibility Congress will not be in session 60 days from the time of submission. That puts it in our court, we gather. Each Chamber of Congress would then have to approve the reorganization plan.

Assuming that the plan clears Congress, what is the posture of the Department on implementing the reorganization plan? Are you gearing up and underway to move into reorganization?

Secretary BROWN. Yes, we are, Mr. Chairman. We are ready to go as soon as the Congress acts.

Senator WILLIAMS. A great deal of your statement does deal with that monstrous problem we have faced, you have faced, and we have heard about, and that is the paperwork problem. And we are fortunate indeed Senator Bentsen has devoted so much of his time to this, and I would like to now turn to Senator Bentsen for questions he has of you, and then we will go to Senator Javits.

Senator BENTSEN. Thank you very much, Senator Williams.

Let me congratulate you on what I think is an excellent statement. I have been concerned about the prudent man rule, and I see the regulations that you have proposed and I commend you. I think that will help.

I do not agree that previously investment in small companies was not deterred. The testimony before my pension subcommittee was that when they were faced with that question, they just quit investing in small companies. Now, in a period of time, that does not bring any massive change in investment portfolio, of course. But I think what you have proposed, that a prudent man can go into small companies, even though there is more risk, as long as he keeps a balanced portfolio, is a good move.

Since the enactment of ERISA, the Treasury and Labor Departments have been concentrating on the issuance of regulations, exemptions, and the approval of plan amendments. Now that those tasks have moved forward, you are going to have greater focus on plan audits.

Can you explain what Treasury and Labor have done to try to avoid inconsistent audits and how your branch offices are working together?

Secretary BROWN. Senator Bentsen, let me ask Assistant Secretary Burkhardt to respond to that question.

Mr. BURKHARDT. Senator, we are in the process now of being very wary of the duplication in terms of investigation and have worked out with Internal Revenue Service a checklist so the items that would be audited by the Internal Revenue Service on a typical audit. Information we would develop through the same kind of audit would be automatically transferred to us so that we would know, for example, in our area offices or regional offices which plans are being audited and the information that was gleaned from that report. In this way, we would not have the kind of duplicative investigation we have had in the past.

Senator BENTSEN. Senator Wendell Ford brought something to my attention the other day, information that he had received from one of his constituents, and that involves the confidentiality of pension information that is given to the Labor Department. There is a publication entitled "ERISA Benefit Plans Financial Directory of Pension Funds '78–79."

Now, he was expressing some concern that this publication includes information on the amount of pension benefits that individuals receive and other data of a personal nature.

Are you familiar with that, and if so, what steps can be taken to try to protect the confidentiality of the individual participants?

Mr. BURKHARDT. Let me make one preliminary comment. My lawyers can correct me.

The primary purpose of the law was reporting disclosure act so participants would, in fact, know what their pension benefits were. But in an effort to do that, we also have information on the financial condition of the plan, the amount of money collected and the amount of money paid out, so it would not be inconsistent with our reporting requirements.

Senator BENTSEN. I am not arguing about that at all. I am not really arguing—I am asking a question—about public knowledge of the individual participants' pension information.

Do you have knowledge of that? Senator Ford was asking me.

Secretary BROWN. I do not believe that is a Labor Department report. Our reports require financial conditions of the various funds be published but not detailed by individuals beneficiaries' amounts except perhaps in some reference averages.

At least I am not aware of any report from the Labor Department.

Ms. GALLAGHER. That is right. There are some organizations which have been compiling the plan data which is submitted to the Labor Department and which is a matter of public record, and to the extent that that plan data involves very small plans, there has been some concern that people will correctly or incorrectly draw inferences about the financial situation of the person sponsoring or participating in those plans.

The collection of the information which has to be publicly filed with the Labor Department has been the source of some complaints. What we have said is that the purpose of ERISA is to provide disclosure. The disclosure is only about information as to which there is no personal interest of privacy and that therefore there is no inhibition on the collection or sorting out or making available of that information to people who may want it.

Senator BENTSEN. Let me get back to another question you raised on actuarial computations and standardized accounting practices.

Previously pension costs could have been 5 or 10 percent of pretax expenses for a company. Now you find them typically getting up to 15 and 20 percent so the flexibility of actuarial alternatives becomes really quite important. Coupled with that is the problem that you run into on actuarial assumptions.

Let us take a case where you get into negotiations on wages. Let us take the *Caterpillar* case, for example, that was reported in Fortune magazine.

They negotiated a pension increase in 1976 with the United Auto Workers, but their pension expenses dropped from about $106 million to $100 million, and the unfunded vested liability declined from $440 million to $270 million.

Now, the principal reason was, of course, that Caterpillar raised both the interest and the wage assumptions, and the higher interest rate assumption predominated and brought about that kind of a bias.

Now, I know all parties are exercising good faith. At least we hope so. But when you have competing objectives of management and labor, they are trying to arrive at a settlement, and one of the things they can do and still keep the profits up per share for the next year is change the actuarial assumptions. Management will be long gone probably by the time reality comes to face to the pensioners, whether these assumptions were right, and I suppose leaders of the labor union would be long gone, too, at that time.

But the person who finally pays the price is the pensioner.

Now, what do you think we ought to be doing in the way of causing these companies to disclose the actuarial assumptions?

Secretary BROWN. Let me ask Ian Lanoff to respond to that question.

Mr. LANOFF. Senator Bentsen, as you know, and as I testified recently before your subcommittee, the Department of Labor was as concerned about this problem as you have expressed you are this morning. For that reason we have initiated a high priority project to come up with a method of plans reporting in an accurate fashion their pension liabilities. As the Under Secretary mentioned in his testimony, within a month we will be filing in the Federal Register proposed changes to the schedule B form which is attached to annual financial report forms beginning in the 1978 plan year. Included amongst our proposals for change will be the requirement that plans disclose the form of major actuarial assumptions that they have used in computing their pension liability figures.

The proposal also includes the requirement that for purposes of preparing the figure that we will be requiring that all plans use a single actuarial cost method, the unit credit cost method, the idea there being if every plan in the country uses the same actuarial cost method in computing pension liability figures, you will be able to compare relative pension liability of different plans in a fair and measurable way.

So we are aware of the problem. We do feel we have come up with a solution that we will be proposing soon, and rather than follow some of the earlier proposals along these lines, we also believe—believe it or not—that we have come up with a proposal that will be of all the alternatives the least costly to plans to prepare. We do think we have found a solution to this problem, and beginning next year every plan in the country will be reporting the kind of information you would like to see them report.

Senator BENTSEN. You have comparability where you can see how they compare to the guidelines in effect, but you still allow them some flexibility and judgment?

Mr. LANOFF. At this point, that is right. What we will be doing is requiring them to disclose actuarial assumptions they use. Up to now, as I understand it, plans have not been required to do it and have not volunteered to do it.

Senator BENTSEN. That is of real concern to me.

Mr. LANOFF. That is right. I take it, based on what is disclosed, we will then be able to determine whether the assumptions that had been used are sound and we will be able to use it for enforcement purposes, and the public will be able to use it for information purposes in evaluating the reported liabilities of the plans.

Senator BENTSEN. Senator Williams, I have too many other questions. I defer to my colleague.

Senator WILLIAMS. Senator Javits?

Senator JAVITS. Thank you very much. I will address just two subjects because I know you will be asked a great deal more by others.

One is your regulation on the prudent man rule.

Do you believe at this stage that the contents of your regulations ought to be encased—I used that word advisedly—in law, or do you believe the proposed rules ought to remain regulations so that they may be subject to change as experience dictates?

Secretary BROWN. The latter, Mr. Chairman. We think it should remain a regulation. As you know, we have issued proposed regulations a short time ago.

Senator JAVITS. As an experiment in regulating, what would you think of the idea of giving assurance to business that the regulations you promulgate will remain in effect say for one year? There is a risk in that, but is not the risk compensated for by the fact that people will know what to rely on and will know you are not going to change in midstream?

Secretary BROWN. That is a tough call, Senator Javits. The typical retreat of a person in an executive agency would be to say as long as we have a safety clause. But the principle, of course, of the regulation really ought to be out there; you ought to indicate it; and for all practical purposes it is there for a good piece of time. We agree with that principle, but this is an especially complex, difficult area, as you know, and we would hesitate to get that in concrete.

Senator JAVITS. Frankly, I would rather you had the period of certitude and wrote your safety clause. If we did not like it, we could holler about it. Even that would give some degree of assurance, subject to what the safety clause says.

It seems to me that this is worth your consideration because the prudent man rule is the one that causes many problems. So I strongly commend that to you.

Think it over and see what you can write as an escape clause which is as precise and limited as possible, but give business the assurance that this is it for a definite period of time.

Secretary BROWN. Be glad to do that, Senator.

Senator JAVITS. The other question is about *Daniel*. Senator Williams and I took our lives in our hands, as you know, even with our best friends, and came to what was for us a very difficult position on *Daniel* in view of the fact that we are both well known to be pro labor, pro underdog, and so on.

Of course, what has been overlooked in the few bricks which have been hurled at us is the fact that the workers who have won more and better pension plans and more and better benefits could be hurt by the *Daniel* decision. The possibility that *Daniel* is going to drain away what other participants could get because of thousands of potential special cases, is of course very harmful to the interested workers. For our solicitude on that score, we have not gotten much credit, Mr. Chairman.

But about *Daniel*, what I would like to ask you is this. Obviously you have taken the position and the Solicitor General in behalf of the Administration has taken the position that *Daniel* should be reversed

But what about the common law fraud aspects of *Daniel?*

As I understand it, the *Daniel* complaint is based upon the antifraud provision of the Federal securities laws as well as State, common law antifraud provisions. I do not think you can answer it now, and I do not want you to answer it off the top of your head; but I do think the Department should give some study to what might be done about the straight issue of fraud and the accessibility of the Federal courts for the purpose of redressing fraud on a common law basis.

So, assuming that the Supreme Court overrules *Daniel* what should be done about the facilitation of straight issues of fraud, particularly regarding class actions, given the nature of the people who seek a remedy?

I would greatly appreciate your advice and views on that score.

Is that feasible for you?

Secretary BROWN. Yes. We will submit something for the record. It is a very important issue.

Senator JAVITS. It would be helpful to me as a lawyer as I try to sift through the information.

Thank you, Mr. Chairman.

Senator WILLIAMS. Thank you, Senator Javits.

Back to *Daniel*, the reorganization that you are about to embark upon of course, is reorganization of present ERISA functions of the Departments of Labor and Treasury, IRS. If *Daniel* should be upheld, you have a new partner—the SEC— in this, have you not?

Secretary BROWN. Yes.

Senator WILLIAMS. How would that impact? What would be the departmental impact if *Daniel* should be upheld by the Supreme Court? Have you thought about this at all?

Secretary BROWN. We have thought about it, Mr. Chairman. It would really be very chaotic. It would seem to me we would have to go back to the drawing boards. It would be a very difficult situation. We would have to make every effort to draw up coordinate kinds of procedures and plans. It would put a cloud over the entire reorganization.

Senator WILLIAMS. Coming to a fine bead on the situation presented in the *Daniel* case, there was a break in service that denied Daniel the pension. All pre-ERISA, by the way.

Secretary BROWN. All pre-ERISA.

Senator WILLIAMS. Since ERISA, the rules of a plan on breaks in service are fully known to participants, am I right?

Secretary BROWN. That is correct.

Senator WILLIAMS. In other words, the situation of Mr. Daniel, the situation there presented is now impossible unless there is negligence in the plan's administration under ERISA today?

Secretary BROWN. I would say that is correct unless there was something retrospective.

Senator WILLIAMS. Not retrospective.

Secretary BROWN. This is all post-ERISA.

Mr. BURKHARDT. I think, Senator, the whole question of break in service is whether or not it is fully explained in the summary plan description.

Senator WILLIAMS. That is the point.

Mr. BURKHARDT. If it is in the summary plan description and the employee has access, which he has to under the law because it has to be mailed to him, then he should know what the break in service rules are with regard to that plan. But that still gets us to the other question Senator Javits raises which is a very important one, and that is what if, in fact, the plan is portrayed as something different by an organizer, by a business agent, by plan administrator and the rest, the fraud questions. I think they are at the heart of this. We have to be able to answer that particular dilemma.

I think, though, that in terms of the law, it is very clear, our regulations are very clear about what has to be in summary plan description, and I do not think that any worker could misunderstand if the plan is complying with the law, what the break-in-service rule is with regard to his plan.

Senator WILLIAMS. We still have the situation you have hypothesized, a misstatement by someone in a position of authority with respect to the pension plan.

Mr. BURKHARDT. That is right.

Secretary BROWN. That is correct. It goes to the whole fraud question.

Senator WILLIAMS. But as far as the substance of the plan, this law as it is—and as your regulations have implemented it—insures that every participant knows what his rights are, what his obligations are in terms of employment continuity and other plan rules, in order to be a beneficiary; is that right?

Secretary BROWN. That is correct.

Senator WILLIAMS. Just one further question before we return again to Senator Bentsen.

You are going to simplify the summary annual report?

Secretary BROWN. That is correct.

Senator WILLIAMS. You are in that process?

Secretary BROWN. We are in that process right now.

Senator WILLIAMS. Retaining the requirement that each participant be supplied a summary annual report?

Secretary BROWN. Yes; that is correct.

Senator WILLIAMS. This is one aspect on which we have received a great deal of expression of concern over cost. Just the paper, the handling, the printing and mailing of the annual report to every participant is a great burden. I am just wondering whether you have weighed fully the benefits of requiring this as an annual mailing to every participant in the plan?

Secretary BROWN. Mr. Chairman, we have weighted this very carefully. We believe that the existing SAR is really altogether too onerous and altogether too burdensome. There is no question but that we ought to try to boil it down and make it as summary, but as effective as possible. We think that the disclosure provisions, on an annual basis, is important, because it contains certain significant kinds of information. We are going to really attempt to get this down to as small a piece of paper as possible, and make it as painless on the employer as possible, by taking the information, significant information, directly from his regular annual report.

Senator WILLIAMS. We will keep pursing the question of whether it is really essential to the participant that the document be automatically furnished. There are other ways that information could be readily available without the burden of all that mailing.

Secretary BROWN. We are in the same position. We intend to stay on top of this one, too. We may, after experimenting, go to posting, as suggested in S. 3017.

Senator WILLIAMS. I notice Senator Matsunaga is here. Senator Matsunaga is very interested in the preemption questions under ERISA.

Senator Mastunaga, do you want to proceed now?

Senator MATSUNAGA. I have one question I would like to put to Secretary Brown, if I may.

Senator WILLIAMS. Fine.

Senator MATSUNAGA. Thank you, Mr. Chairman.

On page 14 of your prepared statement, Mr. Secretary, you state that you are opposed to S. 1383 because it would remove existing ERISA protections with respect to the reporting, disclosure, and fiduciary responsibilities of health plans.

Now, as you probably know, in the case of the Hawaii State health plan, it is the State which operates the plan. So that the reporting disclosure and fiduciary responsibilities are fully backed by the government itself.

If that be the case, would you then remove your opposition to the bill as proposed?

Secretary BROWN. Senator, let me respond by saying that the broad preemption features of ERISA are really a double-edged sword. They are very pervasive, as you know. They are what you are troubled with in Hawaii, where here we have an extension of health benefits. It is very hard for a Labor Department official not to seriously weigh extension of benefits which we believe in against the whole issue of the importance of preemption. Preemption is important because it is a tremendously complex area.

Were we to have 50 different benefit provisions for corporations, multiemployers to deal with, were we not to consider that these matters are so important that the Congress itself, as it did in 1974, when it established the broad preemption feature, should deal with these issues as a national question, we are troubled, of course, because in this case the benefits are somewhat beyond what are prescribed in this ERISA.

On the other hand, we think that the broad preemption features of ERISA are very important, and we would abandon those only after careful and diligent study.

Senator MATSUNAGA. Suppose a State had already enacted a health plan approach before ERISA, and supposing also that that State plan met all standards as set forth in ERISA, and in some instances even provided stricter provisions for safety than ERISA, now in the light of other programs, which the Federal Government has going on, which are national in scope, and which do not, in fact, have preemption provisions, would you not agree that the program, such as that in effect in Hawaii, ought to be allowed?

Secretary BROWN. Senator, I guess I would have to stand on my statement. I know that it may seem incongruous, but as soon as we move toward narrow preemption provision, we will get into the great difficulty of trying to define what is and what is not better by way of a pension plan, or by way of a benefit plan.

Is it better to have certain kinds of fiduciary responsibilities that go beyond the current fiduciary responsibilities——

Senator MATSUNAGA. Are you not overlooking the fact that we already have many such national programs in effect? What we propose is not without precedent.

Secretary BROWN. Senator, I am very certain that the Senate and the House, in considering this broad creation feature in ERISA, must face that issue squarely. It is probably the broadest preemption feature——

Senator MATSUNAGA. What I am objecting to is the tendency to take a broad brush and say this is it, and not take a look at the individual case. This is what bothers me about the position that you have taken.

Secretary BROWN. Senator, I have tried to indicate that we feel very strongly about broad preemption position, and we have taken this position throughout the history of ERISA. That does not mean we are not willing to study and work with the committee with regard to special and significant and specific problems.

I am trying to indicate our posture. Our posture is one of feeling that it is terribly important.

Senator MATSUNAGA. Let me get this one more thing off my chest.

The administration which you represent has, for all intents and purposes, a program designed to bring about, maybe not as fast as some of us would want, as announced by the President, but a final objective of bringing about health insurance for as many, if not all of the people of these United States.

Hawaii has taken the initiative, whereby its programs cover 98 percent of the entire population, and half the inpatient utilization of the national average. We are setting an example for the entire Nation, and you come here and say, "Hawaii, I think you are going too far ahead," and strike us down.

The only reason the case went into court was that the State law was applied to out-of-State employers. This was the case of *Standard Oil* v. *Agsalud*.

I do not know whether you are familiar with the case or not, but while the court in its decision did say that the act affects interstate commerce in view of out-of-State compliance provisions, it also stated that the ultimate remedy for this issue is in the Congress, and not in the courts. It was for that reason that Senator Inouye and I, representing Hawaii, introduced the bill which is now before this joint subcommittee.

No further questions.

Senator WILLIAMS. As I mentioned, we will come back to Senator Bentsen who has other questions.

Senator Inouye is here, and I understood you did want to give your presentation later.

Senator MATSUNAGA. Senator Inouye is prepared now.

Senator WILLIAMS. Could we continue with Senator Bentsen, and then come to your statement, Senator Inouye?

Senator BENTSEN. Let me say, Senator Williams, I would defer to Senator Inouye. I do want to call attention to the time, and I am not addressing this remark to you, Senator Inouye, but we still have Treasury and the IRS to be heard from.

Senator WILLIAMS. And the SEC.

Senator BENTSEN. I will defer any questions I have to my colleague, Senator Inouye.

Senator MATSUNGA. Mr. Chairman, we have a panel of witnesses from Hawaii, and Senator Inouye will introduce them at this point, so if we can have the panel.

Senator BENTSEN. I will address my other questions in writing to the Department of Labor.

Let me also say to the Secretary, I have been very encouraged by what I have heard this morning.

Senator JAVITS. May we know when we will have their departmental analysis of S. 3017?

Secretary BROWN. It is almost completed.

Senator WILLIAMS. We were told by Labor Day we will have it.

Secretary BROWN. Yes.

Senator WILLIAMS. And your detailed comments on the other bills, too?

Secretary BROWN. Yes.

Senator JAVITS. Thank you.

Senator WILLIAMS. If there are any other questions, we will submit them in writing to you.

Secretary BROWN. Thank you, Mr. Chairman.

[The following material was subsequently supplied for the record.]

U. S. DEPARTMENT OF LABOR

OFFICE OF THE SECRETARY

WASHINGTON

SEP 8 [illegible]

Honorable Harrison A. Williams, Jr.
Chairman
Committee on Human Resources
United States Senate
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your request for the views of the Department of Labor on S. 3017, the "ERISA Improvements Act of 1978." S. 3017 would make major changes in the Employment Retirement Income Security Act of 1974 (ERISA).

The changes proposed by the bill address major areas including jurisdiction, growth of plans, employee benefits, securities law coverage, multi-employer trusts, and reporting and disclosure.

S. 3017 establishes an independent administrative agency--the Employee Benefits Commission--to oversee ERISA, consolidating functions now performed by the Departments of Labor and Treasury and the Pension Benefit Guaranty Corporation (PBGC).

To stimulate the growth of plans the bill would provide tax incentives for the establishment of new plans and would create a new type of pension plan - a "special master plan." This special master plan is intended to be especially attractive to small businesses because of the reduced paperwork.

S. 3017 would provide tax incentives to employers who improved the participation and vesting provisions of their plans. It would also provide a tax deduction for employee contributions to pension plans. Additionally, it would improve survivor benefits by providing for survivors' rights in the vested benefits of the deceased spouse.

The bill also contains provisions related to the decision by the U. S. Court of Appeals for the Seventh Circuit in Daniel v. International Brotherhood of Teamsters.

Another provision would give the new Commission responsibility for defining and enforcing solvency and reserve standards for commercially marketed multiemployer trusts that provide "insurance-like" protections but sometimes are not subject to regulation by State insurance commissions because of ERISA.

Finally, S. 3017 would eliminate the summary annual report, would change the effective period of summary plan descriptions from five years to ten years, and would propose changes in the reporting forms and requirements.

The President has proposed a reorganization plan to realign responsibilities between the IRS and the Department so as to avoid duplication and confusion to the public. We believe this realignment will provide an immediate solution for the short term to many of the difficulties addressed by S. 3017. The reorganization plan contains a provision committing the administration to submit to the Congress an assessment of the plan's effectiveness and to recommend appropriate legislation and reorganization proposals for the long term administrative structure of ERISA not later than April 30, 1980.

Rather than enact major amendments to ERISA at this time, we feel it would be more appropriate to proceed under the Reorganization Plan until early 1980 and to analyze the effect of the President's reorganization proposal and the administrative actions being undertaken by the Department. In early 1980, all proposals for a long term structure for ERISA administration will be considered including the single agency approach of S. 3017. We believe that many of the objectives of S. 3017 will be met by the reorganization and by administrative actions. Moreover, at this later date, the President's Commission on Retirement Policy will be in the process of formulating its recommendations and can advise the Administrator and the Congress on proposed changes in overall national retirement policy.

We do, however, have opinions on many of the issues in S. 3017. We are enclosing a detailed analysis of the provisions and our views on them.

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

Sincerely,

Ray Marshall

Secretary of Labor

Enclosure

Analyses of Proposals

Title I -- Sections 121, 122, 125, 126

Proposal: The bill would establish an independent agency, the Employee Benefits Commission, which would assume and consolidate ERISA functions now performed by DOL, PBGC and the IRS. These functions would include the authority to certify to the Secretary of Treasury the tax qualification of a plan and the entitlement to additional tax credits as proposed in this bill. The Commission would be headed by a chairman appointed by the Secretary of Labor.

Analysis: The new agency is intended primarily to resolve the dual-jurisdiction aspects of ERISA. The single agency concept must be viewed in the context of measures already taken to resolve dual-jurisdiction problems. A realignment of DOL and IRS jurisdiction has been proposed under the reorganization authority of the President. This realignment is intended to correct current jurisdiction problems, for example, joint processing of requests for exemption from prohibited transactions. A series of other dual-jurisdiction problems have already been resolved which include issuing of major regulations, the filing of certain annual reports with only one agency, and coordinating enforcement efforts.

Assessment: The Department opposes this proposal at this time. A single agency for the administration of ERISA would have certain advantanges and disadvantages when compared to the present dual jurisdiction system, but it is the view of the Department that the reorganization proposal presents an immediate solution to dual jurisdiction for the short term. A decision on a single agency approach should await a reasonable period of experience under the Reorganization Plan, after which an evaluation of that experience will determine the appropriate long term administrative structure of ERISA. As provided in the Plan, the Administration will submit to the Congress an assessment of the Plan and our recommendations on appropriate legislation and reorganization proposals not later than April 30, 1980.

Title II -- Section 201(b)(2)

Proposal: The bill would clarify the definition of "party-in-interest."

Analysis: This section amends and clarifies the existing definition of "party-in-interest" by removing certain categories of persons that are believed to be unlikely to influence the administration of the plan and by adding certain other categories that were omitted by error originally.

An item by item comparison of the current and proposed definition follows:

3(14) -- party-in-interest means --

A. Current: Any fiduciary (including but not limited to, any administrator, officer, trustee or custodian), counsel, or employee of such benefit plan.

Proposed: Any fiduciary, counsel or employee of such plan.

Assessment: The current parenthetical statement tends to confuse. The new language is clearer.

B. Current: A person providing services to such plan.

Proposed: A person providing professional services to such plan, or a person providing nonprofessional services on a continuous basis to such plan.

Assessment: This removes a category of persons that is unlikely to exert any influence over the administration of a plan.

C. Current: An employer any of whose employees are covered by such plan.

Proposed: An employer any of whose employees are covered by such plan, if the employees of such employer constitute five percent or more of all employees covered by the plan.

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Comment: The proposed change is apparently based on the proposition that an employer of fewer than 5 percent of a plan's participants will not be in a position to exercise improper influence over the plan, and on the further proposition that the prohibitions of, for example, section 406, should only extend to members of classes likely to be able to exercise such influence. Both propositions warrant careful scrutiny.

D. Current: An employee organization any of whose members are covered by such plan.

Proposed: An employee organization any of whose members are covered by such plan, if the members of such employee organization constitute five percent or more of all employees covered by the plan.

Assessment: See Comment C.

H. Current: An employee, officer, director (or an individual having powers or responsibilities similar to those of officers or directors) or a ten percent or more shareholder directly or indirectly, of a person described in subparagraph (B), (C), (D), (E), or (G) or of the employee benefit plan; and

Proposed: An officer, director, (or an individual having powers or responsibilities similar to those of officers or directors), ten percent or more shareholder, or a highly compensated employee (earning ten percent or more of the yearly wages of an employer) or a person described in subparagraph (d)*, (D), (E), or (G).

*This appears to be a typographical error in the draft bill; should be (C).

Assessment: The proposal eliminates from the definition of a party-in-interest all employees except the highly compensated employee-who is likely to be able to exert infuence over the administration of a plan. We support this element of the proposal. The added language also eliminates a cross-reference to subparagraph "B." This is opposed. The deletion eliminates as parties-in-interest, the officers, etc., of organizations which may be performing fiduciary services to the plan.

I. Current: A ten percent or more (directly or indirectly in capital or profits) partner or joint venturer of a person described in subparagraph (B), (C), (D), (E), or (G).

Proposed: A ten percent or more (in capital or profits) partner, or joint venturer with, a person described in subparagraphs (C), (D), (E), or (G).

Assessment: We approve the purpose of the change from "partner or joint venturer of" to "partner or joint venturer with". We understand that the purpose of this change is to codify the interpretation of section 3(14)(I) previously taken by the Department. We believe that a more accurate rendition of the position would be "partner or joint venturer in". We disapprove of the deletion of subparagraph "B" for the same reasons set forth in our comment on 3(14)(H).

J. Current: The term "relative" means a a spouse, ancestor, lineal descendant, or spouse of a lineal descendant.

Proposed: The term "relative" means a brother, sister, spouse, ancestor, lineal descendant, or spouse of a lineal descendant.

Assessment: This corrects an omission in the original Act.

Title II -- Section 201(b)(5)(A)

Proposal: The bill would revise the definition of "multiemployer plan" to include a plan that is collectively bargained and has ten or more contributing employers and would allow a collectively bargained plan having more than one employer but fewer than ten contributory employers to be a "multiemployer plan" if the Commission finds it would be consistent with the purposes of ERISA.

Subparagraph (A)(ii) of the current definition set forth in section 3(37) would be redesignated as subparagraph (A)(i), and subparagraph (A)(iii) of the current definition would be deleted. Subparagraph (A)(iii) requires that each of the contributory employers must contribute less than 50 percent of the aggregate contribution for the plan to qualify as a multiemployer plan.

S. 3017 would also delete subparagraph (B)(i) in the current definition and redesignates (B)(ii) as (B). The deleted subparagraph deals with further restrictions on the definition of multiemployer plans in industries dominated by a single employer.

Analysis: This proposal reflects certain problems inherent in the existing definition of "multiemployer plans." That definition excludes as a multiemployer plan those plans where one employer makes 50 percent or more of the aggregate contributions for a year, even though the plan may have all other characteristics of a "multiemployer plan." In addition, it causes plans to move in and out of multiemployer plan status in sucessive years as a result of fluctuations in the amount of the principal employer's contribution.

Assessment: The definition of multiemployer plan is of fundamental importance. It determines whether a plan may take advantage of special rules for multiemployer plans contained in titles I, II and IV of ERISA. The entire set of special provisions for multiemployer plans is currently being examined as part of PBGC's study on restructuring termination insurance for these plans. We believe it would be inappropriate at this time to amend the definition, and hence the scope of this most important concept, without first evaluating the recommendations proffered by PBGC.

The Department wishes to defer on this proposal pending the Administration's consideration of PBGC's full set of recommendations on termination insurance for multiemployer plans.

Title II -- Sections 201 and 266

Proposal: The bill would include in section 3 of ERISA a definition of the term "employee beneficiary association" in order to clarify the intention that such an association is one in which employees participate as members and in which eligibility for membership is based on a commonality of interest with respect to the members' employment relationship. In addition, a new section would be incorporated into ERISA providing that every uninsured welfare plan subject to the Act shall comply with solvency and reserve standards prescribed by the Secretary.

Analysis: The definition of "employee organization" in section 3(4) of ERISA includes the undefined term "employee beneficiary association." Many socalled "multiple employer trusts" (METS) have claimed to be employee welfare benefit plans established or maintained by employee organizations within the meaning of section 3(4) on the premise that they are employee beneficiary associations. The primary objective sought by most of these METS seems to have been to avoid insurance regulation by the States. (ERISA preempts State regulation of employee benefit plans.)

The inclusion of a definition of employee beneficiary association would limit the likelihood that a MET could qualify as an employee welfare benefit plan and thus not be subject to State insurance requirements by virtue of Federal preemption. Under the above amendments, the Department would also be responsible for defining minimum solvency and reserve standards for those uninsured welfare plans subject to ERISA in an attempt to provide viable safeguards for participants of such plans.

Assessment: The Department supports the objective of this proposal but feels that the proposed language needs to be broadened to resolve the METS issue. The Department would be happy to work with the Committees to develop appropriate language.

Title II -- Sections 201, 271, 274

Proposal: The bill would provide that an employee's interest in an employee benefit plan would not be deemed to be a security under State law or under Federal law unless the plan is a voluntary eligible individual account plan; it would further provide that an interest in a bank trust or separate account of an insurer issued to an employee benefit plan would not be deemed to be an investment company under Federal or State law.

Analysis: This proposal is intended to remove from the possibility of regulation under another Federal scheme the many employee benefit plans which do not have significant investment characteristics. In enacting ERISA, Congress designed uniform Federal standards for employee benefit plans. Applying the securities laws to plans is unnecessary and undesirable and threatens an intolerable retroactive financial burden.

This proposal would revise section 514 of ERISA by providing that:

(a) ERISA supersedes Federal and State securities laws to the extent that the laws might be applied to the interest of an employee in an employee benefit plan;

(b) The interest or participation of an employee benefit plan subject to ERISA in a single or collective trust maintained by an insurance company is not to be considered a security within the meaning of Federal or State securities laws; and

(c) Single or collective trusts and separate accounts are not to be considered investment companies for purposes of Federal and State laws.

Subparagraph (a) focuses on the problem created by the Daniel v. Teamsters' case where the district court ruled that a participant's interest in a compulsory, noncontributory multiemployer defined benefit pension plan was an investment security and subject to appropriate securities laws. The Seventh Circuit U.S. Court of Appeals affirmed the lower court decision. In the case before the appellate court, the Department filed an *amicus* brief urging the Seventh Circuit to reverse the district court.

Subparagraphs (b) and (c) deal with banks and insurance companies investing the assets of benefit plans through single or collective trusts or through separate accounts. It is possible that this proposal might encourage insurance companies and banks to render greater services to plans at a lower cost. However, we are not aware of any study which shows that the application of the securities laws has discouraged services to plans or that this proposal remedies any detrimental effect of the securities laws. On the other hand, the proposal would deprive many plans of existing and longstanding protections of securities laws traditionally applied to anyone (including small plans) in the comingled fund.

Assessment: We are in favor of legislatively reversing the Daniel decision.

Title II -- Sections 221 and 223

Proposal: The bill would eliminate the requirement that an administrator must furnish a Summary Annual Report (SAR) to each participant and each beneficiary receiving benefits under the plan, and permit annual statements to satisfy the requirement concerning data on accrued and vested benefits that must be furnished to employees.

Analysis: Section 104(b)(3) of ERISA requires that statements and schedules described in sections 103(b)(3)(A) and (B), plus other material, be furnished to plan participants and beneficiaries annually. This includes assets and liabilities, as well as receipts and disbursements. Section 105 requires that data on total accrued benefits and vested benefits be furnished to participants and beneficiaries upon request but not more than once annually.

Eliminating the reporting requirement as proposed would reduce the quality of plan benefit information currently provided to participants. The Department has proposed a new SAR regulation which provides a reporting format that calls for less but more meaningful information. The new SAR provides participants with the most important financial data about their plan, but does not require compiling new information since such information can be taken directly from the Annual Report. It also imposes less burdensome requirements on plan administrators in terms of the amount of material which must be compiled, duplicated and delivered.

The Department will also propose shortly a regulation concerning employee benefit statements which will require that important and useful information be furnished to participants and beneficiaries while imposing a relatively small burden on administrators.

Assessment: The Department opposes this proposal because it is unnecessary in view of the Department's new SAR regulation. To avoid mailing costs, the Department is willing to consider alternative methods for making information available, such as posting, under appropriate circumstances.

Title II -- Section 222

Proposal: The bill would permit the Secretary to exempt or modify by regulation the reporting and disclosure requirements for pension plans. This proposal provides the Secretary with basically the same exemption and modification authority for pension plans that presently exists for welfare plans.

Analysis: Section 110 of ERISA currently allows the Secretary to prescribe alternative reporting methods for pension plans if it can be shown that, among other things, the existing reporting requirements will substantially increase plan costs or impose unreasonable administrative burdens with respect to plan operations. Our experience to date has shown current section 110 is sufficient for eliminating unnecessary requirements as evidenced by the alternative reporting methods already established.

Assessment: The Department opposes this proposal.

Title II -- Section 224

Proposal: The bill would require that the Commission, not later than 18 months after the date of enactment, combine the plan description (EBS-1) and the determination letter application forms (Form 5300 series).

Analysis: The ERISA reorganization proposal stated that the requirement to file an EBS-1 by new plans will be abolished. This should have no effect on information available to the Federal Government and plan participants, as tax-qualified plans will continue to file the 5300 series with the IRS, and plan participants will continue to receive the SPD which contains the same information as the EBS-1. The Department will continue to receive copies of the SPD from which plan characteristic information may be extracted.

Assessment: Because the Department has announced its intention to propose a regulation which would abolish the requirement for new plans to file an EBS-1, this proposal appears unnecessary.

Title -- Section 225

Proposal: The bill would require that the Commission develop reporting forms and requirements which, to the maximum extent possible, take into account the different types and sizes of plans and report back to Congress on its progress in this regard within 18 months and again within 24 months after the enactment of this section of the ERISA Improvements Act.

Analysis: The intent of the proposal is to make reporting forms and procedures more acceptable to plan administrators and more responsive to the diverse needs of plans based on their type and size. The Department has been attempting to achieve this objective through administrative action. The Forms 5500-C and 5500-K, and the new SAR regulations reflect the Department's efforts to consider the different characteristics of plans in developing forms.

Assessment: The Department supports the intent of this proposal; however, its objective can be accomplished by administrative action.

Title II -- Section 226

Proposal: The bill would modify the provision of ERISA that permits but does not require actuaries and accountants to rely upon the analyses of the other. It would make such reliance compulsory.

Analysis: The intent of this proposal is to minimize the duplicative efforts of accountants and actuaries in preparing statements regarding plan operations and liabilities as required in the reporting provisions of Section 103 of ERISA. This proposal reflects the larger problem of accurately describing the liabilities of a pension plan and relating these liabilities to the financial structure of the sponsoring corporation.

The work of DOL and IRS has been hampered by the current lack of uniformity of actuarial assumptions and methods used in calculating pension plan liabilities. However, requiring actuaries to use data prepared by accountants will not aid in establishing uniformity. At this time, the Department believes priority should be given to defining a uniform method of calculating and describing pension plan liabilities before any compulsory acceptance of data is mandated.

The Department has been working with the Financial Standards Accounting Board and the American Academy of Actuaries to obtain a single realistic way of describing the liabilities of pension plans based on the expected experience of that plan and the current dollar value of the future liabilities discounted to the present. The Department has developed a set of proposals involving revisions to Schedule B of the Annual Report which will furnish a clear statement of the plan's liabilities. Further, there may well be valid professional objections on the part of actuaries and accountants to accepting without question each other's work.

Eliminating the sources of conflict between actuaries and accountants by legislation may be counterproductive. The two skills are quite different and the conflict may really be more of a limited overlap of responsibilities rather than a costly or duplicative overlap of functions. Accountants traditionally verify the existence of resources used throughout an organization. The assumptions an actuary makes about a workforce are similar in nature to the assumptions made about any other inventory of resources. Good business practice demands independent verification. Misleading data about workforce characteristics given to an actuary could cause faulty assumptions that may lead to long-term financial problems.

Conversely, advance information to actuaries about potential mergers or spinoffs, changes in product lines and the consequent changes in workforce characeristics would allow actuaries to give immediate data to management about the long-term consequences of these actions. Providing a strict delineation of responsibilities between accountants and actuaries might hinder necessary cooperation and review between these parties.

Assessement: The Department opposes this proposal. The administrative action taken to provide for better and standarized reporting of pension fund liabilities will resolve the major concern addressed by this amendment. The long-term cooperation of the professional associations concerned should resolve other differences.

Title -- Section 227

Proposal: The bill would provide that an administrator must furnish to each participant, not less frequently than every tenth year, a summary plan description which shall be updated by the integration into the document of all plan amendments, if any.

Analysis: Section 104(b)(1) of ERISA currently provides that an administrator furnish an updated Summary Plan Description (SPD) to each participant every five years if there have been plan amendments in the interim and a summary plan description every ten years regardless of whether there have been amendments. The proposed amendment is an attempt to further reduce the administrative costs by decreasing the frequency of preparing SPDs. The number of amendments to a plan during a ten year period, however, may make it virtually impossible for participants to keep abreast of their plan's provisions. The SPD represents the most vital communication mechanism to participants.

Assessment: The Department opposes this amendment.

Title II -- Section 228

Proposal: The bill would provide that the accountant shall not express an opinion regarding statements of assets and liabilities of common or collective trusts maintained by a bank or similar institution or of a separate account maintained by an insurance carrier or of a separate trust maintained by a bank as trustee if the institution will certify the statement as accurate.

Analysis: The proposal amends section 103 to further define an accountant's responsibilities as they apply to the expression of opinions under the circumstances cited in the proposal. This is already provided in the Annual Reporting Regulations. Such an amendment would make mandatory what is presently permissive under the statute.

Assessment: The Department supports this amendment provided that certification is made by the institution.

Title II -- Section 229

Proposal: Effective dates

(a) Plan years beginning on or after enactment: reporting exemptions, elimination of summary annual report, opinions of actuaries and accountants, summary plan description update, and scope of accountant's opinion.

(b) Provisions effective one year after enactment: consolidation of forms and improvement of reporting requirements.

(c) Provisions effective 18 months after enactment: disclosure of accrued benefits.

Analysis: This proposal which cites the dates on which the various provisions of title II of the ERISA Improvements Act are to become effective, does not seem to pose any problems.

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Title II -- Sections 231 and 265

Proposal: To encourage portability and reciprocity, the proposal would amend ERISA to remove any real or perceived limitations on the transfer of contributions from the "away plan" to the "home plan" when a participant in a collectively-bargained pension or welfare plan is working "away" from his "home" area where he is covered by his "home plan." The employer contributing to the "away" plan is not treated as an employer maintaining the "home" plan. Among other things, the proposal would add to the statutory exemptions from prohibited transactions an exemption covering this type of transfer of contributions.

Analysis: Generally, there are no prohibited transaction limitations on transfers of assets between plans if there is no party-in-interest relationship. Thus, some plans have no ERISA limitations on reciprocity. The Department is currently examining a request for a class exemption in situations where the prohibited transaction provisions may be applicable to situations such as those to be covered by the proposed legislation. With respect to fiduciary responsibility limitations on reciprocity, no limitations are perceived if plans are properly drafted and implemented. There is, however, the need to add provisions to protect both plans in the event of termination . . . and the termination insurance program.

Assessment: The Department recognizes the usefulness of facilitating appropriate reciprocal agreements, but we believe the desired result can be achieved administratively.

Title II -- Section 232

Proposal: The bill would provide that the computation period for determining years of service may be deferred until the first day of a plan year in the case of a plan where rights and benefits are determined on the basis of all of an employee's service without regard to the date on which the employee commenced participation in the plan.

Analysis: The proposal would permit plans to use an administratively simpler method of measuring completion of a year of service for purposes of eligibility to participate, since the same computation period, i.e., the plan year, could be used for all employees for all purposes. However, the proposal would be less favorable to certain employees than current section 202(a)(3)(A).

Assessment: The Department supports the purpose of this proposal but believes that its effects on the entire class of participants should be subject to further study.

Title II -- Section 233

Proposal: The bill would amend section 204(b)(3) of ERISA to provide that in the case of maritime industry plans, 125 days of service will be treated as 1,000 hours for purposes of applying the 1,000 hour of service threshold requirement for partial benefit accrual.

Analysis: Section 204(b)(3)(E) of ERISA might be interpreted to require maritime industry plans to credit employees with a full year of participation for purposes of benefit accrual for only 125 days of service. The proposal would eliminate the ambiguity in section 204(b)(3)(E) by making it clear that 125 days of service is equivalent to the 1000 hour of service threshold for partial benefit accrual in section 204(b)(3)(C) and need not represent full benefit accrual. The proposal conforms to the interpretation adopted by the Department in its minimum standards regulations.

Assessment: The Department supports this proposal. However, the statutory reference in the proposal should be section 204(b)(3)(E), not section 204(b)(3)(F). In addition, the term "days of service," not "days of employment," should be used.

Title II -- Section 234

Proposal: The bill would allow a multiemployer plan to provide that the accrued benefit to which a participant is entitled upon the individual's separation from service is (A) the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates or by employment in different bargaining units and (B) determined for purposes of section 204(b)(1)(A) and (b)(1)(C) by projecting the normal retirement benefit to which a participant would be entitled if the individual continued to accrue benefits at the average of the rates applicable to that person's period of actual participation.

Analysis: This proposal would permit multiemployer plans to provide for different accrual rates for different periods of time (e.g., to provide a different accrual rate in each successive collective bargaining agreement for the period during which the agreement is in effect) and to provide for different accrual rates for different bargaining units. The effect of this proposal would be to permit different accrual rates to be determined by each collective bargaining agreement relating to the plan. There appears to be no provision in the existing law that would prohibit these practices if they do not cause backloading. The amended language, however, could possibly permit circumvention of the backloading limitations.

Assessment: The Department opposes this proposal.

Title II -- Section 235

Proposal: The bill would place additional restrictions and, in certain circumstances, impose financial penalties on retired participants of multiemployer plans who return to work while receiving retirement benefits.

Analysis: This proposal further restricts the options available to a retired participant in a multiemployer plan who chooses to work while receiving retirement benfits. Section 203(a)(3)(B) states that it is not a violation of the nonforfeiture provisions of ERISA if benefits are suspended for the retired participant who returns to work "in the same industry, in the same trade or craft and the same geographic area" covered by the plan paying benefits to the retiree.

The proposal would change this provision to "in the same industry, trade or craft and the same geographical area." Thus the original restriction would allow an electrician in the home construction industry in N.E. Ohio to take a job while retired as an electrician in the same geographic area but in an industry other than the home construction industry. This proposal would prevent this same worker from receiving pension benefits while employed as an electrician in that geographic area regardless of the industry in which he is employed. It is the view of the department that the current ERISA provisions are sufficient to protect plans and at the same time adequately address the right of retirees to receive earned benefits. Current ERISA provisions are also consistent with the recent ADEA amendment which protects the right to work of older Americans.

In addition to our objections regarding the objective of the proposed amendment, the manner in which it is drafted presents technical problems. As structured, the proposal assigns the burden of proof to retirees to demonstrate that their employment does not violate the conditions of the plan. We question whether this is equitable, especially in view of the fact that retirement benefits would be suspended while the matter is being adjudicated.

The proposal also prescribes the imposition of penalties on "working retirees" who do not report their employment to the plan. We believe such penalty provisions are inappropriate.

<u>Assessment</u>: The Department opposes this proposal.

Title II -- Section 236

Proposal: The Bill would provide that any plan amendments adopted prior to January 1, 1980, which comply with final regulations, shall not violate ERISA's Title I because such an amendment alters an amendment adopted after ERISA was signed into law and prior to the issuance of such final regulations.

Analysis: Assuming that this proposal addresses past services and benefits, plan sponsors can already revise plan amendments that will adjust future accruals. DOL and IRS have permitted some cutbacks in vesting and accrual amendments adopted to conform with the ERISA guidelines so that plans can later adopt the provisions of final regulations. Amendments, however, to allow still further cutbacks, could substantially erode the protective provisions of sections 204(g) and 203(c)(1) of ERISA. For example, it would be particularly unfair to employees who acted in reliance on prior plan amendments to permit the retroactive reduction of benefits accrual based on plan amendments adopted prior to the issuance of final regulations. Retroactive plan amendments generally threaten employee security and participants' justifiable reliance on plan provisions.

Assessment: The Department opposes this proposal to the extent it permits retroactive benefit reductions or other retroacive modifications beyond that which is currently permitted.

Title II Section 237(1)

Proposal: The bill would provide that a welfare plan may not decrease disability benefits as a result of increased social security benefits.

Analysis: The proposed amendment is intended to remedy what was probably an oversight in the drafting of ERISA. There is no reduction in pension benefits to a retiree if social security benefits are increased (section 206(b)(1)). The proposed amendment would provide parallel protection for participants in welfare plans.

Assessment: The Department is generally inclined to support the objective of this proposal but will be conducting an analysis of the cost and benefit implications.

Title II Section 237(3)

Proposal: The bill would provide that a pension plan may not reduce benefits because of a workers' compensation award.

Assessment: The Department is currently studying this proposal and expects to report its analysis to the Committee shortly.

Title II -- Section 238

Proposal: The bill would require a plan that does not provide annuity benefits to provide a lump sum death benefit to the spouse of a participant who is at least 50 percent vested in his or her benefits and who dies before receiving the portion of benefits vested; and require a plan that does provide annuity benefits to provide a survivor annuity to the spouse of a participant who is at least 50 percent vested and who dies before the payment of benefits commences.

Assessment: The Department is currently studying this proposal and expects to report its analysis to the Committee shortly.

Title II -- Section 239

Proposal: The bill would authorize the Secretary of Labor to prescribe elapsed time systems of measuring service, including safeguards to ensure that employees whose service is measured in terms of elapsed time are, in the aggregate, not disadvantaged by comparison with other employees.

Analysis: The Department has issued proposed and interim regulations permitting the use of an elapsed time system of measuring service. The proposal would explicity recognize that an elapsed time system of measuring service is permitted.

Assessment: The Department supports this proposal.

Title II -- Section 251

Proposal: The bill would provide that the funding method may take account, and for plan years beginning after December 31, 1980, shall take account, of all plan provisions, including provisions which have not yet affected participants as to entitlement to, or accrual of, benefits.

Analysis: This proposal is apparently designed to make compliance with the minimum funding standards of ERISA easier for a plan that is experiencing funding problems by enabling the plan to take into account amendments providing for future reductions in benefit accruals immediately upon adoption of the plan amendments. The proposal would appear to reduce the number of instances in which retroactive reductions in accrued benefits are necessary to ease funding problems. Funding requirements would not be affected by the proposed amendment if they are applied to both increases and decreases in benefit levels and are limited only to collectively bargained plans. However, the IRS should retain the authority to disallow the of this method where the total effect of amendments to the plan is to evade the requirements of the Internal Revenue Code or ERISA. Otherwise, plans could manipulate the funding standard account and the deduction rules by successive amendments and the rejection of previous amendments.

Assessment: The Department will support this proposal only if: (a) it applies to both benefit increases and decreases, (b) it is limited to collectively bargained plans, and (c) the IRS can disallow use of this method.

Title II -- Section 261

Proposal: The bill would amend section 401(b) of ERISA by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) In the case of a plan the benefits of which are insured, the assets of the plan shall include the policy under which the benefits are insured but shall not, solely by reason of the issuance of such policy, include the assets of the insurer issuing the policy except to the extent that such assets are maintained by the insurer in one or more separate accounts and do not constitute surplus in any such account. For purposes of this paragraph, the term "insurer" means an insurance organization, qualified to conduct business in a State."

Analysis: The proposed amendment is apparently designed to make clear that the Department's interpretation of section 401(b)(2), as stated in ERISA I.B. 75-2, 29 CFR §2509.75-2, is appropriate.

Assessment: To the extent that the amendment is consistent with I.B. 75-2, the Department supports its adoption.

Title II -- Sections 262, 271(2) and 271(3)

Proposal: The bill would provide that every employer, who is obligated under the terms of a collectively bargained plan (or under the terms of a collective bargaining agreement related to such a plan) to make periodic contributions to such a plan, shall, not inconsistent with applicable law, make such contributions in accordance with the terms and conditions of such plan or agreement.

Analysis: The proposal addresses a recurring problem of multiemployer plans in which employers simply do not contribute to the collectively bargained plan. The proposed amendment would require an employer to make contributions to a collectively bargained plan (or under the terms of a collectively bargaining agreement related to such plan) and would render a failure to make such contributions a violation of ERISA. The proposed amendment will discourage employer abuses and promote sounder funding. The provisions do not permit the Secretary to collect contributions.

The adoption of this proposal should not preclude the exercise by the plan administrator of normal collection procedures, nor in the case of a disputed obligation, to seek recourse through arbitration. Moreover, there should be no inference that the current civil enforcement provisions of section 502 of ERISA would not apply to the minimum funding provisions of section 412 of the Internal Revenue Code.

Assessment: The Department supports the proposal but opposes a related provision of the bill providing mandatory attorney's fees for a plan fiduciary who successfully institutes an action to collect required contributions. Section 502(g) of ERISA more appropriately provides for a discretionary award of attorney fees.

Title II -- Section 263

Proposal: This bill would permit a plan maintained by more than one employer to return an employer contribution within one year after the plan administrator knows that the contribution was made by a mistake of fact.

Analysis: It is possible that an employer may mistakenly believe that all or part of his workforce is covered under a plan. An employer who mistakenly believes his employees are covered and makes contributions to the plan as a result thereof might, under present provisions, forfeit the contributions because section 403(c)(2)(A) of ERISA provides that a contribution which is made by a mistake of fact may only be returned to the employer within one year after payment.

The amendment provides fairness to employers who are likely to make mistaken contributions. It could also increase an employer's willingness to make contributions even though coverage is questionable. We feel, however, the amendment should be limited to collectively bargained plans.

Assessment: The Department supports this proposal provided: (a) it is limited to collectively bargained plans, and (b) reimbursement by plan fiduciaries is consistent with the standards of section 404 of ERISA.

Title II -- Section 264

Proposal: The bill would provide that in the case of a fiduciary who is not an individual, the term "knowledge" in section 405(a)(3) shall mean knowledge actually communicated (or knowledge which, in the normal course of business, should have been communicated) to the fiduciary's officer or employee who is authorized to carry out the fiduciary's responsibilities (or who does in fact carry out such responsibilities) regarding the matter to which the knowledge related.

Analysis: Section 405(a)(3) of ERISA provides that a fiduciary of a plan is liable for the breach of fiduciary responsibility by another fiduciary of the plan if he or she has knowledge of a breach by such other fiduciary unless reasonable efforts are made under the circumstances to remedy the breach.

Assessment: The Department supports this proposal in principle.

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Title II -- Section 272

Proposal: The bill would provide that one of the members representing employers on the ERISA Advisory Council shall be a representative of employers maintaining small plans.

Analysis: The intent of this amendment is to insure that employers maintaining small plans are represented on the Advisory Council on Employee Welfare and Pension Benefit Plans.

Assessment: The Department supports this proposal.

Title II -- Section 273

Proposal: Direct the Secretary to conduct a study of the feasibility of requiring pension plans to provide cost of living adjustments to benefits payable under such plans.

Analysis: The proposal would assist in determining the impact on plans of providing cost of living adjustments and whether such a provision would adversely affect pension plans.

Assessment: The Department has no objection to this proposal.

Title III -- Section 307

Proposal: The bill would prohibit the retroactive disqualification of a plan subject to ERISA unless it is determined that failure to meet the qualification standards in the preceding year was a result of intentional failure or willful neglect on the part of the person maintaining the plan.

Analysis: This proposal recognizes that retroactive disqualification is often punitive to participants rather than to the sponsor who is responsible for the violation. However, limiting application of this sanction to instances of intentional failure or willful neglect raises problems regarding compliance. It may be difficult to prove that these circumstances prevailed, particularly for owner-employees of a small corporation or partnership. Without proof of willfulness, disqualification would only be prospective; this removes the deterrent effect of disqualification.

The Department and the IRS have established arrangements to coordinate enforcement activities, including application of the disqualification sanction. In addition, the President's Reorganization Proposal authorizes the Department to review disqualifications based upon whether plan assets have been managed for the exclusive benefit of participants, and beneficiaries. These coordinative mechanisms together with action being taken by the IRS to selectively apply retroactive disqualification should prevent misuse of this sanction.

Assessment: This proposal is unnecessary because of measures taken by the Department and the IRS regarding retroactive disqualification.

Title IV -- Section 401

Proposal: This bill would add a series of provisions to ERISA to encourage creation of a new master or prototype plan, called a "special master plan," which could be adopted by employers who wish to provide sound retirement income programs for themselves and their employees, without being subjected to the paperwork and other requirements associated with the maintenance of a private pension plan. While this provision applies to defined contribution plans, the Commission is directed to study the feasibility of applying the new "special master plan" concept to defined benefit plans. Under the proposal, special master plan sponsors will have certain limited responsibilities in connection with maintaining the plan which should significantly reduce employers' responsibilities, paperwork requirements and administrative costs.

Analysis: There is the possibility of abuse for "special master plans" because they would be qualified in advance, without having to obtain a Determination Letter from the IRS. Accordingly, certain protections would have to be incorporated into the design of these plans. This may include requiring full and immediate vesting and more stringent minimum age and service requirements.

Assessment: The Department generally supports the proposal but believes that further analysis is needed regarding its effect.

Title I -- Section 125(a).

Title II -- Section 271(4).

Proposal:

The bill would amend ERISA to eliminate the 5 percent and 100 percent penalties that can be assessed against prohibited transactions.

Analysis:

Section 4975 of the IRC provides for a 5 percent tax against a disqualified person who engages in a prohibited transaction. An additional tax of up to 100 percent may be imposed if the transaction is not corrected. Section 502(i) of ERISA gives the Secretary of Labor similar sanctions against a party-in-interest who engages in a prohibited transaction involving any plan not covered by section 4975 of the IRC.

The bill does not provide the authority to impose any tax or sanction comparable to section 4975 of the IRC and 502(i) of ERISA.

Assessment:

The Department is concerned that without some penalty provision, there may not be sufficient deterrent against engaging in prohibited transactions. The Department opposes this proposal.

U. S. DEPARTMENT OF LABOR
OFFICE OF THE SECRETARY
WASHINGTON

Honorable Harrison A. Williams, Jr.
Chairman
Committee on Human Resources
United States Senate
Washington D. C. 20510

Dear Mr. Chairman:

This is in response to your request for the views of the Department of Labor with respect to S. 3193, the "ERISA Paperwork Reduction Act." We believe that the objectives of the bill have already been implemented administratively, or are in the process of being so implemented. We therefore do not believe the legislation is necessary at this time.

S. 3193 is aimed at reducing the administrative costs and reporting requirements incurred by pension plans in complying with ERISA. S. 3193 would require: (1) that tax-qualified plans obtain determination letters from the Internal Revenue Service (IRS) at the time the plan is created; (2) that Form EBS-1 (this Department's plan description form) be combined with the IRS's Forms 5300 and 5301 (which are tax qualification forms that require plan descriptions); (3) that the filing requirement for full annual reports be altered to require that only twenty percent of the plans file complete reports in any one year (plans would file an "annual" (complete) report once every five years and a simplified form during the other four years); and (4) that the Department and the IRS develop a booklet to assist small plans in complying with ERISA.

The Department has taken considerable administrative action in the last 18 months to limit the paperwork burden on plans. Our objective is to require plans to supply only that information which is necessary for the Department to meet its statutory role of protecting the retirement income of participants and beneficiaries. We have announced that we intend to propose to eliminate entirely the requirement for filing the Form EBS-1 (plan description). In addition, the Department and IRS have agreed in principle to develop a cyclical filing program for certain smaller plans; we envision a program in which full financial reports would be required only once every three years.

The Department has developed several informational aids, for both small and large plans, addressing specific problems and providing general assistance. We will continue to develop such aids.

We agree with the objectives of S. 3193. However, we believe that enactment of this legislation is now unnecessary because of the administrative steps taken in the last 18 months, and the steps about to be taken, to meet its objectives.

The Office of Management and Budget advises that there is no objection to the submission of this report.

Sincerely,

Secretary of Labor

Senator WILLIAMS. We will have your presentation now, Senator Inouye.

Senator JAVITS. Before our colleague starts, I want to say that I have the greatest regard and personal friendship for Senator Inouye and Senator Matsunaga. Unfortunately at 12 o'clock I have a ranking member meeting of the Republicans. I will have to attend that. I hope you will forgive me.

Senator WILLIAMS. We are very pleased to welcome you, Senator Inouye and Senator Matsunaga, and your friends from the State, and we look forward to this question that you bring us, and we promise that we will search out the answer.

STATEMENT OF HON. DANIEL K. INOUYE, A U.S. SENATOR FROM THE STATE OF HAWAII; ACCOMPANIED BY DR. JOSHUA AGSALUD, DIRECTOR, DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS; MS. PATRICIA PUTNAM, ASSOCIATE DEAN, SCHOOL OF MEDICINE, UNIVERSITY OF HAWAII; MARIO RAMIL, ATTORNEY GENERAL'S OFFICE, STATE OF HAWAII; ORLANDO WATANABE, DIRECTOR, DISABILITY COMPENSATION DIVISION, DEPARTMENT OF LABOR, STATE OF HAWAII; AND VAN HORN DIAMOND, EXECUTIVE SECRETARY/TREASURER, HAWAII STATE FEDERATION OF LABOR, AFL-CIO

Senator INOUYE. Mr. Chairman, I would like very much before proceeding with the testimony, on S. 1380, to request that my statement on S. 250, which relates to private disability benefit plans, be made a part of the record at this time.

Senator WILLIAMS. Yes, of course.

Senator INOUYE. Before proceeding, Mr. Chairman, I am pleased to introduce to the committee the following citizens from the State of Hawaii. Dr. Joshua Agsalud, director, Department of Labor, and Industrial Relations, State of Hawaii; Ms. Patricia Putnam, associate dean of the school of medicine, University of Hawaii; Mr. Mario Ramil, attorney general's office, State of Hawaii; Mr. Orlando Watanabe, director, disability compensation division, Department of Labor, State of Hawaii; and Mr. Van Horn Diamond, executive secretary/treasurer, Hawaii State Federation of Labor, AFL-CIO.

On behalf of my distinguished colleague, Senator Matsunaga, I would like to thank you for this opportunity to testify in favor of this measure which we introduced.

Mr. Chairman, I realize that most of the issues involved in this matter have been addressed by the panel, and by members of the Labor Department, so with your permission, may I request that my statement, including an editorial which appeared in the Honolulu Star Bulletin, and a copy of the speech which was presented by the majority leader of the Senate of the State of Hawaii, be made a part of the record.

Senator WILLIAMS. They certainly will be.

[The prepared statement of Senator Inouye and the information referred to above follows:]

STATEMENT OF SENATOR DANIEL K. INOUYE BEFORE JOINT HEARING OF SENATE FINANCE COMMITTEE AND SENATE HUMAN RESOURCES COMMITTEE, AUGUST 15, 1978, ON S. 250.

MR. CHAIRMAN:

I AM PLEASED TO APPEAR BEFORE YOU TODAY TO TESTIFY IN FAVOR OF S. 250, LEGISLATION WHICH I INTRODUCED TO CORRECT AN INJUSTICE BUILT INTO MANY PRIVATE DISABILITY BENEFIT PLANS.

DURING THE LAST TEN YEARS, CONGRESS HAS INCREASED SOCIAL SECURITY BENEFITS BY ALMOST 120 PERCENT, TO HELP THE AGED AND DISABLED COMBAT INFLATION. BUT MANY HUNDRED THOUSANDS OF THE NATION'S DISABLED SIMPLY DO NOT RECEIVE THE ADDITIONAL FUNDS WHICH CONGRESS HAS DEEMED NECESSARY TO MEET TODAY'S COST OF LIVING, AND MUST WATCH THEIR PURCHASING POWER DIMINISH AS THEY FIND THEMSELVES ON FIXED INCOMES.

THIS INEQUITY STEMS FROM THE SO-CALLED "OFFSET" FEATURE BUILT INTO THE MOST COMMON TYPE OF PRIVATE DISABILITY INSURANCE, WHERE THE AMOUNT OF PRIVATE INSURANCE BENEFITS DECREASES DOLLAR FOR DOLLAR AS SOCIAL SECURITY BENEFITS INCREASE. INSTEAD OF INCREASING THE MONTHLY INCOME OF THE DISABLED ON THESE "OFFSET" PLANS, SOCIAL SECURITY BENEFIT INCREASES REWARD THE INSURANCE COMPANIES ADMINISTERING THE PLANS, BY LOWERING THE AMOUNT OF MONEY THEY MUST PAY TO DISABLED WORKERS. THIS OBVIOUSLY SUBVERTS THE PURPOSE OF COST-OF-LIVING ADJUSTMENTS.

AS OF JULY OF 1974, ALMOST TWO-FIFTHS OF THE WAGE AND SALARY WORK FORCE IN THE UNITED STATES HAD PROTECTION AGAINST THE RISK OF LONG-TERM DISABILITY THROUGH NON-GOVERNMENT ARRANGEMENTS. MANY OF THESE INSURANCE PLANS CONTAINED THE "OFFSET" FEATURE, WHICH, INSURANCE COMPANIES ARGUE, MADE THEIR LOW COST POSSIBLE. BUT IN RECENT YEARS, THE RATE OF INFLATION HAS TAKEN AN UNEXPECTEDLY SHARP UPWARD TURN, WHICH CONGRESS HAS ATTEMPTED TO COMPENSATE WITH COST-OF-LIVING INCREASES IN SOCIAL SECURITY BENEFITS. THESE INCREASES ARE UNDOUBTEDLY MOST NECESSARY TO THOSE WHO DEPEND ON THEM.

DISABLED WORKERS, BY DEFINITION, ARE LESS ABLE TO SUPPLEMENT THEIR INCOMES THAN OTHERS, AND HAVE NO RECOURSE AGAINST A FIXED INCOME. TO REALIZE, THEN, THAT THESE BADLY NEEDED INCREASES DO NOT REACH THE MAJORITY OF DISABLED WORKERS BUT INSTEAD FORM LARGER PROFITS FOR INSURANCE COMPANIES IS DEEPLY DISTURBING.

MANY DISABLED WORKERS WHO MUST RECEIVE CONSISTENT MEDICAL TREATMENT ARE FEELING A GROWING FINANCIAL BURDEN. ONE CONSTITUENT HAS DESCRIBED THE BRIEF LETTERS INFORMING HIM OF REDUCTIONS IN HIS INSURANCE BENEFIT THAT HE RECEIVES EACH TIME SOCIAL SECURITY BENEFITS INCREASE.

A CANCER VICTIM WHO MUST UNDERGO CHEMOTHERAPY EACH WEEK, HE IS FINDING IT MORE AND MORE AND MORE DIFFICULT TO MAKE ENDS MEET. IT IS UNTHINKABLY CRUEL THAT A DISABLED PERSON MIGHT FIND IT NECESSARY TO HALT NEEDED MEDICAL TREATMENTS IN ORDER TO PAY THE GROCERY BILLS.

IN 1974, THE EMPLOYEE RETIREMENT INCOME SECURITY ACT WAS PASSED TO PREVENT "OFFSET" PROVISIONS IN PRIVATE PENSION PLANS, AS MANY RETIRED EMPLOYEES FOUND THEMSELVES ON FIXED INCOMES. THE INEQUITIES OF OFFSET PROVISIONS IN PRIVATE LONG-TERM DISABILITY INSURANCE PLANS HAVE ONLY RECENTLY BECOME WIDELY KNOWN, AS THE ACCELERATING RATE OF INFLATION PUT AN UNBEARABLE SQUEEZE ON DISABLED WORKERS.

A SIMILAR PROBLEM TO THAT WAS SOLVED BY THE PASSAGE OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT, I BELIEVE THAT THIS INJUSTICE IN PRIVATE DISABILITY INSURANCE CAN BE SOLVED IN A SIMILAR FASHION.

MY BILL, S. 250, WILL REMEDY THIS INJUSTICE; IT WILL PREVENT SOCIAL SECURITY COST-OF-LIVING INCREASES FROM BECOMING WINDFALLS TO INSURANCE COMPANIES. IT AMENDS THE 1974 EMPLOYEE RETIREMENT INCOME SECURITY ACT AND THE 1954 INTERNAL REVENUE CODE BY PROHIBITING THE ACCRUAL OF THE INCREASED SOCIAL SECURITY BENEFITS TOWARD DEFRAYING, REDUCING, OR SUBROGATING THE BENEFITS OWED RECIPIENTS UNDER PRIVATE INSURANCE COMPANIES.

BY FREEZING THE "OFFSET" OF INSURANCE PLANS PROVIDING DISABILITY BENEFITS, CONGRESS WILL ENSURE THAT DISABLED WORKERS WILL RECEIVE THE INCREASES INTENDED TO AID THEM, PREVENTING INSURANCE COMPANIES FROM MAKING AN EASY PROFIT WHILE THESE POLICY HOLDERS SUFFER.

IT IS MY SINCERE HOPE THAT THIS COMMITTEE WILL ACT EXPEDITIOUSLY ON THIS MEASURE; WE HAVE WAITED TO RECTIFY THE WRONG DONE DISABLED WORKERS LONG ENOUGH.

STATEMENT OF SENATOR DANIEL K. INOUYE BEFORE THE JOINT HEARING OF THE SENATE FINANCE COMMITTEE AND THE SENATE HUMAN RESOURCES COMMITTEE, AUGUST 15, 1978, ON S. 1383.

MR. CHAIRMAN:

MY ESTEEMED COLLEAGUE SENATOR SPARK MATSUNAGA AND I WOULD LIKE TO THANK YOU FOR THIS OPPORTUNITY TO TESTIFY IN FAVOR OF S. 1383, LEGISLATION WE INTRODUCED TO INSURE THAT THE STATE OF HAWAII'S PREPAID HEALTH CARE ACT WILL BE INCLUDED IN THE CATEGORY OF LAWS EXEMPT FROM THE PREEMPTION PROVISION OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.

AFTER SEVERAL YEARS OF DEBATE, IN JUNE OF 1974 THE HAWAII STATE LEGISLATURE ENACTED THE PREPAID HEALTH CARE ACT, AND HAWAII BECAME THE FIRST STATE IN THE NATION TO ENACT A COMPREHENSIVE SCHEME OF MANDATORY EMPLOYEE HEALTH INSURANCE. THE ACT REQUIRES EMPLOYERS IN THE PRIVATE SECTOR TO CONTRIBUTE AT LEAST ONE HALF THE PREMIUM COST OF A MINIMUM HEALTH BENEFIT PACKAGE TO REGULAR EMPLOYEES WHO WORK 20 HOURS OR MORE PER WEEK. EMPLOYEES MAY NOT CONTRIBUTE MORE THAN 1.5 PERCENT OF THEIR SALARIES TOWARD THE PLANS.

GRADUALLY EXPANDED, TODAY THE BENEFIT PACKAGE INCLUDES VARIOUS MEDICAL AND HOSPITAL BENEFITS, SUCH AS MATERNITY AND MENTAL HEALTH CARE, AND MOST RECENTLY, TREATMENT OF ILLNESSES RESULTING FROM ALCOHOLISM AND DRUG ABUSE. HEALTH PLANS NEGOTIATED UNDER COLLECTIVE BARGAINING AGREEMENTS ARE EXEMPT FROM THE ACT AS IT WAS FELT THAT SUCH NEGOTIATED BENEFITS ARE MORE LIBERAL THAN THOSE REQUIRED UNDER THE ACT. IN EXPECTATION OF THE ENACTMENT OF A NATIONAL HEALTH PLAN, THE PROVISIONS OF HAWAII'S STATUTE ARE WRITTEN TO TERMINATE UPON THE ENACTMENT OF SUCH A NATIONAL PLAN.

AT THIS POINT, 95 TO 98 PERCENT OF ALL HAWAII RESIDENTS HAVE SOME FORM OF HOSPITAL-MEDICAL INSURANCE, MOST INCLUDING PROTECTION AGAINST CATASTROPHIC ILLNESS. THIS INDICATES THE SUCCESS OF THE ACT IN ACCOMPLISHING ITS OBJECTIVE, AS IN 1971 MORE THAN 17 PERCENT OF THE UNEMPLOYED IN HAWAII DID NOT HAVE REGULAR MEDICAL INSURANCE. FURTHERMORE, ALTHOUGH THERE IS A PROVISION IN THE ACT FOR PREMIUM SUPPLEMENTATION FROM STATE REVENUES, EMPLOYERS HAVE NOT SUFFERED ANY SIGNIFICANT ECONOMIC DIFFICULTIES IN COMPLYING WITH THE LAW UNAIDED, AND FEW HAVE REQUIRED PREMIUM SUPPLEMENTATION.

THE LAW HAS ALSO STIMULATED GROWTH OF THE INSURANCE INDUSTRY IN HAWAII. TWO LOCAL NON-PROFIT CARRIERS, THE HAWAII MEDICAL SERVICE ASSOCIATION AND THE KAISER FOUNDATION HEALTH PLAN, HAVE BEEN CHOSEN BY A SUBSTANTIAL NUMBER OF EMPLOYERS. THE BALANCE OF THE STATE POPULATION RECEIVES MEDICAL CARE BENEFITS FROM COMMERCIAL INSURERS, SPECIAL INDUSTRIAL PROGRAMS, MEDICARE, AND CHAMPUS.

WHEN THE CONGRESS AND THE ADMINISTRATION BEGIN DRAFTING LEGISLATION EMBODYING A NATIONAL HEALTH INSURANCE PLAN, WE WOULD DO WELL TO EXAMINE HAWAII'S LAW, AS IS STATED IN THE HONOLULU STAR-BULLETIN OF AUGUST 3, 1978.

WITH YOUR PERMISSION, MR. CHAIRMAN, I WOULD LIKE TO HAVE THIS EDITORIAL MADE PART OF THE RECORD AT THIS POINT. HAWAII, I BELIEVE, COMES CLOSEST TO FOLLOWING PRESIDENT CARTER'S TEN PRINCIPLES FOR A NATIONAL HEALTH PLAN. THE STATE HAS ACHIEVED NEARLY UNIVERSAL HEALTH COVERAGE WITH VERY LITTLE OUTLAY BY THE STATE GOVERNMENT, WITH FREE ENTERPRISE CARRYING MOST OF THE WEIGHT, WITH INDIVIDUALS RETAINING FREEDOM OF CHOICE IN SELECTING HEALTH CARE PRACTITIONERS, AND WITH EFFECTIVE COST CONTAINMENT BY THE MAJOR LOCAL CARRIERS. THUS, HAWAII'S LAW FITS THE PRESIDENT'S STANDARDS PRECISELY AND DEMONSTRATES THEIR MERIT.

BUT THE LEGAL STATUS OF THE HAWAII PREPAID HEALTH CARE ACT, PERHAPS THE MOST PROGRESSIVE AND COMPREHENSIVE STATEWIDE HEALTH INSURANCE PROGRAM IN THE NATION, IS CURRENTLY IN JEOPARDY. FOLLOWING A SUCCESSFUL FEDERAL DISTRICT COURT CHALLENGE MADE UNDER ERISA BY THE STANDARD OIL COMPANY OF CALIFORNIA, THE U.S. DEPARTMENT OF LABOR HAS TAKEN THE POSITION THAT UNDER ERISA'S CURRENT STATUTORY LANGUAGE, THE ACT MUST BE PREEMPTED WITH RESPECT TO THOSE EMPLOYERS WHO ARE ENGAGED IN COMMERCE, OR IN AN INDUSTRY OR ACTIVITY AFFECTING COMMERCE.

IN RENDERING HIS NOVEMBER 11, 1977 DECISION ON THE CASE, JUDGE CHARLES B. RENFREW STATED:

"IT TROUBLES THE COURT, AS IT TROUBLES DEFENDANTS, THAT CONGRESS PREEMPTED STATE HEALTH INSURANCE LAWS APPARENTLY WITHOUT SPECIFIC DISCUSSION OF THE NEED FOR SUCH A STEP. THE WORKERS WHOM ERISA WAS PRIMARILY INTENDED TO PROTECT MAY BE BETTER OFF WITH STATE HEALTH INSURANCE LAWS THAN WITHOUT THEM, AND THE EFFORTS OF STATES LIKE HAWAII TO ENSURE THAT THEIR CITIZENS HAVE LOW-COST COMPREHENSIVE HEALTH INSURANCE MAY BE SIGNIFICANTLY IMPAIRED BY ERISA'S PREEMPTION OF HEALTH INSURANCE LAWS.

FEDERAL LEGISLATORS SHOULD HEED THE ADMONITION THAT JUSTICE BRANDEIS ADDRESSED TO THE FEDERAL COURTS:

> 'TO STAY EXPERIMENTATION IN THINGS SOCIAL AND ECONOMIC IS A GRAVE RESPONSIBILITY. DENIAL OF THE RIGHT TO EXPERIMENT MAY BE FRAUGHT WITH SERIOUS CONSEQUENCES TO THE NATION. IT IS ONE OF THE HAPPY INCIDENTS OF THE FEDERAL SYSTEM THAT A SINGLE COURAGEOUS STATE MAY, IF ITS CITIZENS CHOOSE, SERVE AS A LABORATORY, AND TRY NOVEL SOCIAL AND ECONOMIC EXPERIMENTS WITHOUT RISK TO THE REST OF THE COUNTRY.'"

THE PRIMARY FOCUS OF THE DEBATE SURROUNDING THE PASSAGE OF ERISA WAS CLEARLY NOT THE ENACTMENT OF A NATIONAL HEALTH INSURANCE PROGRAM AND, ACCORDINGLY,

ERISA DOES NOT ESTABLISH STANDARDS THAT ARE IN ANY WAY COMPARABLE TO HAWAII'S STATUTE. OUR BILL, S. 1383, WOULD SPECIFICALLY MODIFY ERISA SO AS TO PROVIDE THAT INNOVATIVE HEALTH INSURANCE LAWS SUCH AS HAWAII'S WOULD BE TREATED IN THE SAME MANNER AS DISABILITY INSURANCE LAWS, WORKER'S COMPENSATION LAWS, AND UNEMPLOYMENT COMPENSATION LAWS, AND THEREBY BE EXCLUDED FROM PREEMPTION.

IN ALL CANDOR, I FEEL THAT THERE MAY BE MORE DESIRABLE SOLUTIONS TO THE HAWAII PREPAID HEALTH CARE ACT/ERISA CONFLICT, AS ALL AVENUES HAVE NOT BEEN FULLY EXPLORED.

I WOULD FULLY AGREE WITH SENATOR WILLIAMS THAT THIS IS A VERY COMPLEX ISSUE AND THAT IT WILL TAKE A SIGNIFICANT AMOUNT OF TIME AND STAFF RESOURCES TO RESOLVE. ACCORDINGLY, I WAS PARTICULARLY PLEASED BY HIS RECENT PROPOSAL TO ME THAT "ALTHOUGH WE COVER THIS SUBJECT FULLY IN OUR UPCOMING HEARINGS, WE NOT ATTEMPT TO ENACT CHANGES RESPECTING ERISA'S PREEMPTION OF STATE LAWS DURING THIS SESSION OF CONGRESS. HOWEVER, AS PART OF NEXT SPRING'S ERISA LEGISLATION, I WILL CERTAINLY WORK TO INCLUDE APPROPRIATE PREEMPTION CHANGES AS PART OF THAT LEGISLATIVE PACKAGE."

IT IS OUR SINCERE HOPE THAT THE COMMITTEE WILL ACT EXPEDITIOUSLY ON THIS MATTER, AND HELP TO SAVE WHAT IS ONE OF THE MOST INNOVATIVE AND SUCCESSFUL STATE HEALTH INSURANCE PROGRAMS IN THE NATION FROM TERMINATION DUE TO AN INADVERTENT LEGISLATIVE OVERSIGHT IN DRAFTING ERISA. AS JUDGE RENFREW STATED, THE REMEDY "IS NOT IN THIS COURT BUT IN CONGRESS."

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Hawaii Health Plan Could Be a Guide

Critics of President Carter's 10 standards for national health insurance ought to take a look at Hawaii before they yell too loud.

We may be the single state that comes closest to embodying the principles in action — and they work pretty well.

What gaps exist in local health care insurance can be closed by expanding present insurance services — no need to provide new ones.

From 95 to 98 percent of all residents of the state have hospital-medical insurance of some kind, and most of this includes some form of protection against catastrophic illness. The big gap is a lack of coverage for chronic illness that needs long-term nursing home care.

Private insurance organizations are the major providers of our health insurance. The Hawaii Medical Service Association (HMSA) covers 510,000 residents, the Kaiser Permanente Medical Care Program covers 110,000, and 60,000 more persons are covered under other private insurance programs.

In addition, the federal government provides direct health care to 56,000 military personnel, covers 70,000 military retired and military dependents under the CHAMPUS program, aids 90,000 older citizens with Medicare, and helps 65,000 medically indigent with Medicaid. That totals up to 961,000, which is more than the current estimated resident population of some 900,000. The difference is explained by individuals being covered by more than one program.

The state also is estimated to have a gap group of some 25,000 immigrants, persons who work less than 20 hours a week and persons with assets too great to qualify for Medicaid who have no health insurance. They could buy plans from either HMSA or Kaiser but have not.

The single stroke that brought Hawaii closest to universal coverage was the 1974 state legislative act mandating employers of even a single employee to provide health insurance for every employee who works 20 hours a week or more and his dependents. Employer and employee share the cost, with the employee charged no more than 1.5 percent of his annual income. HMSA and Kaiser are the biggest providers of this service, but some big firms like Sears Roebuck self insure.

To oversee compliance with this plan, the state government added only about a dozen employes to the Department of Labor staff already monitoring temporary disability insurance.

Hawaii's move to compliance with the 1974 law was relatively painless because private health insurance in the state already was widespread. This had been stimulated in part by a 1947 proposal for a territorial government health insurance plan. The move at the time was considered extremely radical and failed to pass the Legislature. It did, however, stimulate the medical profession's support of HMSA and later acceptance of the Kaiser Plan in the community.

There is evidence that Hawaii also has better medical cost control than the rest of the nation, as well as wider coverage. HMSA, for instance, carefully monitors to prevent unnecessary hospitalization. Here hospital days per 1,000 population average 390 per year versus 900 nationally.

HMSA estimates the total spending, private and government, for health services in Hawaii last year was about $467 million. This is 7.3 percent of First Hawaiian Bank's estimate of $6.644 billion in personal income. National outlays are believed to be higher even though service is less comprehensive.

Hawaii thus has achieved nearly universal health coverage with very little outlay by the state government, with free enterprise carrying most of the load, with individuals retaining free choice of physicians, and with effective private enterprise cost policing by HMSA and Kaiser.

This fits Carter's 10 standards precisely. In addition, HMSA holds overhead administrative costs to 6.5 percent which probably is an impossible low for a government bureau.

Critics of the Carter plan ought to be asked what is so bad about Hawaii's coverage. We doubt they will be able to come up with serious objections that can't be met by simply expanding the existing coverages. This is a process that has been underway here for 30 years anyway.

Georgetown University Health Policy Center
Seminar on State Health Insurance Plans
Mayflower Hotel, Washington, D.C.

September, 1977

THE POLITICAL PLANNING OF A STATE HEALTH INSURANCE PROGRAM

By Senator Donald D. H. Ching
Majority Leader
Hawaii State Senate

The concept of prepaid health care based on mandatory employment-related coverage was a brand new idea when first introduced in the Hawaii Legislature in 1971. It became law three years later as Act 210 of the 1974 legislative session.

Enactment of our Prepaid Health Care Law climaxed several years of lively discussion in the Legislature, and for many of us who supported it, Act 210 marked yet another milestone in the growing body of progressive legislation placed in our statutes since our Islands became a sovereign state in 1959.

Measured against the national background, the law represented a significant achievement in terms of social progress. Yet, while there was much discussion between introduction and enactment, the proposal was not widely viewed as politically controversial by the public at large. As a matter of fact, in my nearly 20 years of experience in our Legislature, I have seen a lot more heat generated over issues of considerably lesser public import.

To be sure, there was resistance and opposition from the traditional opponents of so-called "social legislation." But there was not the hue and cry that one might expect, considering the novelty of the concept.

This is not to say that the spectrum of political thought in Hawaii does not cover any ground to the right of center. Let me assure you we do have traditional conservative views held by many in our State, and I, for one, believe this is a healthy condition. But to the credit of those who did not adhere to the concept, their opposition was not based on the emotionalism that too often attends and distorts vital public issues of the day.

I believe the law was generally accepted by the public because of the kind of political climate we have in Hawaii and because the law was viewed as a logical extension of the kinds of programs that were already in effect at the time.

Let me briefly describe our Prepaid Health Care Law, then attempt to present an account of its chronological place in the context of Hawaii's legislative history.

The Act requires virtually every employer in the State to provide regular employees a health insurance program and to contribute at least one-half the premium cost for the employees' coverage. The major categories of employees excluded are insurance and real estate salesmen paid entirely by commissions and individuals under 21 working under a parental relationship.

The employee's contribution is limited to no more than 1.5 per cent of his monthly salary. A "regular" employee is defined as one who works at least 20 hours a week, excepting seasonal hires in Hawaii's pineapple industry.

Health plans negotiated under collective bargaining agreements are exempt because such negotiated benefits are, for the most part, more liberal in coverage or employer contributions than required under the Act.

An employer can elect to provide a plan which obligates the insurer to either reimburse the expenses of health care or to directly furnish the required health care benefits. The level of benefits provided must be equal to or medically reasonably substitutable for those benefits provided by prepaid health care plans of each type -- direct or reimbursed -- which has the largest number of subscribers in the State. In Hawaii, the standards are thus based on the Kaiser Health Foundation's Plan I, in the case of direct services, and the Hawaii Medical Service Association's (Blue Shield) Plan IV, in the case of reimbursed expenses. Both the Kaiser and HMSA plans are basic, comprehensive medical plans emphasizing ambulatory care.

Plans offered by other insurers may be provided, upon review and approval of a seven-member advisory council comprised of consumer, employer, medical profession, and health plan representatives.

What kind of coverage is required by our law? Every qualifying plan must include the following:

-- 120 days of hospital benefits, plus outpatient services.

-- surgical benefits, including anesthesiologist services.

-- medical services, including home, office, hospital visits, and intensive medical care.

-- laboratory, x-ray, and radio-therapeutic services necessary for diagnosis and treatment.

-- maternity benefits, provided an employee has been covered for nine months prior to childbirth.

-- and, under an amendment added last year, substance abuse benefits for alcoholism and drug addiction, including outpatient services and detoxification and acute care benefits.

The foregoing summarizes the basic provisions of our law.

How, then, did we come to enact what some may view as an extremely liberal mandatory health insurance program?

First, it should be noted that we have a substantial body of progressive and advanced social legislation in Hawaii. This is true of our labor laws, our educational system, our public welfare program, and in our judicial system. For instance, our minimum wage law, wage and hour law, workers' compensation, temporary disability insurance, and unemployment insurance programs all have standards comparable to the highest in the Nation. In addition, we also have a public defender program and a criminal injuries compensation law. We also have a no-fault insurance law and a medical malpractice law, the latter amended this year to remove the mandatory feature and to permit doctors the option of forming cooperative indemnity plans to protect themselves against liability judgments.

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Our public assistance program is so liberal it is causing us severe financial strains -- but that's another story, and I won't digress into it, except to note that we eagerly look forward to federal reform initiatives promised by the Carter Administration.

The political foundation for eventual enactment of our prepaid health care law was further set during the mid-sixties in a program popularly labeled "The New Hawaii," adopted jointly by the legislative majorities and the Administration.

During this period, dramatic changes were advanced in terms of Hawaii's social, economic, and political conditions. Basically, the stated objective was to enact laws and programs to insure equal treatment and equal opportunities for all citizens. If this sounds simplistic, it should be borne in mind that Hawaii was pretty much the political domain of the sugar and pineapple plantation interests up until the end of World War II and that when, for the first time in our history, we elected a Democratic Governor and Democratic majorities in both houses of the State Legislature in 1962, there were not a few who thought the revolution was at hand.

But the changes we sought were achieved in orderly, not revolutionary, fashion. And there was early ferment for novel and innovative legislation to extend equal opportunity in basic human concerns to all segments of our society.

It appeared logical to move toward some form of mandatory prepaid health care law. The question then was how best to extend coverage to the uninsured working men and women of Hawaii and thereby provide them "equal treatment" as a matter of social equity. Moreover, how could this be best achieved without any substantial added costs to the State, bearing in mind that our centralized system imposes unusually heavy financial burdens on the State?

To determine cost factors and the numbers and classes of employees in the uncovered "gap group," a study was commissioned through the Legislative Reference Bureau, the Legislature's principal research arm. Dr. Stefan A. Riesenfeld, former University of California law professor and a widely recognized authority on social legislation, now counsel to the U.S. State Department, was selected to do the research. Professor Riesenfeld had prepared an earlier report for the Legislature on temporary disability insurance, which study was extremely valuable to us in enacting our TDI law in 1969.

The Riesenfeld report, published in 1971, was a thorough and comprehensive study. Acknowledging the difficulty of precisely quantifying need, the report generally concluded that, among the State's employed, 11.7 per cent did not have hospital coverage, 13.5 per cent lacked surgical coverage, and 17.2 per cent did not have regular medical insurance.

The existence of a significant number of otherwise uncovered potential beneficiaries of the proposed legislation formed the primary policy consideration of the program. Other factors considered included the rising costs of health care and the need to assue the most practical method of ensuring the financial availability of health care for Hawaii's working men and women. Thus, the overall health of our population was the over-riding concern; without ensuring the ready accessibility of health care, how could optimum health care be maintained?

Data compiled and analyzed in the report were very thorough. Sources outside the State included the Health Insurance Association of America, the Health Insurance Institute, the Bureau of Labor Statistics, the Social Security Administration, and the Bureau of the Census. Information from State agencies included data from the State Statistician and the Departments of Taxation, Planning and Economic Development, Social Services and Housing, and Labor and Industrial Relations. Data was also gathered from labor unions, the Hawaii Employers Council, the HMSA, Kaiser Foundation, and through questionnaires mailed to all employers covered by the Hawaii Employment Security Law.

Data used included statistics relative to the following:

-- Population by age levels, civilian and military. The latter distinction was important because of the sizeable permanent military presence in Hawaii.

-- Labor force, public and private.

-- Population entited to Medicare.

-- Extent of prepaid health plan coverage for hospital, surgical, and medical benefits, both for subscribers and dependents.

-- Size and type of business of private employers.

-- Medical assistance recipients and expenditures.

As indicated by the sources of data, the full range of interest groups became involved in the process, whether employer or employee oriented.

During our legislative committee hearings, testimony was presented by representatives of the insurance industry, the health professions, the University of Hawaii Schools of Public Health and Social Work, the Comprehensive Health Planning Council, and a wide range of individual citizens.

There was very little question as to whether the plan proposed would be comprehensive or catastrophic in its approach. The Riesenfeld report recommended the comprehensive coverage plan and specifically recommended the adoption of prevailing coverages in the State, which then became the legal minimum. This reflected the health care habits and patterns of the State and set a floor without unduly disrupting the existing schedules of coverage.

The decision to make coverage mandatory was central to the legislation proposed. Before enactment of Act 210, voluntary participation was, in effect, the public policy of the State.

As to the question of affordability, the only new cost factors imposed upon the State were founded upon the administrative requirements of the law and anticipated premium supplementation.

Administration of the new program proved to be quite easy, as it was smoothly meshed in as a responsibility of the Disability Compensation Division of the State's Department of Labor and Industrial Relations. Thus, three important employee benefits programs were placed under one umbrella: the well-established Worker's Compensation Law; the TDI law passed in 1969; and the 1974 Prepaid Health Care Act. (Incidentally, you may have noticed that what used to be known as Workmen's Compensation is now referred to as Workers' Compensation in our State, reflecting the many similar amendments we have adopted consonant to our accepted policy on equal rights.)

Much to our pleasant surprise, the administrative expenses of Act 210 have been comparatively low. Initially, we authorized 11 new positions in the Disability Compensation Division, with an appropriation of $250,000 in General Funds to cover salaries and other expenses. Much to the division's credit, Act 210 was implemented with substantially the existing staff. The first appropriation thus lapsed, and it was renewed this year at the same annual level on the expectation that additional personnel will be recruited during the next biennium.

A feature of Act 210 is a provision for premium supplementation financed by the State to cover employer premium requirements caused by limits imposed on employee contributions. This feature subsidizing employer contributions was included to provide a cost protection for marginal small businesses. Initially, $375,000 was set aside in a trust fund for premium supplementation. Again, to our pleasant surprise, there has been little need to supplement premiums. It's estimated that, to date, only some $20,000 to $30,000 has been tapped from the trust fund in subsidies. Meanwhile, the fund is held in an interest-earning status.

What are the numbers that actually surfaced as a consequence of Act 210? The division reports that about 18,500 employers have thus far been registered. However, the extent of newly covered workers has been difficult to establish because many of the registered employers had voluntary programs in effect before Act 210. Dr. Riesenfeld has estimated some 40,000 employees were not covered at the time he conducted his study. The Disability Compensation Division is of the opinion that actually more than 40,000 received new benefits because of the requirement that employers cover at least half of the premium costs.

Of the 18,500 employers, all but some 1,000 have elected plans offered by the State's two major insurers -- HMSA and Kaiser. The approximately 1,000 employers who have opted for plans offered by other insurers are the major source of additional workload upon the division. Each submittal in this category must be reviewed by the advisory council.

The advisory council provision serves another purpose. During the course of legislative hearings on the act, public health advocates had expressed concern that the required benefits might be too rigid and unresponsive to changes in health care over the years. The Prepaid Health Care Advisory Council provisions were thus added to establish an appropriate agent to review medical equivalency of benefits.

To conclude, in light of Hawaii's experience, I believe any national health insurance plan should take into consideration the course that we have opted for. I am confident the standards we have set would meet any that a federal law would impose. As a means of encouraging other states to follow suit, or to adopt a true state plan such as Rhode Island's, I suggest federal legislation provide support grants to at least cover administrative costs and any necessary premium supplementation expenses.

Finally, let me summarize the conditions that led to the successful adoption and implementation of Hawaii's Prepaid Health Care Act:

1 -- A political climate sympathetic to social needs.

2 -- Timeliness in terms of progressive improvements to the general body of social legislation already on the books.

3 -- A comprehensive study of a state's needs, to arm proponents with the information necessary to justify the proposed legislation.

4 -- Open discussion involving all interested elements within the public.

5 -- The last may be an element not very common to other jurisdictions, but I believe it was an important consideration in our own deliberations. This is the fact, well established in our study, that the majority of employees insured under voluntary plans or through government-employee programs were covered under plans offered by two major insurers in the State. Having a clear pattern to follow in prevailing benefits, it was easier to overcome resistance against extending similar benefits to all the State's working men and women.

I hope our experience and the foregoing thoughts presented for your discussion prove helpful to you in your own endeavors to develop plans for extending health care benefits to all others who need such coverage in our Nation.

Mahalo.

Senator INOUYE. May we open ourselves up to questions at this point, sir? This is just to expedite the hearing.

Senator WILLIAMS. What is the status now, after that court decision, of the Hawaii law?

Mr. RAMIL. The case is now in appeal in the Ninth Circuit Court, and all briefing has been done. Oral arguments, we do not know when that will be.

Senator WILLIAMS. Now, what happened to this health care coverage, mandated under State law, as a result of the limbo situation you are in because of that case?

Mr. WATANABE. My name is Orlando Watanabe; I am administrator of the Disability Compensation Division.

Our posture is that the *Standard Oil* case applies to Standard Oil only, and all other employers are required to comply with our State law. This is the word that was given to employers in the State, and I think met with a lot of success, taking this particular posture.

Senator WILLIAMS. So your State regulatory agency is continuing to enforce your State law of these health benefits, is that right?

Mr. WATANABE. Except for Standard Oil—except against Standard Oil, I should say.

Dr. AGSALUD. My name is Josua Agsalud. I am director of labor for Hawaii. I would like to say that this particular program is administered by the Department of Labor and Industrial Relations, not a regulatory agency.

Senator WILLIAMS. State Department of Labor?

Dr. AGSALUD. Yes, sir.

Senator WILLIAMS. The *Standard Oil* case was in the district court?

Dr. AGSALUD. California District Court.

Senator WILLIAMS. You have not found employers using that as a base for avoiding your State law? You have continued compliance?

Dr. AGSALUD. Yes, sir. We have had a few inquiries, but we have maintained our position that Mr. Watanabe just gave.

Senator WILLIAMS. Do you have any questions Senator Javits?

Senator JAVITS. Yes; I have one question.

Will one of you describe for us exactly what has happened?

Now, let me first state my own position. I believe in State innovation, and I believe in encouraging State excellence. Therefore, we would like to know exactly what are the nuts and bolts of this problem.

In short, what is the roadblock in ERISA to your operation?

Dr. AGSALUD. If I may lead off, and I will ask Ms. Putnam here, who was one of the authors——

Senator JAVITS. Let there be specificity, because in principle I like what Hawaii is doing very much, and I think Hawaii is to be much commended.

Now, let us see what else it does. Like they say in the drug business, what are the side effects?

Dr. AGSALUD. I, Senator Javits, am at a loss myself on why the U.S. Department of Labor has taken this position.

We have always said that our prepaid health law should not be part of the preemption clause, and we have had our discussions with the U.S. Department of Labor solicitors and officials, and we have maintained that through a preemption argument, or even exemption argument, that Hawaii's prepaid health law does not fall under the preemption clause.

Ms. Putnam can give you the background on this.

Ms. PUTNAM. Mr. Chairman, Senator Javits, one of the anomalous situations we have found is that on one hand part of the Federal Administration really is holding up Hawaii as a potential prototype of our law being the model for national health insurance. In the 10 points that come out President Carter's guidelines for developing national health insurance, we find we track those 10 points very specifically.

Senator MATSUNAGA. Excuse me, could you speak more directly into the microphone.

Ms. PUTNAM. One of the things that we have done is not to interfere with private insurance industry, and that is one of the 10 points, to involve the experience of health insurance.

The alternative, if this effort at the congressional level fails, and if the Ninth Circuit Court of Appeals falls against us, an alternative it so set up a State plan, which would be very monumental, sort of empire building, rather than the simple but sophisticated system that we are using now, incorporating the present existing structure of health coverage in the State.

We like to think of the tens of thousands of members of the work force who have this benefit now that did not have it prior to 1974, in the enactment of our prepaid health care law. Those are the people who will suffer, and by and large those are the underdogs in the labor force that were referred to earlier by this committee.

Those are the most vulnerable people, the low-income workers. And for Labor to take a position that these members of the work force should have a benefit denied, that has been won with so much effort, seems more than anomalous.

Senator JAVITS. So your alternative is to change this plan in such a way that it qualifies as a governmental plan. This would require a complete overhaul of the system, and defeat the simplicity and the efficiency with which it operates now. Is that your case?

Ms. PUTNAM. Very specifically, yes.

Senator JAVITS. Is there any analysis of the specific respects in which this plan would have to be changed if it were to become a governmental plan?

Ms. PUTNAM. The State would become the insurer.

Senator JAVITS. Has the attorney geenral of Hawaii, or anybody else made an analysis of the legal effect of changing this plan to a governmental plan?

Ms. PUTNAM. To my knowledge, that has not been done.

Senator JAVITS. That has not been done? Well, I wish you would let us know, Senator Inouye, because we do not want to burden you.

As you know, I would be very sympathetic to seeing what we could do to help. If there is such an analysis, I think it would be very important for the reason that if we are to carve out an exception, it will have to be an exception which is not going to involve us in many side effects, and so the more we know about the plan, specifically in detail, the better we will be able to consider what exception to carve out.

So I leave that entirely to you, sir.

Ms. PUTNAM. We have attached to our testimony a description of the plan, and of course, we can make available to the staff the laws and regulations that have been promulgated to administer it.

Senator MATSUNAGA. In the written testimony, if I might point out to my colleague, Senator Javits, I think a description of the plan is made, so that I think by reading the written testimony presented the committee members might get an idea of how it functions.

Senator JAVITS. That is true. I also wanted an analysis, if you have it, of how the plan would have to be changed in order to be a governmental plan, and then when we draft an exception, which is what you are seeking, we can be as specific as humanly possible, and avoid as many side effects as possible.

Senator BENTSEN. I think that is a very valid point, which Senator Javits is making. But as I understand the legislation proposed by Senator Inouye and Senator Matsunaga, it is not really carving out new territory, because you have now got workmen's compensation, disability insurance, and unemployment insurance, where you do not have preemption and the States have a paramount force in how those particular plans are drafted. But this is not some great departure from practices that we have seen in related fields in the past that come under your jurisdiction as I would assume in your Labor Department in Hawaii.

Senator INOUYE. The Senator is very correct, sir. This issue is not anything new. As you have indicated, we would like to be treated in the same manner as disability insurance, workmens' compensation and unemployment compensation.

The measure we have introduced does not apply just to Hawaii. It is not a State bill, but it will apply to any State with similar plans that qualify.

Senator WILLIAMS. It seems to me that we have several different schemes under our federal system for the interaction of Federal and State laws.

The first is where Congress has acted by passing legislation that preempts the field. For example, the Labor-Management Relations Act occupies the field of labor relations, and States are preempted from legislating as to the matters and persons covered under LMRA.

The second is where Congress has acted, but has left the states free to enact additional legislation, as long as it is not inconsistent with what the Congress has done. Examples would be the Federal minimum wage law, the Occupational Safety and Health Act, and the Civil Rights laws. The doctrine of Federal supremacy says that a State may not, for example, pass a law requiring payment of a lower minimum wage than the Federal law requires, but a State could require a higher minimum wage.

The third situation is where the Congress has passed no law, and a State is, in that situation, of course free to pass any law it wishes, assuming it does not contravene the U.S. Constitution. An example of this type would be the field of workers' compensation laws. There is no Federal law right now setting standards for workers' compensation, and the States have acted.

Under ERISA, the situation is clearly of the first type I mentioned. And in the general coverage section of ERISA, Congress made it clear that ERISA was not to apply to only a few types of plans that might otherwise have been deemed to be covered by ERISA. These are plans maintained solely for the purpose of complying with applicable State laws dealing with workers' compensation, unemployment compensation, or disability insurance.

The Hawaii law, though, deals with health care; it requires employers in the State to provide health care coverage for their employees. That is different than workers' compensation, unemployment compensation or disability insurance, and so the preemption question arises.

Senator MATSUNAGA. Mr. Chairman, if I may ask one question of the panel, this might help clarify a question raised earlier by Senator Javits.

You heard the testimony of Secretary Brown, and in his statement he said that the Department of Labor is opposed to S. 1383—that is, the bill introduced by Senator Inouye and myself—because it would remove the existing ERISA protections with respect to the reporting, disclosure, and fiduciary responsibilities of health insurance plans.

This appears to be the basis for the objection made by the Department of Labor.

Could you state, Mr. Agsalud, whether or not the State law of Hawaii meets these objections?

Dr. AGSALUD. Yes, sir. I will ask Deputy Attorney General Ramil to elaborate further, but at this point may I say that I believe the basic concept of ERISA is to control State laws, and yet there are existing exemptions which have been mentioned by members of the committee, workmens' compensation, unemployment insurance, and so on, and Senator Inouye has said that we are exempted from that preemption.

My position is why not prepaid health care also? As far as the statement made by the USDOL, we feel that we are providing and guaranteeing these protections through our own State government. Mr. Ramil can elaborate.

Senator MATSUNAGA. Mr. Ramil?

Mr. RAMIL. Senator Matsunaga, I think the point is that the Hawaii Act is a governmental insurance program, rather than employee benefit plan, and therefore the reporting disclosures and fiduciary requirements are not necessary, or are not applicable, in that the Hawaii Act applies to the employer doing business in Hawaii, and not to any State fund established or maintained by that employer.

The Hawaii Act requires employers to pay at least one-half of the premium cost, meaning that we do envision use of insurance policies which is exempted by ERISA, and is backed up by State-administered fund in case that employer is unable to pay his share of the premium cost.

So, as far as ERISA is concerned, the Hawaii Act has no conflict with it.

Senator MATSUNAGA. No conflict?

Mr. RAMIL. Absolutely no conflict. The problem, I believe, Senator, is that you have a broad preemption provision in ERISA, and the problem that we have here in this case is that the Department of Labor always applies a broad definition to the terms of an employee benefit plan, and combined, you would come out with the undesirable consequences we have now.

Senator MATSUNGA. Mr. Chairman, if I may proceed further, we have a representative of organized labor here, the executive secretary-treasurer of the Hawaii State Federation of Labor, AFL-CIO, Mr. Van Diamond.

What is the position of organized labor in Hawaii on this bill before the committee?

Mr. DIAMOND. Senators, as our testimony indicates with the attachments, beginning in January of 1977, by executive board action——

Senator MATSUNAGA. Could you get the microphone closer to you?

Mr. DIAMOND [continuing]. And then followed up by convention resolution of the State Federation Organization in September of 1977, we have gone on record unanimously supporting Hawaii's prepaid health law, and supporting also the proposal that was jointly introduced by yourself and Senator Inouye for its passage.

Senator MATSUNAGA. Organized labor is, then, unconditionally supporting the Inouye-Matsunaga bill?

Mr. DIAMOND. That is correct. The State AFL-CIO is.

Senator MATSUNAGA. Thank you, Mr. Chairman.

Mr. Chairman, I think this is an important point because there has been some indication that organized labor opposes the proposal. But where labor is directly affected by Hawaii State law, organized labor supports the program.

Senator INOUYE. Mr. Chairman.

Senator BENTSEN. Yes, Senator Inouye.

Senator Inouye. Realizing the hour is upon us, I ask unanimous consent that prepared statements of the panel members here be made a part of the record at this point.

Senator BENTSEN. Without objection.

[The prepared statements of Mr. Agsalud and Mr. Diamond, and the reply by Mr. Agsalud to the questions posed by Senator Javits follow:]

GEORGE R. ARIYOSHI
GOVERNOR

JOSHUA C. AGSALUD
DIRECTOR

ROBERT C. GILKEY
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
825 MILILANI STREET
HONOLULU, HAWAII 96813

August 15, 1978

To: The Honorable Lloyd Bentsen, Chairman
Private Pension Plans and Employer Fringe Benefits Subcommittee of the Committeee on Finance

The Honorable Harrison A. Williams, Jr., Chairman
Labor Subcommittee of the Committee on Human Resources

From: Joshua C. Agsalud, Director
Department of Labor and Industrial Relations
State of Hawaii

Re: S. 1383

Chairmen and Members of the Committee, I thank you for the opportunity to present this testimony concerning Senate Bill 1383; I hope you will find it cogent and persuasive. We are here today to urge the passage of S. 1383 in order to clarify that state-mandated comprehensive health insurance plans are not intended to be preempted by ERISA and that they are to be considered in the same light as all other governmentally-required insurance programs. At stake is a unique and innovative plan for providing health care insurance coverage for virtually all workers and many of their dependents at a cost which experience has shown to be affordable for both employees and employers, and which involves only minimal administrative costs on the part of government. It is a plan that works. While universal health insurance continues to be a subject for debate on the national level, Hawaii comes very close to having it right now. A recent federally-funded study[1] concludes that the insurance plans required by the Hawaii Prepaid Health Care Act combine with Medicare, Medicaid and individual plans to cover 96 percent of the civilian population of the State.

1/ Universal Health Insurance in Hawaii, Martin E. Segal Co., Federal Contract No. 299-77-0014.

The Hawaii Prepaid Health Care Act, a summary of which is provided for your information, has as its purpose a two-fold objective. First, to provide health care insurance for workers who were previously unprotected and, second, to mandate a reasonably adequate level of coverage for those whose existing plans provided insufficient benefits.

The means by which these objectives are accomplished are simple. First, all employers are required to provide prepaid health care coverage to their employees and to pay at least one-half the premium cost. The coverage may be from an insurance carrier, a health care contractor or provider, an approved self-insurance plan, or a collectively-bargained plan. Workers may be required to pay no more than half the cost of premiums, but in no event more than 1.5% of their wages.

Second, the law mandates that the benefits provided must be equal to, or better than, those provided under the health care provider or insurance carrier plan having the most subscribers in the state and must, as a minimum, include benefits for outpatient care; 120 days per year of hospital care; medical fees for home, office or hospital visits; laboratory services; maternity care and substance abuse treatment.

Perhaps the most important effect of the enactment of this law has been to mandate adequate, affordable coverage for the workers at the bottom of the wage scale, particularly those without union representation. Prior to its passage, such workers were typically either not covered at all, offered inferior coverage, or offered coverage at rates beyond their means. Now, a full-time, 40-hour-per-week worker earning the minimum wage of $2.65 per hour receives good coverage at a cost to him or her that, by law, cannot exceed $1.59 per week, or about $83.00 per year. A 20-hour-per-week employee, therefore, would only pay about $41.50 per year.

It is the fate of these workers and their families that is my deepest concern should the Hawaii Prepaid Health Care Act be ruled to come under the preemption clause of ERISA. It is they who are most vulnerable to rising medical costs and who are least able to afford insurance protection. It was this concern for the working poor--the gap group that earns too much to qualify for welfare but not enough to afford medical care--that let to the passage of our law, as will now be described by Mrs. Patricia Putman, Associate

Dean of the University of Hawaii's John A. Burns School of Medicine. Mrs. Putman participated in the background study that formed the basis of the law, generally directed the enacting legislation through the state legislature, and currently serves on the Prepaid Health Care Advisory Council.

Mrs. Patricia Putman, Associate Dean
John A. Burns School of Medicine
University of Hawaii at Manoa

Thank you for permitting me to offer my support on behalf of a law for which many individuals and organizations have devoted years of work and inspiration. The origin of the Hawaii Prepaid Health Care Act begins, of course, with a long-felt belief that a means should be found for providing adequate, affordable health care for all, but the specific genesis of the law may be found in a short paragraph in a 1967 appropriations act which requested studies of, and if appropriate, legislative proposals for, increased minimum wages, temporary disability insurance, and prepaid health care insurance. In 1971, the study Prepaid Health Care in Hawaii by Professor Stefan A. Riesenfeld was published by the State Legislative Reference Bureau and a bill was introduced designed to implement the study's recommendations. It was, and is, a unique and pioneering piece of legislation and like most such legislation it was vigorously opposed by those who supported the status quo for both philosophical and economic reasons.

The bill did not pass that year, nor the next, nor the next. But in 1974, impelled by rising medical costs and the lack of substantial progress toward national health insurance, the bill was passed and signed into law as Act 210 of 1974 and became Chapter 393 of the Hawaii Revised Statutes with an effective date of June 12, 1974.

It is crucial to the understanding of the present situation to realize that it was during the same three-year period, 1971 to 1974, that the Congress was working on the legislation that eventually became ERISA. Because ERISA and the Prepaid Health Care Act were developed and enacted simultaneously, neither took the provisions of the other into consideration, and I offer the personal speculation that had the Hawaii act become law in 1971, 1972, or even 1973, Congress would have included language such as we now seek or would have provided by some other means that ERISA was not intended to preempt such government-mandated comprehensive health insurance plans.

It would be strange, indeed, had Congress really intended to nullify a law which has favorably impressed many knowledgeable experts with its success. HEW Region IX, for instance, in its report entitled Outreach Report on National Health Insurance (October 1977) noted that the law "has created, in general, a population that is far more conversant and knowledgeable in matters related to health insurance than populations in other parts of the region." "People...talk more easily about alternatives and options," it continued, "[and] they [have] a better feel for what National Health Insurance could or could not do." The report concluded, "...their collective understanding of a Federal, State and private role in the formulation of health insurance policy would be valuable" in assessing administration proposals.

Another confirmation of the value of Hawaii's successful experiment with prepaid health care insurance comes from the draft of the study alluded to earlier by Dr. Agsalud, which was conducted by the Martin E. Segal Company under Federal Contract No. 299-77-0014. The study, entitled Universal Health Insurance in Hawaii, developed criteria for the evaluation of Hawaii's law as a prototype for national health care insurance. These included coverage, benefits, equity of financing, equity to providers, incentives to efficiency, acceptability, adaptability, efficiency of administration, and quality controls. The study found that "In terms of these criteria, Hawaii ranks quite high. [I]t is clear that Hawaii has accomplished in large measure what is being sought for the rest of the country."

Even the judge who ruled against the state in Standard Oil v. Agsalud noted that "The workers whom ERISA was primarily intended to protect may be better off with state health insurance laws than without them, and the efforts of states like Hawaii to ensure that their citizens have low-cost comprehensive health insurance may be significantly impaired by ERISA's preemption of health insurance laws." He then cited Justice Brandeis' famous comment, "It is one of the happy incidents of the federal system that a single courageous State, may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."

This is, indeed, what Hawaii has done with respect to prepaid health care, and I cannot believe that Congress, in acting to reform the disgraceful mismanagement and abuse of pension systems, intended to wipe out this most successful "novel social and economic experiment."

I thank you for your time and attention. The balance of the testimony will be by Dr. Agsalud.

Joshua C. Agsalud

Members of the Committee, my summation will be brief. The Hawaii Health Care Act is under attack because it has succeeded only too well. It has required certain employers to provide more benefits--benefits which the people of Hawaii, through their legislators, have deemed essential--than these companies are willing to provide on their own. Having been defeated in the legislative arena, these employers now seek to have the courts frustrate the will of the people and they seek your assistance in doing so. Their case rests on a single issue: Does ERISA prevent the State of Hawaii from enforcing its Prepaid Health Care Act by preempting the field of health insurance legislation for the Federal government? There is nothing in the legislative history of ERISA to suggest such an intent, but a court ruling now on appeal holds that such a preemption was accomplished by inadvertance if not by intention. When ERISA was enacted, there was no apparent need to specifically exclude state-mandated comprehensive health insurance laws from its broad preemption--there were no such laws in existence. Almost simultaneously, however, such a law did come into being, and now some form of specific exclusion is both necessary and appropriate.

Tens of thousands of Hawaii's people are now covered by adequate health insurance as a direct result of the Hawaii Prepaid Health Care Act. It would be a bitter irony if ERISA, a landmark in the struggle to protect the "continued wellbeing and security of millions of employees and their dependents,"2/ were to be used to cripple another milestone in the same struggle.

The battle in the courts has just begun, and while we are confident of a final ruling in our favor, the road to that ruling may consume many years and many thousands of taxpayer's dollars to reach a conclusion that, with your help, can be reached in just a few weeks and at almost no cost by adopting S. 1383 or in some other way clarifying the status of state-mandated comprehensive health insurance laws with respect to ERISA.

2/ ERISA, Section 2(a).

It is important both to the workers of Hawaii and to the nation that this important innovation in health care costs protection is not allowed to die and I respectfully urge your favorable consideration of S. 1383 or some suitable alternative.

I will be happy to answer any questions you may have. Assisting me will be Mr. Orlando Watanabe, Administrator of my Disability Compensation Division--and, I might add, my codefendent in Standard Oil v. Agsalud--and Mr. Mario Ramil, our Deputy Attorney General assigned to that case, as well as Mrs. Putman, whom you heard earlier.

Attachment

HAWAII PREPAID HEALTH CARE LAW

CONCEPT

Mandates subject employers to provide health care coverage to employees who meet eligibility requirements. While it should not interfere with protection provided pursuant to collective bargaining agreements, or lessen protection provided by employer sponsored plans which are equivalent or more favorable to employees, it affords protection to workers who do not have, or have inadequate coverage against the high cost of medical care.

COVERAGE

Unless an employee claims authorized exemption, subject employer must provide prepaid health care coverage at the earliest enrollment date after an employee completes four consecutive weeks of 20 hours each and earns 86.67 times the State's minimum hourly wage. (86.67 x $2.65 = $230 per month)

BENEFIT STRUCTURE

Hawaii's health care plan provides for:

Hospital Benefits:

Out-patient care, in-patient care for at least 120 days in each calendar year covering room accommodations, special diets, general nursing services, drugs, dressing, oxygen, antibiotics and blood transfusion services. Outpatient care for use of outpatient hospital which also provides for surgical procedures and medical care of an emergency nature.

Surgical Benefits:

Surgical services performed by a licensed physician; reasonable after-care visits; services of anesthesiologist.

Medical Benefits:

Necessary home, office and hospital visits by a licensed physician; intensive medical care while hospitalized; medical consultations while confined; diagnostic laboratory services; x-ray films; radio-therapeutic services.

Maternity Benefits:

If employee has been covered by prepaid health care plan for nine consecutive months prior to delivery.

HAWAII PREPAID HEALTH CARE LAW (continued)

Substance Abuse Benefits:

In-patient benefits for detoxification and acute care shall be limited in the case of alcohol abuse to three admissions per calendar year, not to exceed seven days per admission and shall be limited in the case of other substance abuse to three admissions per calendar year, not to exceed twenty-one days per admission.

FINANCING

Employee may be required to contribute one-half the cost of premium, or 1.5 percent of his monthly wage, whichever is less. Employer pays the balance.

If employer's plan does not provide health care benefits equal to, or medically reasonably substitutable for, the benefits provided by prepaid health care plans which have the largest number of subscribers in the State, the plan shall be in compliance only if the employer contributes at least half the employee and dependents cost.

COST CONTROL - REIMBURSEMENT OF PROVIDERS

In accordance with Prepaid Health Care contract.

QUALITY CONTROL

None - except as provided by federal and miscellaneous State laws and control exercised by Health Care Contractors.

HEALTH DELIVERY AND RESOURCES

Depends on contents of health care plan: Kaiser type - emphasis on prevention of illness and early detection of disease. HMSA and Insurance Companies - generally reimbursement for illness and sickness which have occurred.

ADMINISTRATION

Disability Compensation Division oversees program - Ensures that employer's plan meet standards prescribed by law.

August 4, 1978

The Honorable Harrison A. Williams
Chairman, Subcommittee on Labor
Committee on Human Resources
The United States Senate
Washington, D. C. 20510

The Honorable Lloyd Bentsen
Chairman, Private Pension Plans and
Employee Fringe Benefits
Senate Committee on Finance
The United States Senate
Washington, D. C. 20510

Gentlemen:

Local 142 of the International Longshoremen's and Warehousemen's Union fully supports the purpose, intent, and accomplishments of the Hawaii Prepaid Health Care Act.

Although the ILWU has succeeded in providing adequate health care for its members through collective bargaining, we are mindful that there are over two hundred thousand workers in Hawaii who do not have unions to protect their interests in this area and that these workers include a disproportionate number of low-paid, minimum wage employees. It is these workers who most need, and must not be deprived of, the protection the Prepaid Health Care Act provides.

These workers are now assured of comprehensive health care benefits at a cost they can afford, thereby improving the health and well-being of the entire community.

We commend the legislators of Hawaii for their courage and foresight in enacting this law and urge your prompt and favorable consideration of S. 1383.

Respectfully submitted,

Carl Damaso, President
ILWU LOCAL 142

CD:bw

cc: Joshua Agsalud, Director - Hawaii State Department of Labor
howu

hawaii state federation of labor AFL-CIO

August 10, 1978

The Honorable Harrison A. Williams
Chairman, Subcommittee on Labor
Committee on Human Resources
The United States Senate
Washington, D.C. 20510

The Honorable Lloyd Bentsen
Chairman, Private Pension Plans and
Employee Fringe Benefits
Senate Committee on Finance
The United State Senate
Washington, D.C. 20510

Gentlemen:

My name is A. Van Horn Diamond, Executive Secretary-Treasurer of the Hawaii State Federation of Labor, AFL-CIO. I am present here today and authorized to represent Hawaii's State AFL-CIO organization for four reasons:

(1) In response to the requests to testify for S. 1383 by Hawaii's U.S. Senators Daniel K. Inouye and Spark N. Matsunaga, as well as Dr. Joshua Agsalud, Director of Hawaii's State Department of Labor & Industrial Relations.

(2) As Executive Secretary-Treasurer of the State AFL-CIO who happens also to be a board member of the Hawaii Medical Services Association, it was felt my comments would be beneficial to protecting the Hawaii Prepaid Health Care Law.

(3) The Hawaii Prepaid Health Care Act can serve as a possible model for a National Health Care system.

(4) The Hawaii State Federation of Labor, AFL-CIO, by Executive Board action (January 31, 1977) and by State Convention Resolution (unanimously adopted September 10, 1977) opposes Hawaii's Prepaid

33 549 272

Suite 216 • 547 Halekauwila Street • Honolulu, Hawaii 96813 • Telephone 536-4945

Health Care Law being pre-empted by Federal application of pre-emptive authority under ERISA; and, supports exempting Hawaii's statute as proposed by S. 1383.

The legislative history of the Hawaii Prepaid Health Care Act is a moving story of a concerned and compassionate Hawaii State Legislature; of a State Legislature decisively enacting legislation to meet a vital need of the citizens of Hawaii. It is also a story of patience and patience lost.

- Of patience, awaiting the enactment of a Federal law by the Congress relating to National Health Insurance. Clearly, this is a need perceived and known by our State legislators; a need vital to the general well-being of our people.

- Of patience lost, by the continued inability of the Congress to enact such legislation, even as health care cost were unaccountably and substantially increasing.

Indeed, this is also the story of a State government and public concerned, perhaps disturbed, that those under any health care plan or of those covered, in some way, had inadequate health care (benefit) coverage; had inadequate protection to meet the known and spiraling costs of medical care, including the possibility of catastrophic loss.

Confirmation of this concern is succinctly stated in the 1974 State of Findings & Purpose relating to the Hawaii Prepaid Health Care Act.

> "Section 393-2. FINDINGS AND PURPOSE. The cost of medical care in case of sudden need may consume all or an excessive part of a person's resources. Prepaid health care plans offer a certain measure of protection against such emergencies. It is the purpose of this chapter in view of the spiraling (sic) cost of comprehensive medical care to provide this type of protection for the employees in this State. Although a large segment of the labor force in the State already enjoys coverage of this type either by virtue of collective bargaining agreements, employer-sponsored plans, or individual initiative, there is a need to extend that protection to workers who at present do not possess any or possess only inadequate prepayment coverage.

> "This Chapter shall not be construed to interfere with or diminish any protection already provided pursuant to collective bargaining agreements or employer-sponsored plans that is more favorable to the employees benefited thereby than the protection provided by this chapter or at least equivalent thereto."

Further, despite the historical ebb and flow of congressional efforts to consider National Health Care legislation, Hawaii had hopes that this sort of legislation might be enacted. Consequently, Hawaii's State Legislature, in its wisdom, foresaw legal and administrative problems--if the Congress did enact such legislation. Therefore, Hawaii's Legislature specifically included under the Health Care Law a statutory "drop-dead" proviso, to wit:

> "Section 393-51. TERMINATION OF CHAPTER. This chapter shall terminate <u>upon the effective date of federal legislation that provides for voluntary prepaid health care for the people of Hawaii in a manner at least as favorable as the health care provided by this chapter, or upon the effective date of federal legislation that provides for mandatory prepaid health care for the people of Hawaii."</u> (emphasis added).

The Employee Retirement Income Security, I contend, by no stretch of the imagination, provides voluntary health care for the people of Hawaii. In fact, it does not even provide such benefits for the people of the United States of America. It does not now even provide for mandatory prepaid health care.

The effect of Federal pre-emption, under the current and seemingly strained reasoning of the U.S. Labor Department, robs the people of Hawaii, possibly the only citizens under the Flag of these United States, of any meaningful protection against the substantial burdens of the spiraling costs of medical care.

Clearly, this should not be permitted to happen. Indeed, clear thinking cannot permit this to occur. The only tolerable pre-emption of Hawaii's Prepaid Health Care Act would be when the Congress finally and decisively enacts a National Health Care Law.

We respectfully and urgently request the Congress to enact a National Health Care Act. We ask that the minimum health care benefits be at least equal to or, preferably, more favorable than those enumerated in our state statute.

Page 4

Thank you for this opportunity to speak for Hawaii's Prepaid Health Care Law. More importantly, we hope you will favor S. 1383 so that Hawaii's law and its major purpose(s) continue--without ERISA pre-emption.

The real solution is to aggressively move toward passing a National Health Insurance Law with benefits comparable, preferably superior, to those provided by Hawaii's State Law. Until then, Hawaii's law should be left alone, lest our situation be like a crab trying to climb out of a bucket only to be pulled back into the bucket by those inside the bucket.

Thank you.

Sincerely,

A. Van Horn Diamond
Executive Secretary-Treasurer

AVHD:em

Enc.

DANIEL K. INOUYE
HAWAII

United States Senate

ROOM 442, RUSSELL SENATE BUILDING
WASHINGTON, D.C. 20510
(202) 224-3934

August 3, 1978

Mr. A. Van Horn Diamond
Executive Director
Hawaii State Federation of Labor
5541 Pia Street
Honolulu, Hawaii 96821

Dear Van:

On August 15, 1978, the Subcommittee on Labor of the Senate Human Resources Committee and the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Finance Committee, will be holding a joint hearing on Senator Matsunaga's and my bill, S. 1383, the proposed amendment to the Employee Retirement Income Security Act of 1974, which would insure that the Hawaii Prepaid Health Care Act will not be preempted by Federal statute.

At our request, a delegation from the Hawaii State Department of Labor, including the Director, Dr. Joshua C. Agsalud, will be coming to Washington on that date to testify before the joint committee hearing.

As you know, this is an extremely important bill for the State of Hawaii. For many historical reasons, however, organized labor at the national level would appear to adamantly oppose any exemption for the Hawaii act. Accordingly, I feel it would be most beneficial to the State of Hawaii if you would be able to come to Washington to testify on behalf of the Hawaii State Federation of Labor.

I understand that you have already had a number of preliminary discussions with the National AFL-CIO regarding the importance of the bill to Hawaii and, this combined with the fact that you are on the Board of Directors of the Hawaii Medical Service Association, would make your testimony even more critical.

Aloha,

Dan.

DANIEL K. INOUYE
United States Senator

DKI:jmpl

United States Senate
COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

August 3, 1978

Mr. A. Van Horn Diamond
5541 Pia Street
Honolulu, Hawaii 96821

Dear Van:

As you may know, the Subcommittee on Labor of the Senate Committee on Human Resources and the Subcommittee on Private Pension Plans and Employee Fringe Benefits, of which I am a member, of the Senate Committee on Finance will be conducting hearings on August 15-17 on pending legislation to amend P.L. 93-406, the Employee Retirement Income Security Act of 1974 (ERISA).

S. 1383, introduced by Senator Inouye and myself, to provide for an exemption for the Hawaii Prepaid Health Care Act of 1974 from the provisions of ERISA, will be included as a subject of these hearings. Joshua Agsalud and Orlando Watanabe of the Hawaii State Department of Labor and Industrial Relations, Mario Ramil Deputy Attorney General, and Patricia Putman of the University of Hawaii School of Medicine will be appearing before the joint subcommittee hearing on August 15 to testify in support of S. 1383.

In view of your previous strong support of the Hawaii Prepaid Health Care Act and your position in the Hawaii State Federation of Labor, I believe that your testimony in support of S. 1383 before the joint subcommittee hearings would be a critically important addition to the testimony which will be delivered by the above-mentioned panel from Hawaii.

I would therefore greatly appreciate your thoughtful consideration of the possibility of appearing with the Hawaii panel during the joint hearings on August 15, or in lieu thereof, submitting a written statement for the hearing record. If you have any questions regarding the subcommittee hearings, please do not hesitate to contact me or any member of the Hawaii panel.

Aloha and best wishes.

Sincerely,

Sparky

Spark Matsunaga
Member, Subcommittee on Private
Pension Plans & Employee Fringe Benefits

GEORGE R. ARIYOSHI
GOVERNOR

JOSHUA C. AGSALUD
DIRECTOR

ROBERT C. GILKEY
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
825 MILILANI STREET
HONOLULU, HAWAII 96813

August 7, 1978

Mr. A. Van Horn Diamond
Executive Secretary-Treasurer
Hawaii State Federation of Labor
Room 216
547 Halekauwila Street
Honolulu, Hawaii 96813

Dear Mr. Diamond:

I will be in Washington on August 15, 1978 to testify on behalf of S. 1383, which would exempt Hawaii's Prepaid Health Care Law from ERISA's application.

As Executive Secretary-Treasurer of the Hawaii State Federation of Labor, you have been one of the foremost proponents of Hawaii's Prepaid Health Care Law. Your contacts in Washington are numerous and could be beneficial in assisting Hawaii to obtain this important exclusion. I am therefore requesting that you assist our efforts in whatever way possible. Should your budget and time permit, your presence at the hearing in support of our position will be in my opinion improve Hawaii's chances of obtaining passage of S. 1383.

Sincerely,

Joshua C. Agsalud
Director of Labor and
Industrial Relations

GEORGE R. ARIYOSHI
GOVERNOR

JOSHUA C. AGSALUD
DIRECTOR

ROBERT C. GILKEY
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
825 MILILANI STREET
HONOLULU, HAWAII 96813

May 12, 1978

MEMORANDUM

To: Mr. A. Van Horn Diamond
Executive Secretary-Treasurer
Hawaii State Federation of Labor, AFL-CIO

From: Robert C. Gilkey, Deputy Director
Department of Labor and Industrial Relations

Subject: ERISA

The following is a brief summary of the ERISA problem on which we will testify in Washington on June 1. We will appreciate any assistance which you can obtain for us in securing Congressional support for our position.

Section 514, Employee Retirement Insurance Security Act (ERISA)

"...the provisions of this title and Title IV shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 4(a) and not exempt under section 4(b)..."

This provision of ERISA according to USDOL ruling would supersede any State law which provides for employee welfare benefit plans established or maintained by an employer engaged in commerce.

Comments

The Hawaii State Prepaid Health Care Law requires employers engaged in business in Hawaii to provide health care benefits for their employees. The Standard Oil Company of California balked against a new requirement passed by the State Legislature that drug substance abuse benefits be included in its health care plan.

Mr. A. Van Horn Diamond
Page 2
May 12, 1978

The employer filed suit in the San Francisco U.S. District Court claiming ERISA preempted the Hawaii Prepaid Health Care Law and, therefore, was in its rights not to comply with the new requirement. The District Court judge ruled in the employer's favor. The impact of the decision, if not appealed by the State, would effectively nullify the protection provided the workers of Hawaii from the spiralling costs of medical and hospital costs. Accordingly, the State of Hawaii has filed an appeal with the U.S. Ninth District Court of Appeals, and has also secured the aid of Hawaii's congressional delegation in introducing an amendment to exclude a state prepaid health care law from the purview of ERISA. The appeal and legislative amendment is pending.

No. 9

RELATING TO HAWAII'S PREPAID HEALTH LAW.

WHEREAS, Hawaii's Prepaid Health Law requires all employers to provide their employees with a partially underwritten health plan; and

WHEREAS, Hawaii's Prepaid Health Law benefits primarily those workers who are yet to be unionized; and

WHEREAS, Hawaii's Prepaid Law also benefits some local unions who use its terms as the base for negotiated benefits; and

WHEREAS, Hawaii's Prepaid Law is presently being challenged by Standard Oil of California as being preempted by the Pension Reform Act (1974) also known as ERISA; and

WHEREAS, Hawaii's Prepaid Law can serve as a working model for proposed National Health Care legislation in the Congress, provided, it is not preempted by ERISA and/or federal court interpretation; now, therefore,

BE IT RESOLVED that the Hawaii State Federation of Labor, AFL-CIO, strongly support the exemption of Hawaii's Prepaid Health Law from the ERISA preemption provisions; and

BE IT FURTHER RESOLVED that the State AFL-CIO urge the Congress, through Hawaii's delegation, to protect Hawaii's Prepaid Health Law.

Submitted by: HSFL Executive Board

Legislative Committee recommends adoption: Yes X No ____

Convention Adoption: Yes X No ____

Hawaii State Federation of Labor, AFL-CIO
Adopted unanimously at its Seventh Biennial Convention, September 1977.

HONOLULU ADVERTISER: TUESDAY, AUGUST 8, 1978

Insuring national health

HA 8-8-78

President Carter has opened himself up to charges of being not particularly serious about national health insurance with his administration's vague pronouncements on the subject recently.

Carter's views came in the form of 10 guidelines to Health, Education and Welfare Secretary Joseph Califano for developing an insurance program.

AS THE CULMINATION of more than a year of study by a special administration task force, the guidelines lack substance.

They commit Carter to comprehensive health-care coverage for all Americans — with a significant role for the private insurance industry (a point with which we concur). But that is nothing new.

What is new is that Carter intends to spend no additional federal money on such a program until fiscal 1983, which would be near the end of his second term — if he is re-elected.

Even then, he wants a plan that would be put into effect gradually. This has caused Senator Edward Kennedy, the leading health insurance advocate on Capitol Hill, to break with the president. Kennedy and a number of organizations working for a comprehensive program worry that with an incremental approach, opponents would have repeated opportunities in Congress to undermine the system.

Kennedy now plans to submit his own legislation later this year and hopes it will come up for a Senate vote before the end of 1980.

The subject is obviously complex; health care is the third largest industry in America.

Yet Democratic presidents since Harry Truman have endorsed the concept of national health insurance. The Carter administration is not dealing with new ideas. Thus its unwillingness to commit itself to specifics and to a faster pace at this late stage is disappointing.

HAWAII SHOULD BE among states least adversely affected by the continued delay since health insurance coverage in the islands already ranks among the most comprehensive in the country.

State legislation in 1974 required all employers to offer a health insurance plan meeting prescribed standards. Between [illegible] and [illegible] percent of Hawaii's residents are believed to be covered by one such program or another.

Yet in much of the country, numerous individuals and families have no protection against catastrophic medical expenses. This shouldn't be the case in the world's most prosperous country.

A clearer and speedier commitment from the Carter administration to enact a system providing such protection for everyone in America is overdue.

GEORGE R. ARIYOSHI
GOVERNOR

JOSHUA C. AGSALUD
DIRECTOR

ROBERT C. GILKEY
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
825 MILILANI STREET
HONOLULU, HAWAII 96813

August 30, 1978

To: The Honorable Lloyd Bentsen, Chairman
Private Pension Plans and Employer Fringe Benefits Subcommittee of the Committee on Finance

The Honorable Harrison A. Williams, Jr., Chairman
Labor Subcommittee of the Committee on Human Resources

From: Joshua C. Agsalud, Director
Department of Labor and Industrial Relations
State of Hawaii

Subject: Reply to Question Posed by Senator Javits

I. Nature of the Hawaii Prepaid Health Care Law

In order to respond properly to Senator Javits' question with respect to amending the Hawaii Prepaid Health Care (PHC) Law to make it consistent with ERISA, we would like to clarify the nature of the PHC Law and its relationship to other state-mandated insurance programs for the benefit of employees. One cannot properly speak of amending the PHC Law to "conform" with ERISA because it is not the type of program which ERISA was enacted to regulate. The provisions of ERISA, therefore, have nothing in common with the PHC Law and cannot in any logical way be applied to it.

In form and function, the PHC Law is closely related to, and specifically designed to complement, two well-established insurance programs that are explicitly excluded from ERISA preemption: workers' compensation (WC) and temporary disability insurance (TDI).

Through the WC program, employees are insured against both wage loss and medical costs related to injuries and illnesses suffered on the job, while the TDI program offsets wage loss and the PHC program alleviates medical costs related to off-the-job sickness or accident.

Thus, the three programs--WC, TDI, and PHC--together form a comprehensive legislative scheme to protect workers from hardship related to injury or illness whether suffered on or off the job. In each case, employers are required to procure insurance coverage or provide self-insurance in accordance with standards established by statute, and in each case the state's role is to assure that coverage is provided as required by law, to arbitrate disputes between employers and employees, and to preserve the rights of workers to receive benefits to which they are entitled.

The PHC Law is clearly and unquestionably within the class of state-mandated insurance programs intended by Congress to be excluded from ERISA preemption. It is just as clearly not the type of trustee-controlled benefit plan the abuses of which called forth ERISA in the first place. There are no funds which must be set aside, invested, and managed by someone today in order to provide benefits 20 or 30 years in the future. Coverage and eligibility are established by law, not by employers or unions. And, most of all, the employees' rights are guaranteed by the full power of the State.

The Hawaii Prepaid Health Care Law is intended to provide significant relief to employees in the State from the heavy cost burden of comprehensive health and medical care coverage. At the time of the law's passage in 1974, many workers already had this kind of protection through collective bargaining, public employee programs, or voluntary action. Much of the existing coverage, however, was inadequate to the workers' needs; moreover, there were tens of thousands of regular members of the work force who were not covered at all. This health insurance "gap group" consisted, by and large, of low-wage workers in the services and retail trade industries.

The law now requires all private employers to provide group prepaid health care insurance for their employees who work at least 20 hours per week after four consecutive weeks of employment. This coverage may be provided either by a plan which actually furnishes the health care coverage (Health Maintenance Organization, or HMO, type coverage) or by a plan which reimburses the employee for health care costs.

The health and medical benefits required by the law are substantially identical to the benefits provided under the existing plans of the two types (HMO and reimbursement) having the most subscribers in the State, the Kaiser Foundation Health Plan (HMO) and the Hawaii Medical Services Association (reimbursement). In this way, the legislation embodies a community-set standard for the benefit structure.

In order to discourage unneeded and uneconomic duplication of coverage, employers need not cover employees who have coverage under a federal law, who are covered as a dependent under another plan providing the required benefits, who are public assistance recipients, or who are covered by another employer.

The general rule for premium cost allocation is 50% by the employer and 50% by the employee, with the employer empowered to withhold the employee's share from wages. However, in order to avoid an undue burden on low-wage earners (a principal reason for the law's enactment), a ceiling of 1.5% of wages is placed on the employee's contribution. If that amount equals less than half of the premium cost, the employer is required to pay the difference. To prevent an excessive cost to marginal employers with few employees, partial subsidies are available from the State's general revenues for a portion of their employees' premiums.

The PHC Law is administered by the Disability Compensation Division of the Hawaii Department of Labor and Industrial Relations, which also administers the workers' compensation and temporary disability insurance laws. As detailed in the following analysis of the administration and enforcement of the PHC Law, the intentional complementary nature of the three laws enhances their efficiency and effectiveness by making it possible to administer all three with the same facilities, staff, and records.

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II. Administration and Enforcement

A. Introduction

Hawaii is the only State that has enacted landmark legislation protecting eligible workers from hardship as a result of injuries or illnesses suffered both on and off the job, including providing for compulsory health insurance to pay for medical and hospital care. The Workers' Compensation Law, first enacted in July 1915, provides benefits to cover wage loss, medical and hospital care and other costs incurred as a result of occupational injuries or illnesses; the Temporary Disability Insurance Law, enacted on June 30, 1969, assures workers wage loss benefits for nonoccupational injuries or illnesses; while the Prepaid Health Care Law, enacted on June 12, 1974, assures workers benefits for medical and hospital costs resulting from nonoccupational injuries or illnesses. These three laws are aimed at alleviating the economic hardships of workers on account of injury or illness. The protection afforded by the three laws gives workers a sense of assurance and well-being which they would not otherwise have.

B. Similarity of Laws--Determinative Factor in the Administrative Scheme of the Prepaid Health Care Program

Except for a few exemptions specified in the coverage provisions, the three laws protect almost all workers who earn wages in Hawaii. All three laws require employers to provide the required coverage--either through licensed insurance carriers or State-approved self-insurance. The similarity of the three coverage and enforcement provisions makes it advantageous to place the administrative responsibility for all three programs under one agency--the Disability Compensation Division of the Department of Labor and Industrial Relations. With the WC and TDI programs already functioning when the PHC program became a reality, all that was required was to revise the division organizational structure to include the new program, and to expand certain position descriptions to include PHC duties. In terms of health care positions, only five new positions were needed exclusively for the new program. Other position increases--primarily two new auditors and two

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investigators--were granted because of workload increases in the WC and TDI programs and the addition of PHC duties to these positions.

C. Primary Functions of the PHC Staff

The goal of the PHC program is to assure all eligible workers that they are provided adequate health care coverage by their employers. To achieve this goal, the PHC staff performs a number of important functions including employer registration, plans review, investigation and audit, and record maintenance.

1. Employer Registration

The implementation of the PHC program begins with the registration and identification of employers subject to the PHC Law. At the outset of the program, finding the most feasible system of accomplishing this was the biggest hurdle to overcome. Fortunately, this problem was easily solved by the use of the account number system previously adopted from the Unemployment Insurance Division by the TDI program. Since the coverage provisions of the TDI Law are similar to the PHC Law, the account numbers issued to TDI-subject employers could also be used to identify PHC-subject employers. Using the TDI computer, the PHC staff was furnished the name, address and account number of each employer to whom an account number had been issued and all the necessary questionnaires and information sheets regarding the PHC program were sent to these employers. This procedure enabled the PHC staff to contact and inform all subject employers of the need to provide PHC coverage for their employees, and of the added requirement that their health care provider submit the health care plan to the PHC staff in order for the employer to be considered in complinace. Employers who failed to respond despite follow-ups were referred to the investigation staff. Now, Form DC-3 (copy attached) is sent to all new employers.

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2. Plans Review

Ensuring the adequacy of employer plans is the main aim of the TDI/PHC plans review function. Depending on circumstances, this function may be performed by the staff or by the appointed PHC Advisory Council. There are certain plans provided by Hawaii's two largest health care providers (Hawaii Medical Service Association and Kaiser Foundation Health Plan) that have been reviewed and accepted as "standard" plans. When a plan provides benefits which deviate from the law, the staff initially reviews and rejects any plan which excludes any required benefits, such as substance abuse. The employer is notified of his substandard plan and apprised as to what benefits need to be included or modified to bring the plan up to standard. When a plan contains benefits that are alleged to be equal to, or medically reasonably substitutable for, the benefits required by law, such a plan is referred to the PHC Advisory Council for reivew and recommendation as required by statute.

3. Investigation and Audit

The primary function of the division investigators and auditors is to ensure that employers and insurers (including health care providers) comply with the TDI, WC and PHC Laws. Thus, when employers fail to provide coverage or coverage is substandard, investigators are dispatched to inform employers of the need to comply with the coverage requirement. When employees complain under the PHC Law that the medical or hospital costs have not been paid or that they have had to pay from their own pockets, the investigators act to ensure that these costs are properly paid or reimbursed by the employer if coverage had not been provided or had been canceled by the health care provider. Auditors make a thorough review of employers' records on a regular basis to ensure that employees' share of health care premium and TDI costs do not exceed statutory limits, and if the employees' share does exceed statutory limits, that the employer refunds the excess amount to the employees.

When persuasion and warnings fail to convince employers to comply with the laws, more severe enforcement actions--including penalties, fines, and enjoining of the employer's business--may be taken to bring about compliance.

4. Record Maintenance

Maintaining an accurate and up-to-date file of WC, TDI and PHC plans and records is an integral part of the program. All plans and employer records are placed into the computer by employer account number. All source documents are also retained for a period of time in employer folders and by account number sequence. Employer plan records and information are constantly updated as new transactions take place, such as changes in health care provider, cancellation, and other information. The computer file is also updated as providers and insurers submit weekly and monthly listings of employers covered by or dropped from their programs.

5. Other Functions

a. Premium Supplementation Fund

The division administers the WC, TDI and PHC special funds. The PHC premium supplementation fund is used for two purposes: (1) to assist "hardship-case" employers with less than eight employees in paying the employer's share of the premium cost, provided they meet certain qualifying requirements; and (2) to pay the health care costs of an employee whose employer is noncomplying or bankrupt, subject to reimbursement by the defaulting employer. In the former case, the auditor reviews the employer's financial records to determine if his financial condition meets the qualifying requirements, and in the latter, the investigator recommends, after a thorough investigation, the use of the premium supplementation fund to pay for the employee's health care costs.

b. Administrative Hearings

In any case involving the use of the premium supplementation fund to pay for health care costs, or the levying of penalties or fines against a defaulting employer, or appeals filed by an employer or employee regarding prepaid health care benefits, such cases are heard by an independent hearings officer. Similar hearings are held in the WC and TDI programs.

III. Relationship to ERISA

With respect to welfare plans, Part One of Title I of ERISA provides for reporting and disclosure requirements. The basic purposes of these requirements are to inform employees of their rights, and to assist the Secretary of Labor in determining the financial soundness of the plan. Thus, the fund administrators are required to provide each participant and each beneficiary with a summary description of their plan drafted in language understandable by the average plan participant and to make available a copy of the plans' annual report.

Part Four of the Title sets forth the fiduciary standards for the management of employee pension and welfare benefit plans. These standards provide in part that the plan be in writing, the assets be held in trust exclusively for the benefit of employees, and that the plan investments be diversified. A "prudent man" standard is established for fund administrators, and prohibited financial transactions are listed.

ERISA is not a national health care program providing health benefits to all our citizens. It merely provides protection by way of reporting, disclosure and fiduciary requirements to employees who were able to afford and participate in their employers' private plan.

Admittedly, the Hawaii PHC Law is not designed to regulate existing private employee benefit plans through reporting, disclosure and fiduciary requirements. It is a governmental insurance program designed to provide health care protection to workers who were unable to afford such protection. The PHC Law, like WC and TDI, is directed at employers and health care providers and not at fund administrators. The U.S. Department of Labor's opposition to S. 1383 becomes meaningless since under the Hawaii Law, the rights of the employees do not depend solely on "funds" administered by the employer or its administrator but is guaranteed by the statute itself through a "fund" administered by the State of Hawaii. The PHC Law mandates employers to pay at least one-half of the premium cost for their eligible employees thereby creating health insurance plans for employees in most need of such protection. The U.S. Department of Labor's position would deprive these employees of such health insurance protection because "it would remove existing ERISA protections with respect to the reporting, disclosure and fiduciary responsibility of health plans." The irony in the situation requires no belaboring.

Furthermore, the legislative history of section 4(b)(3) of ERISA strongly indicates that all governmental insurance programs are not covered by ERISA. In distinguishing private employee benefit plans from governmental insurance programs, the Final Report of the Senate Committee on Labor and Public Welfare on Welfare and Pension Plans Investigation of April 16, 1956 stated:

> "This [governmental insurance programs] has stimulated the growth of private disability insurance.
>
> The vast private programs complement the government programs. Both play a vital role in our national life. It is apparent, therefore, that legislation must assure the soundness and honest administration of private programs in the interest of the beneficiaries." [S. Rep. 1734, 84th Cong., 2d Sess. 16 (1956)].

Since WC, TDI and the PHC Law are administered in the same manner by the same state agency, there is no logical reason for ERISA to preempt the PHC Law and not the other enumerated governmental insurance programs.

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It is therefore clear, from the legislative intent behind the PHC Law and the manner in which the law is administered by the State, that it is not inconsistent with or in conflict with the purposes and spirit of ERISA. In fact, preemption of such a comprehensive health insurance law would be contrary to the stated purpose if not the spirit of ERISA; that is, to ensure the continued well-being and security of millions of employees.

Attachment

State of Hawaii
Department of Labor and Industrial Relations
DISABILITY COMPENSATION DIVISION
P. O. Box 3769
Honolulu, Hawaii 96812

Form DC-5
Rev. 7/77

QUESTIONNAIRE ON WORKERS' COMPENSATION, TEMPORARY DISABILITY INSURANCE AND HEALTH CARE COVERAGE

Employer Name (Last, first, middle) Type or print)		DOL Account No.
DBA Name, if any	Nature of Business	
Street Address	City and State	Zip Code
Place of Business, if different from above	City and State	Zip Code

1. Check the appropriate box(es) to indicate whether the required coverage has been obtained.
   a. I already have ☐ WC ☐ TDI ☐ HC coverage
   b. I am excluded from ☐ WC ☐ TDI ☐ HC coverage because (explain): ______

   (The Department of Labor will notify you if your exclusion is disallowed).

2. WORKERS' COMPENSATION PLAN (Chapter 386, Hawaii Revised Statutes)
   a. ☐ I would like to apply for self-insurance.
   b. ☐ I have secured coverage by insuring with: ______
   Insurance Carrier Name

   ______ Insurance Agency Name ______ Effective Date ______ Policy Number

3. TEMPORARY DISABILITY INSURANCE PLAN(S) (Chapter 392, Hawaii Revised Statutes)
   a. Indicate the extent employees are covered or will be covered by your plan(s).
      ☐ All my employees are covered under one plan.
      ☐ Certain classes of employees are covered under different plans Indicate in b below the type of plan(s) and the class(es) and number of employees affected.
   b I have or plan to have the following type(s) of TDI plan:

☐ PLAN 1
Insurance purchased or to be purchased from a licensed insurance carrier which pays statutory benefits.

______ Insurance Carrier Name

______ Assn Name & Addr., if applicable

______ No. of employees covered ______ Effective Date

☐ PLAN 2
Self-insured plan. Attached are copies of plan and financial statement.

______ Assn. Name & Addr., if applicable

______ Effective Date

______ No. & classes of employees covered

☐ PLAN 3
Sick leave plan covered under an employer-employee collective bargaining agreement. Attached is a copy of sick leave provisions (If more than one union or benefits are paid by insurance carrier, enter information under item 5 on reverse.)

______ Name of Union

______ Agmnt Eff. Date ______ Agmnt. Exp Date

______ No & Classes of employees covered

☐ PLAN 4
Insurance purchased from a licensed insurance carrier which pays better than statutory benefits.

______ Insurance Carrier Name

______ Assn. Name & Addr. ______ Effective Date

______ No & classes of employees covered

   c. Indicate classes of employees excluded and the number excluded in each class.

Excluded Class	Number Excluded
1.	
2.	

   d. Deductions made from employee's wages to pay for premiums? ☐ Yes ☐ No
   (You cannot deduct more than one-half the premium cost nor more than .5% of the employee's weekly wages.)

4. HEALTH CARE PLAN(S)—(Chapter 393, Hawaii Revised Statutes)

a. ☐ Health care coverage not required because (give reason): ....

b. Indicate the type(s) of plan(s) you already have or will have.

☐ TYPE 1—A plan which requires the prepaid health care plan contractor, such as Kaiser, to furnish the required health care benefits.

Name of health care plan contractor ....

Plan No. .... Group No. .... Effective Date ....

Classes of employees covered by plan .... No. covered ....

☐ TYPE 2—A plan which requires the prepaid health care contractor, such as HMSA, to defray or reimburse the expenses of health care. If coverage is by insurance company, attach copy of plan for review by department.

Name of health care plan contractor ....

Plan No. .... Group No. .... Effective Date ....

If not under your name, give employer's or association's name under which your health care is registered ....

Classes of employees covered by plan .... No. covered ....

☐ TYPE 3—A plan in which health care benefits are provided according to a collective bargaining agreement. Send copy of agreement containing health care provisions. If more than one union, enter this information in item 5 below. If benefits are paid by insurance company, attach copy of plan for review by department.

Name of union ....

Name of health care plan contractor ....

Name or number of plan .... No. covered ....

Effective date of agreement .... Expiration date of agreement ....

☐ TYPE 4—A self-insured plan with satisfactory proof of solvency and financial ability to defray or reimburse health care benefits. Attach copies of plan and financial statement.

Name of health care plan contractor ....

Plan No. .... Group No. .... Effective Date ....

Classes of employees covered by plan .... No. covered ....

c. Indicate the number of employees you think will be exempted from coverage and the reason for their exemption.

No. of employees	Reason for exemption
....	Works less than 20 hours a week
....	Covered as a dependent under a qualified health care plan
....	Covered by primary employer
....	Covered by a State or Federal health care plan
....	Covered by State-governed medical assistance or employee is public assistance recipient
....	Other coverage obtained from .... (name of health care contractor) which meets the PHC Law (attach copy of plan and send to DC Division).
....	Other ....

d. If applicable, indicate your share and employee's share of the premium cost. (Note: you cannot deduct more than one-half of the premium nor more than 1.5% of the employees wages. If employee's share is less than half, you must pay the remaining portion.)

1. Total monthly premium cost per employee for employee only coverage $..........

a. Employee pays $.......... b. Employer pays $..........

2. Total monthly premium cost for employee and dependents coverage $..........

a. Employee pays $.......... b. Employer pays $..........

5. ADDITIONAL INFORMATION

....

....

Signature	Title	
Print Name	Telephone	Date

Answers To Questions Posed By Senator Matsunaga

SENATOR MATSUNAGA:

In your testimony you indicated that the cost of administration is minimal. May I ask you to elaborate? Can you tell me how much in dollars this program is costing Hawaii in general funds?

MR. WATANABE:

The FY 1978 budget for the Disability Compensation Division was $1,078,000 of which $188,000 was spent exclusively for the administration and management of the Prepaid Health Care program.

SENATOR MATSUNAGA:

I think Hawaii has done an outstanding job in providing for mandatory health insurance but I feel there must be something else. That is, are there some groups not covered and/or is additional coverage desirable? Please name the groups and type of coverage.

MR. WATANABE:

Present law requires coverage of employees working 20 or more hours a week after four continuous weeks of employment. The next step would be to cover all employees including the self-employed and their dependents regardless of hours worked. The additional coverage desirable would be prescription drug, dental and vision care coverage. Before coverage is expanded, we must look at the cost before decisions are made.

SENATOR MATSUNAGA:

Recently the President presented to HEW Secretary Califano ten guidelines to be followed in the development of the Administration's legislative proposal for National Health Insurance. If you have had an opportunity to examine those ten points, could you compare them to what the State of Hawaii has accomplished by its Prepaid Health Care Act?

MRS. PUTMAN:

Much of what has been achieved under the Hawaii Prepaid Health Care Law is specifically consistent with some of the President's guideline for formulation of National Health Insurance legislation. For example the Hawaii Act:

1. Assures comprehensive health care coverage to all regular members of the work force (a regular member of the work force is an employee who works at least 20 hours a week for four consecutive weeks).

2. Makes quality health care available to all such employees--with basic, comprehensive out-patient and in-patient benefits for all employees, whether they are high or low wage earners.

3. Gives and preserves substantial freedom of choice as to health professionals, health care institutions and facilities, and prepaid health insurance contractors.

4. Provides for financing the costs of mandatory prepaid health care by contributions from employers, employees, and the State.

5. Includes a significant role for the private insurance industry.

6. Promotes reform such as coverage for ambulatory and preventive services and, of course, mandated use of prepaid plans.

7. Assures consumer representation through an Advisory Council that includes consumer representation in connection with the administration of the Act.

On the other hand, it is noted that the Hawaii Prepaid Health Care Act is not in itself a factor in major reform of the health delivery system. Other efforts and circumstances, however, such as the rigorous cost-containment programs of the Hawaii Medical Services Association and of the Kaiser Foundation certified HMO; the development of group medical practice in the State; the favorable state of health of the population (shown in morbidity/mortality tables); the vigorous competition among HMSA, Kaiser, and the private, commercial insurance industry--all of these factors, in addition to the effective operation of the Hawaii Prepaid Health Care Law bring Hawaii very close to the position that the President has set for a national goal.

SENATOR MATSUNAGA:

Besides this amendment to Section 4(b)(3) of ERISA, what are the other alternatives that will clarify the status of the Hawaii Prepaid Health Care Law with respect to ERISA?

MR. RAMIL:

S. 1383, the amendment to Section 4(b)(3) will clarify that governmental insurance programs are not covered by ERISA. There are also other alternatives--First, the definition of the term "employee benefit plan" can be clarified in Sections 3(1) and 4(a). To include Hawaii's Prepaid Health Care Plan within the above definition will result in undesirable consequences. We note the warning issued by a recent House Report of the Committee on Education and Labor which stated in part:

> "We are mindful of the potentially harmful effects of an overly broad interpretation of the term employee benefit plan when coupled with the policy of section 514." (H.R. Rep. No. 94-1785, 94th Cong. 2d Sess. 48 (1977)).

Second, short of an amendment to ERISA, the Congress could exempt the Hawaii Prepaid Health Care Law from ERISA by giving the Secretary of Labor such authority.

SENATOR MATSUNAGA:

Assuming that S. 1383 is not passed by Congress and assuming further that the U. S. District Court Decision in Standard Oil Co. of California v. Agsalud is affirmed by the Ninth Circuit Court, what can the State of Hawaii do to save its Prepaid Health Care Law?

MR. RAMIL:

Hawaii could establish other forms of health insurance programs which thereby, as a practical matter, would dismantle existing interstate plans with respect to local employees but would definitely not run afoul of ERISA. Thus, Hawaii could establish a health insurance fund to be supported by employer and employee contributions (as provided under the present act) and empower the fund to arrange mandated health care benefits with prepaid health care plan contractors chosen by employee election. This scheme would yield the same benefits and advantages as are provided under the present law except that interstate employers would lose the possibility of providing coverage of the whole work force by a carrier of their choice. Bearing in mind that the state could accomplish the goals of its Prepaid Health Care Law by alternative schemes absolutely outside

ERISA's purview, but at the price of greater inconveniences to multi-state employers and of greater bureaucratic component, it should be manifest that the proposed clarification or correction of ERISA is preferable and more in harmony with the over-all objectives of that legislation.

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Senator INOUYE. Mr. Chairman, may I close the presentation with the State of Hawaii by quoting from the decision of Judge Charles B. Renfrew when he rendered this decision on November 11, 1977. As the judge indicated, this was an interstate transaction. Therefore, he was forced to rule as he did. But in so ruling, he stated the following:

> It troubles the court as it troubles defendants that Congress preempted the State health insurance laws apparently without specific discussion of the need for such a step. The workers whom ERISA was primarily intended to protect may be better off with State health insurance laws than without them, and the efforts of States like Hawaii to insure that their citizens have low-cost comprehensive health insurance may be significantly impaired by ERISA's preemption of health insurances laws. Federal legislators should heed the admonition which Justice Brandeis addressed to the Federal courts.

So, Mr. Chairman, it is our sincere hope that the committee will act expeditiously on this matter and help to save what we believe is one of the most innovative and successful State health insurance programs in the Nation from termination due to inadvertent legislative oversight in drafting ERISA.

Senator WILLIAMS. I appreciate that very much. I would like to tell my good friend from Hawaii that we are very sensitive to the observations and admonitions from the bench. Judicial suggestions to us on gaps or errors or omissions in legislation are taken very seriously. For example, we moved immediately when the Supreme Court told us we had not included pregnancy disability in discrimination in the civil rights laws. We are now held up on it only because of the abortion issue.

We moved then and we will on this, too.

The only limitation, of course, is the time factor.

Senator BENTSON. Let me echo what Senator Williams has said. Frankly, this issue, as I recall, did not come before us on our hearings on the Finance Committee. We really did not deal with this question of health insurance. You have brought up a very major point and one that I join with Senator Williams in saying we will give our immediate attention to.

Senator WILLIAMS. We are very grateful to all of you.

You can see we are all applauding the State of Hawaii.

Thank you very much.

Senator INOUYE. Thank you.

[Correspondence between Senators Williams, Inouye, and Matsunaga relating to the issue of ERISA preemption follows:]

United States Senate

COMMITTEE ON HUMAN RESOURCES
WASHINGTON, D.C. 20510

August 2, 1978

Honorable Daniel K. Inouye
United States Senator
442 Russell Senate Office Building

Dear Dan:

I understand that you and several officials of the State of Hawaii wish to testify at the hearings on S. 3017, S. 250, S. 1383 and other bills to amend ERISA that will be conducted jointly by my Labor Subcommittee and Senator Bentsen's Subcommittee on Private Pension Plans and Employee Fringe Benefits.

At your and Senator Matsunaga's request, S. 250 and S. 1383 were explicitly noticed as subjects of the hearings, and Lloyd and I will be pleased to accommodate you and the Hawaii officials as witnesses at the hearings. To ease our scheduling problems, we would appreciate it if you and the State officials could appear together on the first morning of our hearings, Tuesday, August 15, 1978. Steve Sacher, Special Counsel to the Human Resources Committee, has been in touch with Pat DeLeon and will continue to coordinate with him and with John McLaren of Senator Matsunaga's staff regarding the timing of your appearance on August 15.

In connection with S. 1383, regarding ERISA's preemption provision as it relates to the Hawaii pre-paid health care law, there are certain difficulties from my perspective. As you may recall, the strong ERISA preemption language was placed in the statute to prevent ERISA pension and welfare plans from becoming subject to a multiplicity of State laws, each of which would subject the plan to different obligations respecting plan standards, types of benefits and benefit levels, fiduciary and reporting rules, etc. It was believed that uniform Federal standards imposed by ERISA and the Internal Revenue Code represented a more desirable form of regulation than a multiplicity of state laws which, for interstate plans, would undoubtedly result in disparate treatment of participants under the same plan, depending upon where they lived or worked, and extensive paperwork, red tape and cost burdens for the plan administrators and sponsors.

At the time of ERISA's enactment in 1974, we were aware that the uniformity/multiplicity rationale applied with greater force to pension plans than to welfare plans, because ERISA and the Code regulate the former more extensively than the latter. Nevertheless, welfare plans are subject under ERISA and the Code to very substantial reporting, disclosure, fiduciary, and claims procedure regulation and enforcement. Moreover, even in 1974, more than half-a-dozen states were regulating pension plans (some under laws containing standards even more stringent than those of ERISA) and several more states were poised to enact pension or welfare plan legislation.

In the nearly four years since ERISA's enactment, a series of knotty problems has arisen in connection with the Federal preemption policy under ERISA. In addition to the situation of a state law regulating welfare plans or welfare plan benefits, such as those of Hawaii, California, or, in slightly different form, New Hampshire, ERISA preemption has been the subject of dispute in connection with state regulation of uninsured multiple employer trusts, state laws dealing with age and sex discrimination, alimony and support orders issuing in State divorce proceedings, state escheat laws, community property laws, blue sky laws, and others.

My bill, S. 3017; Senator Bentsen's bills, S. 901, 2992 and 3193; and Senators McIntyre's and Nelson's bill, S. 1745 (all of which are also subjects of our hearings) deal with several matters, but they all have a common thrust, namely, improvement of the private pension system by reduction of required paperwork and red tape, streamlining of administration, and direct and indirect stimulants for the establishment of more and better private sector plans. In addition, my bill seeks to clarify the application of Federal securities laws to employee benefit plans.

Human Resources, Finance, and Joint Tax Committee staff have been working together to develop a bill that is acceptable to both subcommittees. Lloyd Bentsen and I both hope to move a bill through the subcommittees and committees and onto the Senate floor in this session of Congress. We think we can do it if the scope of the bill is relatively narrow.

More ERISA legislation will be required next year, because by July 1, 1979 (pursuant to P.L. 95-214), Congress must take action on the subject of a report presented on June 30, 1978 by the Pension Benefit Guaranty Corporation, dealing with the difficulties of the termination insurance program for multiemployer plans.

I am not satisfied with the present preemption policy under ERISA, but I am quite certain that significant time and staff resources will have to be committed to work out a policy that is more satisfactory and that deals properly with all of the preemption problems mentioned above. I am equally certain that if we attempt to address any of those state law preemption problems in our legislation this fall, we run a grave risk of ending up with something worse than what we have now. Accordingly, I would like to propose that although we cover this subject fully in our upcoming hearings, we not attempt to enact changes respecting ERISA's preemption of state laws during this session of the Congress. However, as part of next spring's ERISA legislation, I will certainly work to include appropriate preemption changes as part of that legislative package.

With best wishes,

Sincerely,

Harrison A. Williams, Jr.
Chairman

cc: Honorable Spark M. Matsunaga

HAW:ssd

DANIEL K. INOUYE
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United States Senate

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August 4, 1978

Honorable Harrison A. Williams, Jr.
Chairman
Committee on Human Resources
United States Senate
Washington, D.C. 20510

SENATOR WILLIAMS, N.J.
1978 AUG -9 AM 10 31

Dear Pete:

I wish to acknowledge receipt of your letter of August 2, 1978, concerning the forthcoming joint hearings which you and Senator Bentsen will be holding on the Employee Retirement Income Security Act (ERISA).

The morning of Tuesday, August 15, 1978, will be a good time for Senator Matsunaga and I to appear with the representatives of the State of Hawaii at your committee hearings.

During my many discussions over the past year with the Governor of the State of Hawaii and members of his cabinet in both our Health and Labor Departments, it has been extremely clear that the State is gravely concerned about the U.S. Department of Labor's position that ERISA should preempt our Hawaii Prepaid Health Care Act. I have also become quite aware of the many complexities that exist in attempting to amend the bill.

Accordingly, your specific suggestion of covering the status of the Hawaii Prepaid Health Care Act during these present hearings, but then postponing possible modifications of the exemption provisions until next Spring's bill, does seem like a most reasonable approach. It is extremely important to the citizens of the State of Hawaii that our Prepaid Health Care Act remain intact; however, I also think that it is equally important to the highest level of our Democratic Administration that innovative health insurance proposals such as Hawaii's are actively encouraged, rather than arrested. This is

Honorable Harrison A. Williams, Jr.
August 4, 1978
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especially the case, given President Carter's personal enthusiasm for a national health insurance proposal under which one of the options would appear to be that our nation should first experiment with various State-run programs, such as Hawaii's, rather than mandate total federal control. In this light, it would seem infinitely inconsistent to me that on the one hand we have the President urging a certain approach, while on the other hand, the U.S. Department of Labor takes the stand that these programs must be preempted by ERISA.

Accordingly, I very much look forward to continuing to work closely with you next Spring in devising a satisfactory solution to what I perceive as a major difficulty.

Aloha,

DANIEL K. INOUYE
United States Senator

DKI:vbf

United States Senate

COMMITTEE ON FINANCE

WASHINGTON, D.C. 20510

July 31, 1978

Honorable Harrison A. Williams, Jr.
Chairman, Subcommittee on Labor
Committee on Human Resources
United States Senate
Washington, D.C. 20510

Dear Pete:

Thank you for providing an opportunity for the consideration of S. 1383, introduced by Senator Inouye and myself, to provide for the inclusion of health insurance programs in the preemption from exemption provisions of P.L. 93-406, the Employee Retirement Income Security Act of 1974, during the joint hearings on pending ERISA legislation by your Subcommittee and the Subcommittee on Private Pension Plans and Employee Fringe Benefits, of which I am a member, of the Committee on Finance on August 15.

I have arranged for a panel of witnesses from Hawaii, who will be representing the official State position on S. 1383, to testify before the joint Subcommittee hearing on August 15. The panel will consist of the following members: the Honorable Joshua C. Agsalud, Director, Department of Labor and Industrial Relations, State of Hawaii; Mr. Orlando Watanabe, Administrator, Disability Compensation Division, Department of Labor and Industrial Relations, State of Hawaii; Mr. Mario Ramil, Deputy Attorney General, State of Hawaii; and Ms. Patricia K. Putman, Associate Dean for Legal and Legislative Affairs, John A. Burns School of Medicine, University of Hawaii at Manoa, Honolulu, Hawaii. An additional individual representing organized labor may be added to the panel at a later date. I will be certain to provide you with the individual's name and title in this event.

I have written to each member of the panel from Hawaii and have requested that they orally summarize their written testimony when appearing before the Subcommittee with the understanding that their complete written testimony

Honorable Harrison A. Williams, Jr.
July 31, 1978
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will be inserted into the hearing record as though delivered in full. Pursuant to the request of your Subcommittee, I have also requested five advance copies of their testimony to be delivered to the Subcommittee on Labor four days before the hearings and 75 copies of the testimony to be delivered to the Subcommittee on the day of the hearing for distribution to the members of the Subcommittees, the media and the general public.

Aloha and best wishes.

Sincerely,

Sparky

Spark Matsunaga
U. S. Senator

SPARK M. MATSUNAGA
HAWAII

CHIEF DEPUTY
MAJORITY WHIP

CHAIRMAN, SUBCOMMITTEE ON TOURISM AND SUGAR
COMMITTEE ON FINANCE

MEMBER:
COMMITTEE ON ENERGY AND NATURAL RESOURCES
COMMITTEE ON VETERANS' AFFAIRS

United States Senate

WASHINGTON, D.C. 20510

August 28, 1978

SEP -6 AM 10 45

Honorable Harrison A. Williams, Jr.
Chairman, Subcommittee on Labor
Committee on Human Resources
United States Senate
Washington, D.C. 20510

Dear Pete:

Thank you for providing me with a copy of your recent letter to my colleague, Senator Daniel K. Inouye~~,~~ regarding your suggestion to address the ERISA preemption ~~problem of~~ the Hawaii Prepaid Health Care Act of 1974 during the consideration of ERISA legislation next Spring.

As you know, I am very much interested in obtaining a proper and expeditious resolution of this problem for the State of Hawaii. However, your suggestion to defer formal action on this issue until next year is reasonable in view of the remaining time for consideration and passage of this year's ERISA legislation. I, therefore, will join with Senator Inouye in working with you and your Subcommittee Staff next year to obtain a final resolution of this most important preemption issue.

Aloha and best wishes.

Sincerely,

Sparky

Spark Matsunaga
U.S. Senator

COMMITTEE ON HUMAN RESOURCES
1978 SEP -6 PM 4 30

cc: Honorable Jacob K. Javits
Subcommittee on Labor
Committee on Human Resources
United States Senate
Washington, D.C. 20510

Honorable Lloyd Bentsen, Chairman
Subcommittee on Private Pension Plans and
Employee Fringe Benefits
Committee on Finance
United States Senate
Washington, D.C. 20510

Senator WILLIAMS. Senator Bartlett is here. We had scheduled him at 11:30. If you would come forward, Senator.

STATEMENT BY HON. DEWEY F. BARTLETT, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator BARTLETT. Thank you very much, Mr. Chairman.

I would like to thank the members of both subcommittees for their efforts in holding these hearings late in the 95th Congress.

I have already delivered to the committee copies of the complete statement on S. 2763 which I introduced on March 13, 1978, and I will very briefly review the points made in that statement.

Before I do, I just noted, Mr. Chairman, the point you just made about the committee paying attention to Supreme Court directives. As far as small companies are concerned with ERISA, they are very unlikely to be able to take a matter to the Supreme Court because of the extreme cost to them. So there are a lot of unresolved legal matters that do pertain to small companies, and I think do need attention.

The bill addresses some of the more pervasive problems noted by a number of my constituents, including attorneys, certified public accountants, insurance people, and businessmen. There are numerous problems with ERISA, and S. 2763 seeks to remedy only a small number of them.

I supported Public Law 93–406, and continue to believe that it is imperative that protections be provided to employees. However, when legislation creates a situation where businesses are terminating plans, the employee is left with no protection.

Mr. Chairman, I will now briefly describe each section of S. 2763:

Section 1 raises the limit of planned assets that may be invested in one investment from 10 percent to 30 percent. The 10-percent limit may be practical for large corporations; however, small employers cannot set up an individual plan under these circumstances. Small companies, for example, are forced to have some assets not invested at all, turn to insurance companies, or in some cases have decided to terminate the plan.

Section 2 eliminates the requirement for payment of plan termination insurance to the Pension Benefit Guarantee Corporation for those plans funded entirely by insurance. There is no need for this additional payment since the insurer under this set of facts assumes the full liability on the plan. Normally, if the plan fails, the Pension Benefit Guaranty Corporation, PBGC, pays participants substantial portion of the benefits; however, in a plan funded entirely by the insurance company, the insurance company assumes full liability.

Section 3 authorizes the Secretary of the Treasury to issue a regulation under which insurance company deferred annuity contracts may be exempt from certain funding provisions. Employers who fund pension benefits through a deferred annuity contract are faced with a possible tax problem. The problem arises out of the requirements in the "minimum funding standard and funding standard account provisions" that require "experience credits" to be amortized over 15 years. An employer can only take a tax credit or pay the debit at the end of 15 years, rather than take the credit or pay the debit each year that it occurs.

These sections aggravate cash flow problems and create inappropriate tax results. Since this problem is somewhat complex in nature, I would refer the committee to the text of my full statement.

Section 4 provides that a plan which meets vesting requirements under section 411 of the act will be treated as meeting the requirements of section 401 unless there has been an actual pattern of abuse. This change eliminates an overlapping provision which has created problems for many plans.

Section 5 exempts plans with less than 100 participants from the notification to interested party requirements with respect to "advance determination requests." The notice has not proven of any practical use to employees and has, in some instances, cost an amount equal to 10 percent of the establishment of the plan initially. This is a cost saving measure.

Section 6 provides for the separate treatment of certain plans maintained by employers within multiemployer groups. It addresses both the problem of subsidiary entities within larger corporations, and the problem of liability in multiemployer plans where one of the participating employers has no control over other members in the plan.

With ERISA, both subsidiary and parent company have the same plan. This provides an option, but it does require the ERISA requirements, so it permits the company to go either way.

Finally, section 7 exempts insurance pooled separate accounts under a group annuity contract which are issued to plans under the fiduciary or party-in-interest provisions of the act. The existing provisions make operation extremely difficult because of the extra recordkeeping, clerical, and reporting needs of the various fiduciary responsibility requirements under ERISA. The net result is extreme cost.

State law regulates insurer's separate accounts and requires that separate account assets be owned by the insurer not held in trust. The participation in a pooled separate account under a group annuity contract should not cause the pooled separate assets to become assets of the plan. The operation of pooled separate accounts are similar to those of mutual funds. The latter are presently exempt from fiduciary provisions of ERISA.

Mr. Chairman, I again thank members of the committee for allowing me to make this presentation. I do have and will introduce for the record a statement by Douglas Fox on Senate bill S. 7263 that he had planned to give before these joint hearings, but he was unable to.

I ask to have this made a part of the record.

Senator WILLIAMS. They will be.

We appreciate your comments, Senator Bartlett. Your statement will stimulate the Department to move with greater dispatch, I believe. That pool account question is one of them.

This will be very helpful, your highlighting these needs. We certainly will consider them very carefully.

We cannot promise you comprehensive action within the next 38 days, by the way.

Senator BARTLETT. This addresses itself to some of the problem. I think these were problems of principal importance to a number of small companies, so I appreciate your taking action here.

Senator WILLIAMS. Senator Bentsen, any observations?

Senator BENTSEN. Senator Williams, you have well stated it, and I appreciate very much your contribution, Senator Bartlett. You have dealt particularly with some of the problems of smaller companies, and I think your comments will be helpful to us, and we will be working along with Senator Williams of the Human Resources Committee.

Senator MATSUNAGA. I just wish to join my colleagues, Mr. Chairman, in complimenting the Senator from Oklahoma.

Senator BARTLETT. I thank the Senator.

Senator WILLIAMS. Thank you very much.

Senator BARTLETT. Thank you.

[The text of S. 2763 and the prepared statements of Senator Bartlett and Mr. Fox follow:]

95TH CONGRESS
2D SESSION

S. 2763

IN THE SENATE OF THE UNITED STATES

MARCH 17 (legislative day, FEBRUARY 6), 1978

Mr. BARTLETT introduced the following bill; which was read twice and referred to the Committees on Finance and Human Resources jointly by unanimous consent

A BILL

To amend the Employee Retirement Income Security Act of 1974, and the Internal Revenue Code of 1954 to improve the administration and fairness of provisions relating to employee benefit plans.

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

SECTION 1. INCREASE IN LIMITATION WITH RESPECT TO ACQUISITION AND HOLDING OF EMPLOYER SECURITIES, AND EMPLOYER REAL PROPERTY.

(a) GENERAL RULE.—Section 407 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1107) is amended by striking out "10 percent" each place it appears and inserting in lieu thereof "10 percent, or in the case of a plan with less than 100 participants, 30 percent".

SEC. 2. EXEMPTION FROM PLAN TERMINATION INSURANCE FOR PLANS FUNDED ENTIRELY BY INSURANCE.

(a) IN GENERAL.—Section 4021 (b) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1321) is amended—

(1) by striking out "or" at the end of paragraph (12),

(2) by striking out the period at the end of paragraph (13) and inserting in lieu thereof a semicolon and "or", and

(3) by adding at the end thereof the following new paragraph:

"(14) which is a defined benefit plan covered entirely through fully funded insurance policies.".

SEC. 3. INSURANCE COMPANY DEFERRED ANNUITY CONTRACTS.

(a) Section 301 (b) (1) is amended by striking the period at the end thereof, and adding the following language: "or group deferred annuity contracts issued by an insurance carrier (licensed under the laws of a State to do business with the plan).".

(b) Section 301 (b) (2) is amended by striking the period at the end thereof, and adding the following language: "or, in the case of a group deferred annuity contract, such contract provides for the purchase, annually or more frequently, of deferred retirement annuity units as shall have accrued during such period, to be paid for in a single premium payment in full for such unit.".

SEC. 4. COORDINATION OF VESTING STANDARDS AND REQUIREMENTS OF SECTION 401(a)(4) OF THE INTERNAL REVENUE CODE.

(a) IN GENERAL.—Paragraph (1) of section 411 (d) of the Internal Revenue Code of 1954 is amended to read as follows:

"(1) COORDINATION WITH SECTION 401(a)(4).—A plan which satisfies the requirements of this section shall be treated as satisfying any vesting requirements resulting from the application of section 401 (a) (4) unless there has been a pattern of abuse under the plan (such as a dismissal of employees before their accrued benefits become nonforfeitable) tending to discriminate in favor of employees who are officers, shareholders, or highly compensated.".

SEC. 5. MODIFICATION OF NOTIFICATION REQUIREMENT FOR ADVANCE DETERMINATION REQUEST.

(a) IN GENERAL.—The last sentence of subsection (a) of section 3001 of the Employee Retirement Income Security Act of 1974 (12 U.S.C. 1201) is amended by striking out "The Secretary of the Treasury" and inserting in lieu thereof the following: "Except in the case of an application with respect to a plan with less than 100 participants, the Secretary of the Treasury".

SEC. 6. SEPARATE TREATMENT FOR CERTAIN PLANS MAINTAINED BY EMPLOYERS WITHIN MULTI-AND EMPLOYERS.

(a) Subtitle A of title III of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new section:

"SEC. 3005. SEPARATE TREATMENT OF CERTAIN PLANS AND EMPLOYERS.

"(a) For purposes of this Act and for purposes of subchapter D of chapter 1 of the Internal Revenue Code of 1954, a plan (other than a plan which is a multiemployer plan as defined in paragraph (37) of section 3) maintained by a corporation which is a member of a group of controlled corporations (within the meaning of section 1563 of the Internal Revenue Code of 1954) shall be treated as a separate plan from any other plan or plans maintained by any other corporation which is a member of the same group if the plan is maintained separately and independently and if such treatment is not inconsistent with the policy declared in section 2.

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"(b) Notwithstanding any provision of part V of subtitle B of title I of this Act, subtitle D of title IV of this Act, or section 4971 of the Internal Revenue Code of 1954, an employer making contributions under a multiemployer plan (as defined in paragraph (37) of section 3 of this Act) shall not be liable for any penalty, tax, damages, or equitable obligation with respect to the funding of such plan if—

"(1) the employer has fully met the requirements of part III of title I of this Act and of section 412 of the Internal Revenue Code of 1954, and

"(2) such liability which, but for this subsection, would otherwise be imposed on the employer arose out of a transaction or breach of duty over which the employer had no control.".

(b) The table of contents contained in section 1 of such Act is amended by inserting immediately after the item relating to section 3004 the following new item:

"Sec. 3005. Separate treatment of certain plans and employers.".

SEC. 7. INSURANCE COMPANY POOLED SEPARATE ACCOUNTS.

(a) Subsection (B) of section 3(21) of the Employment Retirement Income Security Act of 1974 is amended as follows:

(1) After the date "1940" strike the comma and add the following language: "or a pooled separate account under a group annuity contract issued by an insurance company, licensed under the laws of a State to do business with the plan,".

(2) After the words "cause such investment company" add the following language: "or insurance company".

(3) After the words "such investment company's" add the following language: "or insurance company's".

(4) After the words "principle underwriter" add the following language: "or insurance company".

(5) Strike the period after the words "principle underwriter" and add the following language: "or insurance company.".

(6) After the words "or principle underwriter" in the last sentence of this subsection add the following language: "or insurance company".

(b) Subsection 2 of section 401(b) of the Employment Retirement Income Security Act of 1974 is amended by striking the comma and adding after the words "an insurer" the following language: "or a pooled separate account is established under a group annuity contract,".

SEC. 8. EFFECTIVE DATE.

The amendments made by these sections apply with respect to plan years and applications beginning or submitted more than thirty days after the date of enactment of this Act.

STATEMENT BY DEWEY F. BARTLETT
ON S.2763 BEFORE JOINT HEARINGS OF THE SUBCOMMITTEES ON
LABOR AND PRIVATE PENSION PLANS.

MR. CHAIRMAN:

I WOULD LIKE TO EXPRESS MY APPRECIATION TO THE SUBCOMMITTEE CHAIRMEN FOR TAKING THE TIME TO HOLD THESE HEARINGS EVEN THOUGH IT IS LATE IN THE 95TH CONGRESS. IT IS MY HOPE THAT THEY WILL LEAD TO SUBSTITIVE CHANGES IN THE EMPLOYEE RETIREMENT INCOME SECURITY ACT SOMETIME DURING THE 95TH CONGRESS.

THE EMPLOYEEE RETIREMENT INCOME SECURTIY ACT WAS HERALDED AS A MAJOR INOVATION TO PROTECT WORKERS FROM LOSS OF PENSION BENEFITS. I SUPPORTED THE LEGISLATION WHEN IT PASSED IN THE 93RD CONGRESS, BUT SINCE THAT TIME I HAVE BECOME INCREASINGLY AWARE OF THE "NIGHTMARE" OF PAPERWORK AND CROSS INTERPRETATIONS THAT HAVE BEEN CREATED. THE OBVIOUS EFFECT HAS BEEN AN EVER-INCREASING NUMBER OF BUSINESSES DROPPING THEIR PENSION PLAN.

MR. CHAIRMAN, I ASK THE COMMITTEE'S CONSENT TO INSERT AT THIS POINT IN MY STATEMENT FIGURES PROVIDED BY THE INTERNAL REVENUE SERVICE FOR PLANS, STARTS, AND TERMINATIONS FROM THE YEAR 1970 THROUGH 1977.

THE OBVIOUS NATURE OF THE PROBLEM, AND THE COMMENTS I HAVE RECEIVED FROM OKLAHOMANS, LED ME TO REQUEST LEGISLATIVE

PROPOSALS FROM ATTORNEYS, CERTIFIED PUBLIC ACCOUNTANTS, BUSINESS PEOPLE, AND INSURNACE AGENTS. THE RESULT OF THESE PROPOSALS IS S.2763 WHICH I INTRODUCED ON MARCH 17, 1978.

THE BILL ADDRESSES SOME OF THE MORE PERVASIVE PROBLEMS NOTED BY THESE GROUPS. CERTAINLY I DO NOT REPRESENT THAT THE BILL RESOLVES ALL OF THE PROBLEMS ERISA, AND THESE RECOMMENDATIONS AND OTHERS SHOULD BE FURTHER EXPANDED THROUGH HEARINGS SUCH AS THE ONES BEING HELD TODAY.

S.2763 IS INTENDED TO EASE SOME OF THE BURDENS ON BUSINESS, BUT AVOID JEAPARDIZING PERFECTION NEEDED BY THE EMPLOYEE.

IT IS IMPORTANT TO KEEP IN MIND THAT WHEN A PLAN IS TERMINATED THE EMPLOYEEE IS LEFT WITHOUT ANY PROTECTION. THE ALTERNATIVE OF AN INDIVIDUAL RETIREMENT ACCOUNT IS NOT PRACTICAL FOR MANY PEOPLE BECAUSE OF THEIR LACK OF KNOWLEDGE, OR THEIR INABILITY TO SCHEDULE PERSONAL SAVINGS PROGRAMS.

AT THIS POINT, I WOULD LIKE TO PROVIDE A BRIEF SECTION BY SECTION NARRATIVE DESCRIPTION OF S.2763:

SECTION 1. THIS SECTION RAISES THE LIMIT OF PLAN ASSETS THAT MAY BE IN ONE INVESTMENT FROM 10% TO 30%. A LIMIT OF 30% OF PLAN ASSETS IN ONE INVESTMENT MAY NOT CREATE DIFFICULTIES FOR A MAJOR NATIONAL FIRM WITH A PENSION PLAN. HOWEVER, A SMALL EMPLOYER WHO CONTRIBUTES FROM $3,000 TO $5,000 A YEAR TO A PLAN FINDS IT EXTREMELY DIFFICULT TO FIND PROFITABLE INVESTMENT OPPORTUNITIES FOR BLOCKS OF $300 TO $500. THE ONLY ALTERNATIVE IS TO ALLOW THE PLAN ASSETS TO ACCUMULATE OVER SEVERAL YEARS UNTIL THERE IS AN ADEQUATE SUPPLY OF MONEY TO MAKE

SECTION 2. THIS SECTION ELIMINATES THE REQUIREMENT FOR PAYMENT OF PLAN TERMINATION INSURANCE TO THE PENSION BENEFIT GUARANTEE CORPORATION FOR THOSE PLANS FUNDED ENTIRELY BY INSURANCE. THE PENSION BENEFIT GUARANTEE CORPORATION HAS NO LIABILITY FOR INSURER GUARANTEED BENEFITS AS THE INSURER PROVIDES THE NECESSARY GUARANTEE. PAYMENTS OF THE PREMIUM TO THE PENSION BENEFIT GUARANTEE CORPORATION FOR SUCH FULLY INSURED PERSONS IS A WASTE OF PLAN ASSETS.

SECTION 3. THIS SECTION AUTHORIZES THE SECRETARY OF THE TREASURY TO ISSUE A REGULATION UNDER WHICH INSURANCE COMPANY DEFERRED ANNUITY CONTRACTS MAY BE EXEMPT FROM FUNDING PROVISIONS. EMPLOYERS WHO FUND PENSION BENEFITS THROUGH A DEFERRED ANNUITY CONTRACT ARE FACED WITH A POSSIBLE TAX PROBLEM. THE PROBLEM ARISES OUT OF THE REQUIREMENT IN THE MINIMUM FUNDING STANDARD AND FUNDING STANDARD ACCOUNT PROVISIONS THAT EXPERIENCE CREDITS TO THE PLAN BE AMORTIZED OVER FIFTEEN YEARS.

UNDER DEFERRED ANNUITY CONTRACTS, NO TURNOVER ASSUMPTIONS ARE MADE IN SETTING PREMIUM RATES. THE REASON FOR THIS IS THAT THE EMPLOYER PURCHASES INDIVIDUAL ANNUITIES FROM THE INSURANCE COMPANY FOR BENEFITS AS THEY ACCRUE. ZERO TURNOVER IS THE BASIS ON WHICH PREMIUM RATES ARE SET. WHEN AN EMPLOYEE FOR WHOM DEFERRED ANNUITY PURCHASES HAVE BEEN MADE ON A CONTINUING BASIS TERMINATES EMPLOYMENT, HIS NON-VESTED DEFERRED ANNUITIES ARE CANCELLED. THE EMPLOYER CONTRIBUTIONS RELEASED BY THE

CANCELLATION ARE REFLECTED AS A WITHDRAWAL CREDIT. THIS WITHDRAWAL CREDIT, ACCORDING TO IRS REQUIREMENTS, MUST BE APPLIED IN FULL TOWARD PREMIUMS NEXT BECOMING DUE UNDER THE PLAN BEFORE ANY FURTHER EMPLOYER CONTRIBUTIONS ARE SO APPLIED. SIMILARLY, EXPERIENCED CREDITS DECLARED BY THE INSURANCE COMPANY BECAUSE OF FAVORABLE MORTALITY, INTEREST AND EXPENSE RESULTS, MUST BE APPLIED AGAINST THE PREMIUM NEXT BECOMING DUE.

THE PROBLEM IS THAT WHILE THE CREDITS MUST BE APPLIED IN ONE LUMP SUM AGAINST PREMIUMS NEXT BECOMING DUE, ERISA REQUIRES THAT THE CREDIT BE AMORTIZED OVER FIFTEEN YEARS FOR FUNDING STANDARD ACCOUNT PURPOSES. THUS, ONLY ONE FIFTEENTH OF THE CREDIT MAY BE APPLIED IN THE YEAR DECLARED AND EACH YEAR THEREAFTER TO DETERMINE WHETHER THERE IS A FUNDING STANDARD ACCOUNT DEFICIENCY, AND IF SO, HOW MUCH HAS TO BE PAID BY THE EMPLOYER TO ABATE THE DEFICIENCY AND AVOID A DEFICIENCY TAX ASSESSMENT. THE DEDUCTION FOR THE 14/15 FOR TAX PURPOSES MUST BE DEFERRED UNTIL FUTURE YEARS ON A CARRY-FOWARD BASIS. THIS AGGRAVATES CASH FLOW PROBLEMS AND CREATES AN INAPPROPRIATE TAX RESULT.

SECTION 4. THIS AMENDMENT WOULD PROVIDE THAT A PLAN WHICH MEETS VESTING REQUIREMENTS UNDER SECTION 411 OF THE ACT WILL BE TREATED AS MEETING THE REQUIREMENTS OF SECTION 401 UNLESS THERE HAS BEEN AN ACTUAL PATTERN OF ABUSE.

SECTION 411 HAS BEEN INTERPRETED TO APPLY AN ADDITIONAL RULE OF VESTING IF CERTAIN TURNOVER TESTS ARE NOT MET. THESE TESTS CANNOT BE MET BY A VAST MAJORITY OF EMPLOYERS, AND DELETING THIS PARTICULAR SECTION PERMITS PLANS TO MEET THE MINIMUM VESTING STANDARDS UNDER SECTION 411.

SECTION 401(A)(4) PROVIDES THAT CONTRIBUTIONS OR THE BENEFIT UNDER THE QUALIFIED PLAN CANNOT DISCRIMINATE IN FAVOR OF OFFICERS, SHAREHOLDERS, OR HIGHLY COMPENSATED EMPLOYEES. WITH THESE REQUIREMENTS, THERE IS NO NEED FOR THE ADDITIONAL, AND SOMEWHAT DIFFERENT, REQUIREMENT FOUND IN SECTION 411(A)(1)(B). THIS SECTION ADDS THE REQUIREMENT THAT, "THERE HAVE BEEN, OR THERE IS REASON TO BELIEVE THERE WILL BE, AN ACCRUAL OF BENEFITS OR FORFEITURES TENDING TO DISCRIMINATE IN FAVOR OF EMPLOYEES WHO ARE OFFICERS, SHAREHOLDERS, OR HIGHLY COMPENSATED."

SECTION 5. THIS SECTION EXEMPTS PLANS WITH LESS THAN 100 PARTICIPANTS FROM THE NOTIFICATION TO INTERESTED PARTY REQUIREMENTS WITH RESPECT TO ADVANCE DETERMINATION REQUESTS. BEFORE AN ADVANCE DETERMINATION LETTER REGARDING THE QUALIFICATION OF A PENSION, PROFIT-SHARING, STOCK BONUS PLAN, A TRUST WHICH IS PART OF A PLAN, OR AN ANNUITY BOND PURCHASE PLAN MAY BE ISSUED, THE APPLICANT MUST PROVIDE EVIDENCE THAT EACH EMPLOYEE WHO QUALIFIES AS AN INTERESTED PARTY UNDER THE REGULATIONS HAS BEEN NOTIFIED OF THE APPLICATION FOR SUCH DETERMINATION. ALL PRESENT EMPLOYEES OF ANY EMPLOYER QUALIFY AS INTERESTED PARTIES, AND IF THE PLAN AMENDMENT AFFECTS THE CONTRIBUTIONS FOR, OR BENEFITS TO, ANY FORMER EMPLOYEE, ALL FORMER EMPLOYEES WHO HAVE A NON-

FORFITABLE RIGHT TO AN ACCRUED BENEFIT UNDER THE PLAN, ARE INTERESTED PARTIES AND MUST BE NOTIFIED.

THE NOTICE HAS PROVED OF NO PRACTICAL USE WHATSOEVER TO ANY EMPLOYEE. NOT ONLY IS IT OF LITTLE USE, IT REQUIRES A GREAT DEAL OF ABILITY AND EXPERTISE TO COMMENT ON WHETHER OR NOT THE PLAN MEETS THE REQUIREMENTS FOR QUALIFICATION.

THE COST OF PREPARING AND MAKING THE REQUISITE NOTIFICATION PROPERLY WITH REGARD TO PLANS COVERING A SMALL NUMBER OF EMPLOYEES HAS, IN SOME INSTANCES, BEEN EQUAL TO 10% OF THE COST OF ESTABLISHING THE PLAN INITIALLY, OR AMENDING THE PLAN.

SECTION 6. THIS AMENDMENT PROVIDES FOR THE SEPARATE TREATMENT OF CERTAIN PLANS MAINTAINED BY EMPLOYERS WITHIN MULTI-EMPLOYER GROUPS.

THE EXISTING CODE SECTION, AND REGULATIONS, EFFECTIVELY MEAN THAT ALL THE SUBSTANTATIVE QUALIFICATION REQUIREMENTS OF THE INTERNAL REVENUE CODE ARE APPLIED TO A COMMONLY CONTROLLED GROUP TO DETERMINE IF ANY PLAN MAINTAINED BY ANY OF THE ENTITIES WITHIN THE GROUP QUALIFIES UNDER THE INTERNAL REVENUE CODE. FOR EXAMPLE, IF A SUBSIDIARY OF A PARENT CORPORATION, WHICH MEETS THE CONTROL TESTS, MAINTAINED AN EMPLOYEE-BENEFIT PENSION PLAN PRIOR TO ERISA WHICH QUALIFIED ON ITS OWN IN RELATION TO THE SUBSIDIARY ENTITY, THEN THE PLAN, IF IT IS TO CONTINUE TO BE QUALIFIED UNDER ERISA, MUST MEET ALL THE QUALIFICATION REQUIREMENTS CONSIDERING THE ENTIRE CONTROLLED

GROUP AS THE RELEVANT EMPLOYEE POPULATION. IN EFFECT, IN ORDER TO CONTINUE THE PLAN, THE PARENT CORPORATION IS FORCED TO EITHER ADOPT A COMPARABLE PLAN OR INCLUDE ALL EMPLOYEES OF THE CONTROL GROUP IN THE SUBSIDIARY CORPORATION'S PLAN. THIS REQUIREMENT DISTORTS THE EMPLOYEE PENSION BENEFIT PLAN CONCEPT IN MANY INSTANCES. TERMINATION OF THE "PROBLEM" PLAN IS OFTEN EASIEST AND THE MOST BENEFICIAL ALTERNATIVE.

CONTRIBUTING EMPLOYERS TO MULTI-EMPLOYER PLANS HAVE POTENTIAL LIABILITIES OVER WHICH THEY HAVE NO CONTROL, AND SUCH LIABILITIES MAY ARISE EVEN THOUGH THE CONTRIBUTING EMPLOYER FULFILLS THE REQUIREMENTS OF ITS AGREEMENT WITH THE PLAN. WHEN THE PENSION BENEFIT GUARANTEE CORPORATION PROVIDES BENEFITS FOR A TERMINATED PLAN, THEN AN EMPLOYER BECOMES LIABLE TO THE PBGC FOR 100% OF THE UNFUNDED LIABILITIES IN THE TERMINATED PLAN. THE EMPLOYER'S LIABILITY MAY BE UP TO 30% OF THE EMPLOYER'S TOTAL NET WORTH.

THUS, VOLUNTARY TERMINATION OF THE PLAN COULD OCCUR WITHOUT THE AGREEMENT OR KNOWLEDGE OF THE CONTRIBUTING EMPLOYER, AND CONSEQUENTLY THE CONTRIBUTING EMPLOYER COULD BECOME SUBJECT TO THE PBGC UNDER-FUNDED TERMINATION LIABILITY.

A CONTRIBUTING EMPLOYER TO A MULTI-EMPLOYER PLAN WHO HAS FUNDED HIS PORTION (BASED ON HIS EMPLOYEES) CORRECTLY AND ADEQUATELY SHOULD NOT BE LIABLE TO THE PBGC OR ANY EMPLOYEE OVER WHICH HE HAD NO DIRECT CONTROL.

SEC. 7. THIS SECTION EXEMPTS AN INSURANCE POOLED SEPARATE ACCOUNT UNDER A GROUP ANNUITY CONTRACT ISSUED TO A PLAN FROM THE FIDUCIARY OR PARTY IN INTEREST PROVISIONS OF THE ACT.

REGULATION OF INSURANCE COMPANY OPERATIONS BY STATE AUTHORITIES AFFORDS PROTECTION TO A PLAN PARTICIPATING IN THE INSURER'S POOLED SEPARATE ACCOUNTS WHICH ARE EFFECTIVELY LIKE THOSE A PLAN WOULD ENJOY IN PARTICIPATING IN A MUTUAL FUND THROUGH OWNERSHIP OF MUTUAL FUND SHARES. THE ACT ALREADY EXCLUDES MUTUAL FUNDS AND THE RATIONALE BEHIND THIS EXCLUSION APPLIES EQUALLY TO INSURANCE COMPANY POOLED SEPARATE ACCOUNTS. THESE ACCOUNTS ARE REGULATED BY A STATE INSURANCE DEPARTMENT, AND ARE BROADLY HELD.

THE EXISTING PROVISION MAKES OPERATION EXTREMELY DIFFICULT BECAUSE OF THE EXTRA RECORD-KEEPING, CLERICAL AND REPORTING NEEDS OF THE VARIOUS FIDUCIARY RESPONSIBILITY REQUIREMENTS OF ERISA. THE NET RESULT IS EXTREME COST.

IF POOLED SEPARATE ACCOUNT ASSETS ARE CONSIDERED PLAN ASSETS, THEN A LARGE NUMBER OF TRANSACTIONS INVOLVING POOLED SEPARATE ACCOUNTS, WHICH WOULD BE PROHIBITED TRANSACTIONS UNDER ERISA, COULD OCCUR INADVERTANTLY. FOR INSTANCE, A DIRECT BOND PLACEMENT OR MORTGAGE LOAN MIGHT BE MADE FROM A POOLED SEPARATE ACCOUNT TO AN EMPLOYER WHO, UNKNOWN TO THE INSURANCE COMPANY, IS A PARTICIPANT IN THE POOLED SEPARATE ACCOUNT BY VIRTURE OF

BEING AN AFFILIATE OF THE INSURER CONTRACT HOLDER. LIKEWISE, DIRECTLY NEGOTIATED SHORT-TERM LENDING BY THE INSURER TO A CORPORATE OBLIGOR WHICH, UNKNOWN TO THE INSURER, PARTICIPATES IN THE SEPARATE ACCOUNT, COULD BE A PROHIBITIVE TRANSACTION IF THE 25%-50% OF THE ASSETS TEST USED IN DEFINING "MARKETABLE OBLIGATIONS" IS NOT MET WHEN TAKING INTO ACCOUNT OTHER SUCH BORROWING BY THE OBLIGOR FROM OTHER SOURCES OF WHICH THE INSURER HAS NO KNOWLEDGE.

THERE ARE NUMEROUS OTHER SUCH SIMILAR SITUATIONS, BUT IT IS OBVIOUS TO ESTABLISH THE NECESSARY TESTS WITHIN THE SYSTEM WOULD BE FINANCIALLY PROHIBITIVE.

MR. CHAIRMAN, I WOULD AGAIN LIKE TO THANK THE TWO SUBCOMMITTEES FOR THE OPPORTUNITY TO PRESENT TESTIMONY ON MY LEGISLATION. I REALIZE THAT THERE IS A GROWING RECORD OF PROBLEMS AND RECOMMENDED SOLUTIONS RELATED TO THE OPERATION OF ERISA, AND I LOOK FORWARD TO CORRECTIVE LEGISLATION BEING DEVELOPED FROM THESE HEARINGS AND INTRODUCED DURING THE 96TH CONGRESS.

STATEMENT BY G. DOUGLAS FOX ON S.7263 BEFORE JOINT HEARINGS OF THE SUBCOMMITTEES ON LABOR AND PRIVATE PENSION PLANS

I am a member of a 22-man law firm in Tulsa, Oklahoma. Our firm does the legal and compliance work for approximately 125 to 150 pension and profit sharing plans for corporations located in Tulsa and Northeastern Oklahoma. We probably do more of such work than any firm in the eastern half of our state. The vast majority of the plans that we represent have fewer than 50 participants. Many of them are small businesses and small professional corporations which cannot afford the luxury of computers, full-time personnel managers or large accounting and legal staffs.

I strongly support and endorse S.7263, the Bill introduced by Senator Bartlett, to alleviate some of the problems created by ERISA. ERISA was a classic case of legislative overreaction. It is clear that there were some problems in the pension and profit sharing plan area before ERISA. In my experience, the problems of improper transactions, inadequate funding and discrimination were the exception rather than the rule. ERISA created problems at least as great as those which it sought to solve. It would have been possible, for example, to have drafted legislation that established standards on eligibility, vesting, investments, and plan administration without creating the enormous compliance, accounting and reporting requirements that ERISA did.

It is abundantly clear that ERISA requires the filling out of reports and notices that are never read by government obvious that larger companies can spread compliance and reporting costs over a greater number of employees and frequently have staff and facilities, including computers, which can make compliance at least manageable.

Senator Bartlett's Bill takes an initial but important step toward reducing some of the problems which ERISA caused. I urge its favorable consideration by the Subcommittee.

While it has frequently been said that lawyers are responsible for the trend toward complexity in our laws and that lawyers are the beneficiaries of this complexity, I assure you that most lawyers do not wish to make money by performing needless services, preparing papers and reports that are never read, and collecting fees that are disproportionate to any possible benefit to their clients. I strongly urge Congress to take steps to reduce the staggering burden that has been imposed on American business generally and small business in particular by ERISA.

Senator WILLIAMS. Next we will have Mr. Halperin from the Department of the Treasury.

STATEMENT OF DANIEL I. HALPERIN, ACTING DEPUTY ASSISTANT SECRETARY OF THE TREASURY (TAX LEGISLATION), DEPARTMENT OF THE TREASURY, ACCOMPANIED BY FRED OCHS, DIRECTOR OF THE EMPLOYEE PLANS, DIVISION OF IRS; AND IRA COHEN, DIRECTOR, ACTUARIAL DIVISION

Mr. HALPERIN. Thank you, Mr. Chairman.

Senator BENTSEN. I might, Senator Williams, as we said to the Under Secretary of Labor, we have had many days of testimony by Deputy Assistant Secretary of the Treasury, and his contributions to our deliberations to the Finance Committee have always been very helpful. Delighted to see you this morning.

Mr. HALPERIN. Thank you, Senator Bentsen. I appreciate the opportunity to be here this morning.

With me are Fred Ochs, Director of the Employee Plans, Division of IRS, and Ira Cohen, Director of the Actuarial Division.

My statement deals with most of the areas you previously discussed with Under Secretary Brown. I will try to briefly summarize some of the points we dealt with that primarily involve tax policy.

We will, along with the Labor Department, be submitting a detailed analysis of the entire provisions of the bill.

I would like to make one comment on the proposal for the reorganization plan to eliminate some of the situations of overlapping jurisdiction. As discussed earlier today, we will be evaluating the operation of the interim solution, and by April 1980 we will be making legislative proposals for the future.

I would hope at the same time that there would be further evaluation of some of our concerns with a single agency that have caused our Department not to endorse that approach as yet.

The Treasury has had two main concerns with a single agency. The first is that the private pension system is now based on tax incentives and tax penalties. That continues even under the single agency proposal, S. 3017.

The plans are still given tax benefits if they comply. They still suffer tax penalties if they do not comply.

That requires the new agency to certify to the IRS as to compliance with the tax laws.

Now, there are a few precedents for that, but all of them involve one determination made at a single point in time. The decision as to whether a pension plan qualifies is made not only on the face of the plan but also is a matter of continuing investigation as to its operation and as to how it deals with an ever-changing group of employees. That would mean if Internal Revenue Service is auditing a taxpayer and has to decide whether they are entitled to a tax deduction, or whether a particular employee is entitled to be treated for income or estate tax purposes as if he or she were a participant in a qualified plan, IRS would have to know whether that plan is qualified, and if that determination is to be made by a separate agency, we are left with the problem of how to coordinate that agency's determination with the IRS. So we think there are problems, continuing problems, of so-called dual jurisdiction even under a single agency approach that must be taken into account.

We are also concerned about the possibility of compromising tax equity if the determination of qualification for tax benefits is moved outside the Internal Revenue Service.

I might note that whether or not a plan discriminates in favor of high-income employees and whether or not a plan provides excessive benefits to particular individuals are not matters that are presently within the concern of the Department of Labor. They bear solely on whether a plan is entitled to the tax benefits under the Internal Revenue Code, and with the policy that these tax benefits should not be provided unless they are going to a diversified group of employees, and not excessively to particular individuals. We are concerned that eliminating IRS authority over these issues would have the possibility of compromising tax equity.

We also point out that S. 3017 does leave the Service with jurisdiction in a number of areas, including church and governmental plans. So it is not a clean break.

I think we are really talking, not about single jurisdiction versus joint jurisdiction, but really about where the break should be. The interim reorganization plan put forth by the President breaks it at a particular point. S. 3017 breaks it at a different point.

I think we need to clarify and examine which of those points may be more beneficial in terms of reducing the burden to the greatest possible extent on plan administration.

I just want to make one point on reporting. As you heard, the Department of Labor and the IRS have agreed in principle on a 3-year cyclical filing for small pension plans. Your bill would have a 5-year cycle. The main reason the Service is concerned with getting a report at least every 3 years is the fact that that ties in with the statute of limitations, which is now 3 years. They would want to receive a report, a detailed report, in that time period so that they would still have the time to deal with any violations of the statute.

The main issue that I wanted to comment on this morning is the question of deductible employee contributions to qualified plans. S. 3017 will allow up to $1,000 to be contributed on a deductible basis by an employee, provided the employee's adjusted gross income is $30,000 or less. For employees between $30,000 and $35,000, some smaller amount of deduction is allowed. Those who earn over $35,000 are not allowed a tax deduction for employee contributions.

That provision seems to be aimed at the problems that we have run into by the establishment of individual retirement accounts. Individuals who are not participants in qualified plans are allowed to establish IRA's and take a deduction of $1,500. That has created a situation where former second-class citizens, those who did not have plans established for them by their employers, are now becoming in some people's eyes first-class citizens because they can get the full $1,500 deduction while for other people participating in an employer's plan, the contribution is not only less than $1,500 but, in many cases, of no benefit because the employee terminates service without a vested benefit. These people are looking for the opportunity to make IRA contributions and get an IRA deduction. Trying to solve that problem within the context of an IRA—to reduce the $1,500 limit on IRA contributions by amounts put aside for the employee in a qualified plan, and looking to see whether those amounts vest or not—is enormously complicated and I think wisely avoided by S. 3017.

The problem, however, of opening IRA's up to everybody who participates in a qualified plan is the question of discrimination. We know from our statistics that IRA's are much more widely used by people at high-income levels. We find that 49 percent of people over $50,000 of income who are eligible to use IRA's do so. When you get down below $15,000, we have about 2 percent utilization. If we opened up IRA to people who are participating in qualified plans, that disparity would increase because the large number of high-income people who are now participants in qualified plans would put another thousand dollars away on a tax deductible basis, just transferring one savings account for another.

The bill tries to deal with that problem by limiting the extra $1,000 contribution to those who earn $30,000 or less. We think that this moves in the right direction, but that the income level is too high. It will concentrate tax benefits for people that are around $30,000 which is far above the median level of earnings in this country.

A broader approach to the issue might be to allow employee contributions to qualified plans provided employees who participate form a nondiscriminatory group. We testified on that issue before Senator Bentsen on March 15. We pointed out at that time that the law in this area, the question of what employee contributions can be deducted, has now gone off in about 9 or 10 different directions, and we would hope that it could be made more uniform. The Revenue Act of 1978, as just passed by the House of Representatives, does have three provisions in this area dealing with salary reduction agreements for employees of State and local government, so-called cash and deferred profit sharing plans, and so-called cafeteria plans, where the employee is allowed to select the benefits he or she desires.

What the House bill does, however, in the first two areas, salary reduction arrangements and cash and deferred profit sharing arrangements, is to allow a full tax deduction for employee contributions without adequate nondiscrimination requirements. And in the case of State and local government employees, without the normal limitations on benefits.

Thus, we have trouble with that bill, but it does raise the issue which is similar to the issue raised by S. 3017 of the deduction of employee contributions to qualified plans.

As I say on page 10 of my statement, we have supported S. 4140 introduced by Senator Bentsen, which does allow deductions for employee contributions to qualified plans provided the total put aside by the employer and the employee is not greater than $1,500.

There is also before the Finance Committee, S. 3288, which would allow employee contributions to be deducted if, in fact, the employees that participate and make deductions on their own, form a nondiscriminatory group.

That is the approach the House has taken with so-called cafeteria plans.

That is the approach that we think is the most productive, and we would hope that this committee and the Finance Committee will consider that approach.

One has to keep in mind here that there is a tremendous amount of revenue involved. We think revenue costs under section 303 of the bill is upwards of $2 billion, and that is with the $1,000 limit. Without the limitation, the revenue cost, of course, could be much greater.

Just briefly, I want to discuss the credit for new and improved plans. We recognize that the amount of coverage of the private work force in qualified plans has not appreciably increased from about 50 percent of the work force for a number of years. And we realize within the present framework of tax incentives, it is not likely to go much higher. That, I think, properly encourages people to look for other ways to bring about increased coverage of the private sector in qualified plans.

We have, however, some problems with the suggestion for a credit. The credit can be enormously expensive. If we are going to go this route, we ought to try as hard as we can to focus on those areas that are a problem. The bill would limit the credit to small employers. Many small employers, particularly professional organizations who have relatively high income among their owners, do not resist setting up qualified plans.

We think more investigation needs to be made into the question of identifying those employers that do not establish new pension plans.

Is it the size of the work force?

Is it the average earnings of the work force?

Is it the income level of the corporation?

Perhaps if we can pin it down some more and find out where resistance is, we can target the tax benefits. Because if we do not do that, we are going to spend a lot of money just to get the same amount of coverage we would have obtained in any event. We have no real assurance of how much more coverage will be brought about by this expenditure.

We do support the provision of the bill which would deny IRA contributions to owners of the business. There is a problem when an individual who owns his own business, instead of setting up a qualified pension plan for himself and his employees, puts aside $1,500 a year in an IRA only for himself and leaves his employees out. That results in IRA's leading to less coverage than might have resulted before ERISA was adopted. This certainly was not the intention.

IRA's ought to be solely for those people who did not have a choice as to whether the company would establish a plan or not. They should not be an alternative form of savings for the owner who can make a decision to establish a qualified pension plan.

I might also mention the question of joint and survivor annuities. We are, of course, concerned about the protection of a spouse who has been relying on the worker's earnings for support. But there is a departure being proposed here. Up until now, there has been a separation between pensions and life insurance. Many companies do not have death benefits under their pension plan, but adequately provide for their employees' early death through a life insurance program. And I might point out that the tax law, the way it stands today, actually does encourage that separation.

The joint and survivor annuity provisions up to now have basically said that if an employee has reached the age where he or she could have retired, at that point death cannot lead to lack of protection for the spouse. We have not said that death of the worker at an early age could not cause an otherwise vested benefit to be forfeited.

I think when we move in this area, we are raising several issues.

No. 1, should nonforfeitable benefits be payable even on the death of the worker. Two, if you forfeit, if the worker dies, should it be the worker and spouse who have died before you allow for forfeiture.

The third issue raised by the joint and survivor provision is how much of this should be mandated? Should there be a way for employee and the spouse to elect out?

You have certain situations where a joint and survivor annuity would not make any sense. Perhaps the wife is terminally ill. Perhaps the wife is working and has her own pension and each would rather have a straight life annuity rather than a joint and survivor—cross-survivor benefits from each other's plan.

We think these are important questions. We are not sure what the right answers are to them, but we think they need to be considered before we increase the protection of the joint and survivor annuity rule.

In conclusion, Mr. Chairman, we think enough time has gone by from initial passage of the statute to evaluate the workings of ERISA and to consider needed changes.

We are pleased to have the opportunity to participate in that effort and we would hope to work with you in developing a bill that will continue along the path first started in 1974 and increase the protection in the private pension system.

Thank you.

[The prepared statement of Mr. Halperin follows:]

For Release Upon Delivery
Expected at 10:00 a.m.

STATEMENT OF
DANIEL I. HALPERIN, ACTING DEPUTY ASSISTANT SECRETARY
OF THE TREASURY (TAX LEGISLATION)
BEFORE THE SUBCOMMITTEE ON LABOR OF THE SENATE
HUMAN RESOURCES COMMITTEE AND THE SUBCOMMITTEE ON PRIVATE
PENSION PLANS AND EMPLOYEE FRINGE BENEFITS OF THE
SENATE FINANCE COMMITTEE
August 15, 1978

Messrs. Chairmen and Members of the Subcommittees:

I am pleased to have the opportunity to appear before you today to discuss the several bills you are addressing concerning the private pension system.

The broad policy issues I will address today include those proposals concerning the jurisdiction of the administration of the Employee Retirement Income Security Act of 1974 ("ERISA").

A second area of proposed major change is in ERISA reporting and disclosure requirements. My testimony focuses on those proposed changes affecting requirements specified by the Internal Revenue Code.

The third major area encompasses changes in the rules designed to prevent those persons connected with a plan from engaging in transactions that are likely to lead to conflicts of interest and consequently impairment of plan assets--fiduciary responsibility and prohibited transactions.

The fourth area of broad policy proposals I will address are those designed to encourage more savings for retirement: by the employee through deductions for contributions to employer plans; by the employer through a credit for new and improved plans; and by the development of special master and prototype plans. The denial of IRA deductions in certain cases also furthers this goal.

Finally, I will outline the basic policy issues that are inherent in the changes S. 3017 proposes to ERISA's joint and survivor annuity rules.

We plan to submit shortly a brief analysis and the position of the Department on the less far reaching changes also proposed by S. 3017.

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The Treasury Department will not comment on those issues that fall outside its administration: for example, S. 260 relating to reductions in disability payments; S. 1383 regarding preemption of health plans; and those areas of reporting and disclosure administered solely by the Labor Department.

Dual Jurisdiction

As you know, the President announced last week his Reorganization Plan Number 4. This proposal to divide rulemaking jurisdiction between the Departments of Treasury and Labor is described in the testimony of the Department of Labor. We are confident that this plan will reduce substantially the difficulties caused by the current, overlapping rulemaking authority. The plan is designed to be evaluated in early 1980. Based on that evaluation, the Administration will submit legislative proposals for a long term administrative structure for ERISA. This interim plan does not prevent adopting a single agency approach in the future.

We have not supported the single agency concept to date in part because we are reluctant to thrust a new administrative system on the pension industry before there has been a more in-depth analysis of the problems it raises. There are two major areas of concern to the Treasury Department. First, a single agency will not eliminate the need to coordinate with the Internal Revenue Service; the agencies will have to begin again to learn to cooperate on a different basis. Second, reducing the role of the IRS in determining eligibility for tax benefits may impair equity in the tax system.

The first concern I stated arises because the private pension system is now based on tax incentives and penalties. Like other single agency proposals, S. 3017 uses these incentives and penalties, recognizing that the potential loss of tax benefits may be a more effective deterrent than the threat of injunctive relief or other action by an agency other than the IRS. Under S. 3017, the new agency would certify the tax qualification or disqualification of a plan to the Service. Such qualification affects issues left to the Service, including taxation of participants on distributions and the employer's deduction.

A few, isolated precedents exist for certification by another agency to the IRS for tax purposes. In general, however, these cases involve a single factual determination made at a single point in time. 1/ In contrast, in the area of tax-qualified pension plans, tax qualification must be based on the plan in operation. The result must be continued certification of operational facts as affecting tax liability; initial qualification does not suffice.

This procedure requires coordination of tax audits with the other agency or, if all functions are transferred, presumably an entirely separate audit of pension issues with IRS auditors instructed not to raise such matters. If the IRS is required to await determinations by another agency, its ability to conclude audits of the employer and all plan participants would be impaired. In other words, new types of dual jurisdiction would exist.

Furthermore, the more "certification" one places in a single agency, the more likely it is that tax equity may be compromised. S. 3017 would transfer the Code's qualification standards (including nondiscrimination and limits on benefits for the highly compensated) to the new agency. Discriminatory treatment and excessive contributions may seriously compromise tax equity and yet may have little to do with retirement security, as evidenced by the fact that they are not presently a concern of the Department of Labor. Therefore, continued IRS authority over these issues seems appropriate.

I would also point out that even S. 3017 does not cleanly divide jurisdiction. It does not make all plans subject to the single agency through the certification process. S. 3017 retains jurisdiction in the Service over, among other provisions, individual retirement accounts and the excess contributions tax on Keogh plans. Furthermore, the Code provisions would apply to governmental and church plans and nonqualified plans.

The total division of authority proposed by S. 2352 raises some of these same issues. Employers could be faced with more duplicative jurisdiction if the Labor Department audited a pension plan for violations of prohibited transactions and the Service for tax qualification. Even more important, we believe that the use of the IRS audit force is critical to adequate enforcement of the prohibited transactions rules.

To reiterate, the dual jurisdiction reorganization plan developed within the Administration has important and immediate benefits; it does not develop new problems, nor does it weaken enforcement of employee rights. Nonetheless, we recognize the importance of, and encourage, this dialogue to fully examine the issues before the pension community may again be subjected to a new form of administration.

<u>Reporting and Disclosure</u>

The Internal Revenue Service recently has testified concerning its efforts in the area of reporting and disclosure. Specifically on June 27, the Assistant Commissioner for Employee

Plans and Exempt Orgainzations testified before the Senate Finance Subcommittee on one of the bills considered here, S. 3193. I will briefly address three of the proposals made by that bill and several others considered here.

First, the proposal has been made that the Labor Department's plan description (EBS-1) and the Service's application for a determination letter (5300 series) should be combined into one form. Because the Labor Department is now considering elimination of the EBS-1, concern over it may have dissipated. We believe that further consideration should be given to consolidating IRS and Labor forms, but that consolidation issues can best be pursued administratively.

Second, the bills propose a single form for annual reports by the three agencies. This already has been accomplished through administrative action.

Third, cyclical filing--every five years--is proposed for the annual reports, with staggered filings of the major report every five years and a simplified report in the other years. The Service has agreed in principle with the Labor Department for filing of a compliance-oriented annual report every three years by plans covering fewer than 100 participants. There will be an abbreviated filing in the other years. The three-year cycle is essential considering the statutory assessment period of three years from the date of filing a tax return.

One bill, S. 2992, proposes uniform acounting standards for various purposes for pension plans. The Treasury Department is commenting in detail on S. 2992 in a bill report. That report states that we do not believe legislation is appropriate at this time. First, Treasury is opposed to the requiring of a single funding method for purposes of sections 404 and 412 of the Code (relating to the limitations on deductions and the minimum required contribution). We believe that with respect to reports to plan participants, section 103(d) of ERISA contains adequate statutory authority for the determination of appropriate information for their benefit. The Labor Department is considering this problem and it does not appear essential to mandate a single funding method at this time.

Second, Treasury is concerned that prescribing a uniform method for some purposes will cause it to be used in other areas where it may not be appropriate; and that uniform data may not be produced at a reasonable cost to plans which are using other actuarial methods for other purposes such as the calculation of actual contributions.

Fiduciary Responsibility and Prohibited Transactions

In changing to a single agency, S. 3017 would also delete the excise tax that is now used to deter plan officials from entering into prohibited transactions. Similarly, it would delete the 100% correction penalty. In lieu of these provisions, civil litigation is left as the sole remedy.

It is our belief that the annual excise tax is an effective deterrent to persons engaging in the enumerated transactions. If the only relief available were in equity, the plan often could easily (and basically without cost) undo its transaction. There could be no downside risk to engaging in these transactions. Under the current system, the tax is coordinated with the Labor Department's seeking equitable relief so that participants are made whole, but persons connected with plans also are deterred from ever engaging in the transactions.

Another bill under consideration, S. 1745, also would change the rules applying to fiduciaries. We concur in the Labor Department's analysis of the prudence standard and consequently of their position on this bill.

Deductible Employee Contributions to Qualified Plans

Provisions of S. 3017. -- Under section 303 of S. 3017, an employee who is an active participant in any one of a number of types of tax-favored plans may make a deductible contribution to the plan. The deductible contribution is limited to the lesser of 10% of compensation for the taxable year or $1,000. However, if the indiviudal's adjusted gross income (AGI) exceeds $30,000 ($15,000 in the case of a married individual filing a separate return), the deductible limitation is reduced by 20% of the amount by which that AGI exceeds $30,000 (or $15,000). Thus, for example, a single individual having AGI of $31,000 would have the maximum deductible contribution reduced by $200 (i.e., 20% of the $1,000 excess over AGI of $30,000), and the limitation would be reduced to zero at AGI of $35,000.

The plans to which deductible contributions can be made include plans qualified under section 401 and similar provisions of the Code, governmental plans (whether or not qualified), and tax-deferred annuities maintained by tax-exempt institutions under section 403(b). Thus, self-employed individuals and participants in government plans could benefit under this provision of the bill.

Under a separate provision of this section, a plan could not be qualified under section 401 of the Code unless it accepts deductible employee contributions up to $1,000 per calendar year for each employee.

Problems Affected by the Bill. -- Present law creates two problems which would be affected by S. 3017. S. 3017 seems to be concerned with the ability of a participant in a tax-favored retirement plan to make deductible contributions to an individual retirement arrangement, but it also affects the broader problem of the tax teatment of employee contributions to retirement and fringe benefit programs.

(a) IRA contributions. -- An individual who is entitled to make deductible contributions to an individual retirement acount (IRA) may generally make a contribution up to the lesser of $1,500 or 15 percent of compensation for the year. However, an individual may not make a deductible contribution for a taxable year to an IRA if he or she is an active participant during any part of the taxable year in a qualified plan, a tax-deferred annuity maintained by a tax-exempt institution, or a governmental plan (whether or not qualified). As a result, an active participant in such a plan may not make a deductible contribution, even though the employer's contribution to the plan on his or her behalf might be quite small or the individual might never vest in a retirement benefit because of frequent changes in jobs.

In an extreme example of this disparity, an individual earning $10,000 and not participating in any retirement plan could make a deductible IRA contribution of $1,500, whereas a second individual with the same income who receives an allocation of a minimal amount under an employer-maintained plan would not be able to make an IRA contribution.

There is no easy answer to this dilemma once the decision to create IRAs has been made. Allowing all participants in qualified plans to make deductible contributions to IRAs is unacceptable. IRAs already are inherently discriminatory in that there is much greater utilization by eligible individuals at higher income levels. Opening IRAs to participants in qualified plans will substantially increase this disparity. However, a solution to the problem which remains solely within the current IRA structure and limitations is necessarily complex. For example, efforts to develop procedures to reduce the IRA deduction limitation by the amount of employer contributions allocable to a particular employee under a defined benefit plan have not been successful.

Because of the complexity inherent in an IRA approach, it can be argued that the inequity, if any, should be accepted without further solution. Moreover, although allowing IRAs to individuals who participate in modest retirement plans may mitigate employee objections to establishment of such plans, it is possible that those employees who establish IRAs will resist plan improvements. Therefore, although pressure against the establishment of qualified plans might be reduced, attempts to meld qualified plans with partial IRA deductions within the framework of the current IRA rules could still have an adverse effect on qualified plans. We discussed these concerns at greater length in testimony before the Subcommittee on Oversight of the House Ways and Means Committee on February 16, 1978. In general, the better approach may be to retain IRAs only for employees who do not participate in employer-maintained plans.

(b) Treatment of employee contributions generally.

(1) Present law: The broader problem is the question of the tax treatment of employee contributions to tax-favored employee benefit plans. The law on this point now goes in many directions, due to the variety of types of employee benefit plans in existence and the varying approaches to the treatment of employee contributions to them. These plans include traditional types of qualified retirement plans, so-called "cash or deferred" profit sharing plans, unfunded salary reduction arrangements maintained by State and local governments, and a number of others. In testimony before the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Finance Committee on March 15, 1978, we suggested that Congress and the Treasury together begin to give serious consideration to the possibility of deductions and exclusions for employee contributions to all types of tax-favored deferred compensation arrangements and fringe benefit plans. We pointed out that it seems to us that a unified system could be developed under which amounts set aside at the employee's election are deductible or excludable if the arrangements are nondiscriminatory with respect to both coverage of employees and benefits (or contributions) actually provided and where excessive deferral is not created. However, care must be taken to prevent undue revenue costs. We indicated in March that a possible starting point would be an expansion of the proposal concerning cafeteria plans contained in the President's tax reform program to both cash or deferred profit sharing plans and salary reduction arrangements for government employees. On May 4 we submitted to the Finance Committee and the House Ways and Means Committee a proposal to establish uniform, favorable treatment of salary reduction contributions to those types of plans.

(2) H.R. 13511: H.R. 13511, the Revenue Act of 1978 as adopted by the House of Representatives, deals with three types of arrangements which, as a result of that bill, would continue to receive tax-favored treatment.

(A) Cafeteria plans. -- The bill adopts a provision which is substantially the same as was contained in the Administration's Tax Reform Proposal. The rules for cafeteria plans 2/ would result in nondiscriminatory plan coverage and nondiscrimination in operation of the plan. In measuring nondiscrimination in operation, the plan would have to be nondiscriminatory with respect to both total contributions or benefits and nontaxable benefits elected by participants. The provisions of the bill will allow for the continuance or establishment of an attractive type of employee benefit plan and will incorporate meaningful anti-discrimination features.

(B) Cash or deferred profit sharing plans. -- Cash or deferred profit sharing plans are similar in concept to cafeteria plans, except that they involve qualified retirement plans rather than other types of fringe benefits. Under such an arrangement, an employer offers an employee an election between immediate payment of an amount of compensation in cash or contribution of that amount to a qualified profit sharing plan. For a number of years these arrangements were subject to discrimination rules prescribed under Internal Revenue Service revenue rulings. These rulings generally held that a cash or deferred plan would not be discriminatory if one-half the participation in the plan came from among the lower paid two-thirds of employees eligible to participate. ERISA limited the effect of these rulings to previously existing plans. 3/ H.R. 13511 would essentially apply the rules of the prior revenue rulings to all cash or deferred plans and would make those rules permanent.

The problem with the prior revenue rulings is that they do not assure any degree of participation from the lowest ranking group of eligible employees. Since one-half of the actual participation must come from the lowest paid two-thirds of eligible employees, this requirement can be met by having that degree of participation come from the middle third. Thus, the lower third of the eligible group might have no actual participation, but the plan could be held not to be discriminatory. We believe that there should be stricter discrimination rules which would result in substantial participation from the lowest paid group.

(C) Government salary reduction arrangements. -- For several years, State and local governments were able to establish sucessfully nonqualified, unfunded deferred compensation arrangements on a salary reduction basis. Since the exception under ERISA for governmental plans allowed these plans to be unfunded, an employee participating in one of these arrangements was able to defer tax on the amount of withheld compensation until that amount was paid. Thus, employees of State and local governments were in effect allowed to make deductible contributions to IRAs without any ceiling and despite their participation in another qualified plan. Put another way, they obtained the deferral benefit of qualified plans without any of the restrictions. Except as might be unilaterally imposed under the arrangement, there were no requirements regarding the amounts of salary which could be deferred, offering of the program to a nondiscriminatory group of employees, or nondiscriminatory actual participation in the plan. Proposed regulations published earlier this year would reverse the Internal Revenue Service's position on these arrangements and would result in current taxation of deferred amounts.

H.R. 13511 would basically accord the same treatment to State and local government salary reduction arangements as existed prior to the proposed regulations, except that a limitation equal to the lesser of $7,500 or 33-1/3% of net compensation would be imposed upon annual salary reduction contributions. These limitations can be well in excess of the limitations which are imposed upon the deferral inherent in a qualified retirement plan. Moreover, as in the past, there would be no discrimination requirements in connection with these arrangements.

Our May 4 legislative proposal would have subjected State and local government salary reduction arrangements to the same requirements as would be applied to privately maintained plans in order for all employees to obtain deferral. However, we recognize that there may be legitimate reasons for treating the governmental arrangements separately, since State and local government employees typically work at lower compensation levels than their counterparts in the private sector. Thus, we do not object to the creation of separate rules for these arrangements. However, we do not believe that favorable tax treatment should be available for these plans in the absence of meaningful discrimination rules and deferral limitations appropriate to the nature of the plans and employers.

Methods of Dealing with Discrimination. -- Although attempts have been made to limit it, section 303 of S. 3017 can still result in discriminatory utilization of the tax benefits which would be accorded to employee contributions under the bill. The phase-out of the deductible limitation for higher paid employees does not begin until the individual reaches adjusted gross income of $30,000. Thus, an individual well above the median income level could make a full $1,000 contribution. Because such a person is in a better position to save for retirement, tax benefits from deductible contributions would tend to cluster around the group of employees at that income level.

Another approach to this problem which we have supported is contained in S. 3140. Under that bill, deductible employee contributions would be permitted to an employer plan which is in essence an employer-maintained IRA which, unlike IRAs under the current rules, could also receive employer contributions. The employee's deductible limit would be the amount equal to the difference between the employer's contribtions and the individual's usual IRA deductible limitation. To illustrate the difference, assume that an individual has compensation from an employer of $30,000 for a year (also assumed to be adjusted gross income), and the employer contributes 10 percent of the compensation to an employer-maintained plan for the benefit of that individual. Under section 303 of the bill, the taxpayer could deduct a full $1,000 for an employee contribution in addition to the employer's $3,000 contribution. Under S. 3140, the employer's $3,000 contribution would completely eliminate the possibility of a deductible contribution by that employee.

The most effective method of handling discrimination is a direct approach, such as is contained in the cafeteria plan provisions under H.R. 13511. This is also the result under S. 3288, which is very similar to section 303 of the bill, except that it contains a much more effective discrimination feature. Under S. 3288, deductible employee contributions made to the employer's plan are treated as an employer contribution for purposes of measuring discrimination under the plan. Thus, the employee contributions automatically enter into the traditional measurement of discrimination in employer-derived benefits.

Revenue considerations. -- We have emphasized revenue considerations in the past in connection with proposals dealing with employee contributions to retirement plans. We think it is particularly important to bear the cost implications of section 303 of the bill in mind. We estimate that the annual revenue cost of this section of the bill is between $2 billion and $2.2 billion.

Credits for New and Improved Plans

S. 3017 provides a tax credit in the case of new qualified plans. The credit begins at 5 percent in the first plan year and ends with 1 percent in the fifth year, and is applied to the employer's total plan contribution, up to the deductible limit. The new plan credit is available to employers which are "small businesses" as determined by the administrator of the Small Business Administration. No credit is allowed if the employer terminated another qualified plan at any time after January 1, 1978. The credit is not allowed for contributions to an ESOP. It is, however, available for contributions to Keogh plans.

The improved plan credit of section 305 is available without regard to the small business restriction, but is not applicable to Keogh type plans described in Code section 401(d). The credit applies for all years during which an improved plan is maintained. The bill provides that an improved plan is one which is certified by the Employee Benefits Commission created in Title I of the bill. This certification is dependent on the meeting of one of two alternatives. The first alternative is that both the participation and vesting rules of the plan are significantly more liberal than the minimum requirements of ERISA. The second alternative is that there is some other significant improvement at least equivalent to the vesting and participation improvement possibilities.

According to a study appearing in the November, 1975 Social Security Bulletin, the portion of the nongovernmental labor force covered by a retirement plan was 46.2 percent in 1975. Although that percentage has increased from 42.1 percent in 1970, we have no reason to believe that much more than one-half of the nation's labor force is now covered by private pension plans. Employees working for small employers tend to be among those who are least likely to be covered by a private pension plan. The purpose of the bill is the encouragement of such small employers in the establishment of plans for their employees. The further purpose of the bill is to improve the level of benefits for all plans.

It is probably true that a major improvement in coverage by private plans will not be accomplished within the present framework of incentives. However, there is not to our knowledge sufficient information about the gap in coverage so as to be able to target tax benefits narrowly enough to provide a substantial increase in coverage without an unacceptably large revenue cost. Although the percentage of the work force covered by retirement plans has grown slowly, employer contributions grew from $15 billion in 1971, to $28 billion in 1975. It has been estimated that over the next 10 years contributions could reach $176 billion. Because of the number of plans already in existence or which will be established by employers in any event, there will be a substantial tax cost under the bill even if no employer changes his or her mind as a result of the offered credit. If by 1985 as many as 50 percent of the contribution dollars were to "improved" plans, the tax cost of the improved plan credit would be $4.4 billion.

Perhaps the credit could be made effective if it were more narrowly focused, such as to employers whose work force has a low average pay, those whose income is below specified levels, or those who have a relatively small amount of assets. Without clearer information as to the gap in coverage, we cannot evaluate these possibilities.

We are also concerned over the administrability of the power to certify an "improved plan". Certification requires that the plan be more generous than required by ERISA's minimum standards with respect to the age and service and vesting requirements. Should the change in participation and vesting rights be factually as well as legally significant? For instance, some employers with a very low rate of employee turnover can change from ten-year "cliff" vesting to five-year vesting at little or no cost. If the test is to be one of economic significance under the facts and circumstances, there will be complex actuarial problems to resolve. If the test is that any plan is eligible if by its terms it appears better, there will be many employers receiving the credit at little or no additional cost.

There is an even more difficult administrative aspect of the proposal. As an alternative to "significantly better participation and vesting rights", the bill directs the Commission to look for "some other significant improvement in a participant's benefits and rights under the plan, which is at least equivalent to an improvement which would satisfy the required participation and vesting improvements." The difficulty here is the relative nature of the term improvement. There is no standard. There is no minimum standard under ERISA regarding the amount of benefit granted by the employer.

If the improvement refers to what was done by the employer in some prior year, there will be statutory encouragement to the starting up of very small plans, so that a measurable increase may be granted. If, as suggested by the bill, the maintenance of an improved plan can begin with the first year of a plan (merely by satisfying the participation and vesting side of the test), there will be no prior year's level of contributions or benefits against which to measure.

Master and Prototype Plans

In addition to the preceding measures designed to encourage more savings for retirement, S. 3017 would establish mechanisms for special master plans.

The bill proposes that the master sponsor--the bank, insurance company, or other investment manager--be considered the plan administrator and named fiduciary for purposes of Title I of ERISA. We concur in the Labor Department's support of this part of the proposal.

As you know, the Internal Revenue Service is an enthusiastic supporter of, and has developed several different types of, master and prototype plans. The major difference between S. 3017 and existing IRS procedures for master plans for corporate employers--from the perspective of the tax law--is that under the bill there would be no need for an employer to apply for a letter demonstrating that the plan is qualified. The IRS does not believe such a provision is workable unless a plan covers all employees and has full and immediate vesting. In the absence of this requirement, a determination of qualification cannot be made without examination of the employer's workforce.

Although we do not support such a plan, if a master plan with potentially discriminatory standards were permitted to be qualified without individual examination, appropriate sanctions for marketing and establishing discriminatory plans would have to be developed. Questions must be addressed concerning the type of sanction, the effective date of the sanction, and the party on whom the sanction is to be imposed.

Denial of IRA Benefits to Certain Individuals

Another means of encouraging plans covering more members of the workforce is through denial of IRA deductions where they compete with nondiscriminatory plans. S. 3017 would deny IRA deductions to individuals who are owner-employees in partnerships or sole proprietorships or who are officers or 10%-or-more shareholders of corporations. We support this amendment.

A serious problem in connection with IRAs is that an individual in control of a business can elect to forego a Keogh plan in favor of an IRA. Although the direct tax benefits for that individual may be less under an IRA than under a Keogh plan, the overall cost of the IRA may be substantially less, since the establishment of a Keogh plan would require the provision of benefits for a nondiscriminatory group of employees. Thus, IRAs constitute a serious disincentive to the establishment of qualified plans in many cases. Section 306 of the bill will reduce this disincentive. However, we would not preclude an individual from having an IRA if he or she (or the relevant corporation) has no other employees.

Joint and Survivor Annuity

The changes proposed in S. 3017 to ERISA's joint and survivor annuity rules are highly technical. Yet they raise

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broad and significant policy issues that must be addressed before any changes are effected. Under both Title I of ERISA and section 401(a) of the Internal Revenue Code, special rules apply if a plan provides for the payment of benefits in the form of an annuity. 4/ Under those rules, the annuity benefits must be paid in the form of a qualifying joint and survivor annuity to the participant and his or her spouse unless the participant elects not to receive payment of the benefit in that form. These rules apply generally where the participant has begun to receive benefit payments at or after reaching normal retirement age, or a plan's early retirement age if it has one. The vesting rules of ERISA and the Code provide that employer-derived benefits may be forfeited upon the death of a participant (before or after retirement), except in the case of a survivor annuity payable under the joint and survivor annuity rules. Thus, the employer-derived benefits (other than the survivor annuity) can be forfeited even where a participant is fully vested and dies prior to the commencement of any benefit payments.

Section 238 of S. 3017 would, in substance, change the vesting and joint and survivor annuity rules in two situations. In either case, the surviving spouse of a participant would be entitled to a survivor benefit where the participant is at least 50% vested in employer contributions or benefits and dies before receiving the vested percentage of his or her employer-derived account balance or benefits.

The provisions of this section of S. 3017 are technical responses to limited problems within the scope of the joint and survivor annuity provision. As such, they contain their own technical problems. More important, the amendments proposed in the bill do not directly address several important questions which we believe need to be considered over a longer period of time. We do not yet have answers to these questions ourselves, but we would hope to work with the Committees to arrive at proper results.

The fundamental question is whether the vesting rule which allows forfeiture of employer-derived benefits upon death is a correct approach. The existence of any retirement plan implies that employees have received reduced immediate compensation in favor of the diversion of that compensation into the retirement plan. It can be argued that death should not result in the loss of the diverted compensation. On the other hand, at least in the context of a defined benefit plan, the diversion can be viewed as something like the purchase of an annuity. It is not illogical to accept the loss of future annuity payments on death, even if the annuitant dies before any payments have been made.

The second question follows only if, as a result of examination of the first question, the possibility of forfeiture upon death still remains. The question then is whether the death to be focused upon is solely that of the plan participant or the death of the survivor of the participant and his or her spouse. The current joint and survivor annuity rules, in effect, mean that both deaths must be taken into account in some situations. However, the current rules deal with the problem in a very confused and somewhat arbitrary manner.

The third question is whether, assuming there should be survivor benefit requirements of some sort, the participant should be allowed to elect against benefits for the surviving spouse. If the proper policy is that the law should at least favor survivor benefits, subsidiary issues arise regarding the degree of flexibility which should be involved. For example, would it be appropriate to make survivor benefits mandatory where, at the time of a participant's retirement, the participant is healthy but his or her spouse is terminally ill? Similarly, should the actuarial reductions implicit in the provision of survivor benefits be mandated where the participant's spouse is receiving, or will receive, full retirement benefits resulting from his or her own employment?

FOOTNOTES

1/ Examples of certification include, under prior law, the Department of Commerce certifying import injury for purposes of determining a taxpayer's entitlement to a special five-year loss carryback established under the Trade Expansion Act; the War Production Board certifying facilities as war emergency facilities in connection with the special amortization rules applicable to those facilities. Under present law, there is a similar certification procedure with respect to the amortization of pollution control facilities (I.R.C. Section 169); there is also special treatment for gain or loss under SEC orders (I.R.C. Section 1081) or FCC policy changes for radio stations (I.R.C. Section 1071).

2/ A cafeteria plan is an arrangement under which a participating employee elects the types of fringe benefits to which employer contributions will be applied on his or her behalf. These plans usually include benefits, such as health and accident insurance or group-term life insurance under $50,000, which would be nontaxable under current Code provisions if provided under a non-elective plan. A cafeteria plan usually also includes elective benefits which are taxable, such as current cash distributions. Under H.R. 13511, if a cafeteria plan is nondiscriminatory, a highly compensated employee will be currently taxed only to the extent that he or she elects taxable benefits. If the plan is discriminatory, a highly compensated employee will be currently taxed on the total amount of taxable benefits which could have been elected, regardless of the actual election made by the employee.

3/ The ERISA provision was only a temporary measure. The original freeze was until the end of 1976. It was extended until the end of 1977 by the Tax Reform Act of 1976, and it would be extended further until the end of 1979 by H.R. 9251 which has been approved in different versions by the House of Representatives and the Senate.

4/ Under the Internal Revenue Service regulations interpreting this provision, the special rules apply only where the annuity is a life annuity. Thus, a plan's provision for the payment of an annuity for a term certain or for a term measured by the life expectancy of the recipient would not, in itself, result in application of the special rules.

Senator WILLIAMS. On survivorship, these are complex questions you raise. They all must be understood, and then policy decisions have to be made with respect to them.

Is the Department working on a position with respect to all of these questions?

Mr. HALPERIN. Yes, Mr. Chairman. We hope to submit a position on all of the provisions of the bill, and we will try to see if we can develop one on joint and survivor annuities.

It is, of course, a question of social policy, perhaps something beyond what we are supposed to be expert in, but we would be glad to offer you our opinion on what the right result ought to be.

Senator WILLIAMS. Your department, of course, is clearly the expert in the tax-economic impact of any of the choices we make, both in this survivorship area and on the tax deductible options that we are considering before us in various forms.

We, of course, would rely heavily on your assessment of impact, and whether we can find ways to close the gaps of coverage, and do it in a way that promotes pension plans, and additional coverage—that is what we are talking about—at a price we can afford.

Mr. HALPERIN. Like every issue with additional coverage, if we assume there is a fixed amount of dollars that will be put aside for wages and retirement benefits, if you mandate coverage for additional people, you presumably are shifting it.

Mandating joint survivor annuities would suggest that more of the pension dollar ought to go to employees who die young, leaving a spouse, and perhaps a little less of it to those who do not fit into that category. That is a question of equity between employees.

We hear a lot about any proposal for increased costs, causing disruptions of the private pension system. I would think certainly in the long run, that what we are talking about is how a particular dollar ought to be spent. Perhaps in the short run there is a problem. Any time there is a new benefit, it is very hard to take away from what you already have, so costs do go up in the short run.

Senator WILLIAMS. You mentioned earlier the questions arising out of various ideas for deductions for employee contributions. It has gone off in many different directions now——

Mr. HALPERIN. I think maybe just within the Internal Revenue Code. We have half a dozen different rules in the Internal Revenue Code dealing with this situation, depending upon the nature of who you work for.

If you work for a Government employer, you have a certain ability to set aside, on your own choice; if you work for an educational institution, the rules are different; and if you work for a private employer, that establishes a cash and deferred profit sharing plan, the rules are different than if you work for an employer that has a defined benefit pension plan.

That does not seem to us to make a lot of sense.

Senator WILLIAMS. Is this in an area of discussion for broad consensus?

Mr. HALPERIN. We expect to make recommendations to the Finance Committee in connection with their consideration of the pending tax bill, because the House bill does deal with this area, and we would hope that the Finance Committee could improve on the House bill.

I would think, to the extent that it involves increased coverage, there may be an interest in members of this committee following where that particular bill would go.

Senator WILLIAMS. We do have that kind of interest. Tax legislation and tax policy are properly matters for the Finance Committee, but the social policy implications of those matters—here, increased coverage under good retirement plans for more employees—are also proper subjects for the Human Resources Committee.

Senator Bentsen.

Senator BENTSEN. Mr. Halperin, I am, of course, pleased with the support Treasury has given to my bill, S. 3140, and I do believe, with its nondiscrimination clause it is a good compromise. It leads to an inexpensive way of setting up pension programs, particularly for smaller companies and provides some portability to the employees.

On the question of a single agency, I have not been of that mind. I recognize it has been said here, that this is an interim solution we are talking about, but interim only because no legislation is really permanent as we can work to try to improve it.

I would hope finally we do not have to go to a single agency. I think we have some very able and experienced people in both Labor, Treasury, and the IRS, that can administer the program.

One question that concerns me, and I certainly do not want to see another agency involved, and I am speaking of the SEC, if we can avoid it, and still accomplish the things that are necessary.

Do we not have the discretionary authority in ERISA to accomplish some of the worthwhile things that SEC does in advising, in disclosure, that we can do anyway, and fill that responsibility with just the agencies that are now involved?

Let me give you an example of one of the things that concerns me—performance of a pension fund. Now, the SEC, if you go out to buy mutual funds, they require certain disclosure, performances, and that type of thing. But when it gets to the administration of a pension fund by banks and others, often we really do not know how good or how bad a job they are doing, and it is tough to get the information prepared.

Are there not things that we can do within the provisions of the present legislation we have, with the agencies that we now have, that can give the pensioner a better feel of how the folks are doing that are administering these funds?

Mr. HALPERIN. Let me say first, the Solicitor General's brief submitted to the Supreme Court in the *Daniel* case said a couple of things that I think would alleviate a lot of the fears that people have.

First of all, it suggested any liability would be prospective only. Second, it suggested in deciding what it was an employer had to disclose, that the rules established under ERISA by the departments that had responsibility for administering ERISA would totally govern, and that no one would be able to say, including the SEC, that something else was material.

In other words, the Labor Department would have the say over what was material. So that if you follow that approach, as I understand it, what the *Daniel* case would suggest, is that there is a Federal right of action in the Federal courts for misrepresentation, as Senator Javits discussed earlier.

I think that is something which needs to be studied, whether or not that would cause greater disruption, or would actually be a benefit to participants in the plan.

I guess your question, Senator, is whether we have authority under existing statute to request additional information from employers, from what we have now done, and I would guess that we do have a great deal of discretion, and perhaps Mr. Ochs would want to comment.

Mr. OCHS. We have responsibility under 6058 of the Code, which determining the performance of the plan, for benefit of participants——

Senator BENTSEN. As an example.

Mr. OCHS. We have responsibility under 6058 of the Code, which describes annual report for these plans to determine the content of those reports, and it could therefore be structured, and those reports are public information documents, by the way, they could be structured so as to accomplish that in some fashion, and indeed I believe it would today, but they need to be revised to be directed toward that approach.

Senator BENTSEN. Senator Williams, let me give you an example of what I am talking about.

I sat on the board of a major bank, and had a tough time getting the trust Department to tell me how good or bad a job they were doing. They wanted to always cite me the one task that identified the job, instead of giving me an across-the-board performance.

I also managed a mutual fund management company. We had to show—and they rated us with all other mutual funds, and the people who invested in it, whether we were doing a good job or bad job, and what our investment objectives were, and it seems to me that is information pensioners ought to be able to know. He ought to be able to decide, and have some feel of how good a job is being done in the administration of the assets that finally result in his retirement income——

Mr. HALPERIN. I think I understand, Senator, and we certainly would look into it, to see what authority we have under the present statute, and report if we have inadequate authority.

Senator WILLIAMS. We have the Chairman of the SEC here, by the way, and we will get into this. But you are talking about the SEC's ability to call for the information on performance.

The case that brought this to us, of course, was the case of omission of disclosure of a material fact, as I recall. Senator Javits was talking about fraudulent misrepresentation.

I am glad you raised this one area, performance, whether Daniel encompasses it, and whether that is a possibility within the jurisdiction of present agencies dealing with it. It raises a lot of questions.

We are still searching for the answers.

Well, thank you very much, gentlemen.

Senator Bentsen will have to go to another meeting.

Chairman Williams is here from the SEC, and Senator Bentsen would like to greet you.

Senator BENTSEN. Chairman Williams. I have run overtime on my other commitment. I am sorry I will not be here to hear your oral testimony. I will be pleased to review your testimony in writing, though, and I understand you have presented it to us, and I will read it with great interest.

Senator WILLIAMS. We appreciate your appearance before us in this joint subcommittee effort on amendments to ERISA.

We welcome you.

STATEMENT OF HON. HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY HARVEY L. PITT, GENERAL COUNSEL

Mr. WILLIAMS. Good morning, Mr. Chairman. I have with me Harvey Pitt, General Counsel for the Commission.

I appreciate the opportunity to appear before your subcommittees today to offer the Commission's views on S. 3017, the ERISA Improvements Act of 1978. The Commission is concerned with sections 271 and 274 of S. 3017, which would affect the applicability of the Federal securities laws to employee benefit plans. Our comments are limited, accordingly, to those two sections.

To begin with, I am not here to reargue the 7th circuit's *Daniel* decision. That case, which is now pending before the Supreme Court, held that employees participating in involuntary, noncontributory pension plans are entitled to the protections of the Federal securities laws against fraudulent pension practices. While I believe that the holding of the Court in *Daniel* was correct as to the applicability of the antifraud provisions of the Federal securities laws, I recognize that the decision has raised significant policy questions about the desirability of permitting cases to be brought under the Federal securities laws for fraud in connection with the offer or sale of interests in employee benefit plans. The decision has also focused attention on the absence of antifraud remedies under ERISA. These are the questions which Congress must address in considering sections 271 and 274 of this bill.

Although the answers to these questions are, of course, matters for legislative determination, I want to point out that sections 271 and 274 of this bill would eliminate antifraud remedies provided by the Federal securities laws to participants in employee benefits plans. Such antifraud remedies are not presently contained in ERISA and are not added by this bill.

Moreover, this bill goes much further than the issues involved in the *Daniel* case. That case concerned the interest of an employee in an involuntary, noncontributory employee benefit plan. But, with certain narrow exceptions, this bill would also eliminate the application of the antifraud and registration provisions of the Federal securities laws to voluntary, contributory employee benefit plans.

Of particular concern are voluntary, contributory plans that invest in the securities of the employer corporation. Interests in such plans have traditionally been subject to the full force of the Federal securities laws because employees are, in effect, deciding whether to invest in the securities issued by their employers.

We believe that these employees should have the benefit of the kind of detailed information about the investment risks associated with such an investment that would normally be provided by a Securities Act registration statement. ERISA does not presently provide employees with such detailed information. And, this bill would reduce the present disclosures provided to employees under ERISA by eliminating the presently required summary annual report on the financial condition of the plan.

Similarly, this bill would eliminate the application of the antifraud and registration provisions to certain types of Keogh plans and individual retirement accounts—IRA's. Interests in these plans have usually been protected by the Federal securities laws because financial institutions offer investment vehicles for these plans to unsophisticated self-employed individuals and employees through mass marketing techniques.

Again, we believe that the Federal securities laws provide valuable protections in this area which are not presently afforded by ERISA and will not be afforded by the bill.

Finally, the bill would cover an area completely unrelated to the issues raised by the *Daniel* case—the applicability of the Federal securities laws to purchases by pension plans of interests in certain collective investment media established by banks and insurance companies.

Whatever conclusion is reached as to whether interests of employees in pension plans are or should be treated as securities, there has never been any substantial doubt that interests purchased by pension plans in collective investment media are securities.

As Congress itself recognized in refusing to exempt such interests from the registration provisions of the Securities Act in 1970, such interests are complex in nature and are likely to be sold to unsophisticated self-employed persons. [S. Rept. No. 184, 91st Cong., 1st sess. 27 (1969)]. For this reason, both the registration and antifraud provisions of the securities laws provide needed protections in the sale of such interests. ERISA does not contain comparable disclosure requirements, nor does it adequately protect purchasers of such interests against frauds.

In addition, some of these collective media, including insurance company separate accounts, are presently registered and regulated under the Investment Company Act of 1940, which provides important investor protections beyond those provided by the Securities Act and the Exchange Act.

We believe the bill removes these protections in a particularly inconsistent manner, without substituting equivalent protections under ERISA. Congress specifically considered the applicability of the Federal securities laws to collective investment media, particularly with respect to IRA's, when it enacted ERISA, and the conference report accompanying the bill that became ERISA expressly reflects a determination not to limit "in any way the application of the Federal securities laws" to IRA's. [H.R. Rep. No. 93–1280, 93d Cong., 1st sess. at p. 338]. We know of no reason this conclusion should now be reconsidered.

These are, in summary form, my concerns about S. 3017. The remainder of my testimony, which has been previously furnished to you in written form, is a detailed analysis of sections 271 and 274 of the bill.

At this time I would be happy to answer any questions that you may have.

Senator WILLIAMS. We appreciate your testimony going to new areas that we are suggesting through the legislation. We, of course, are most interested in your comments on the Daniel situation, which is the involuntary, noncontributory situation.

We recognize the governmental division here on whether that situation meets the test of security as covered under present law. It does not have to be said, but I will say it came as a complete surprise to us.

On occasion there are certain things done in legislation where assumptions are made. We find, through judicial processes, that our assumptions were unwarranted. I mentioned earlier, before you came into the room, Mr. Chairman, a situation where we assumed that the 1964 Civil Rights Act covered a discrimination in employment situation, and we later found that we were wrong. Because the Supreme Court found that we had not explicitly stated that the situation was to be considered discrimination; we had not explicitly said it, and therefore it was found not to be. It was a 5-to-4 decision, but that was the decision.

That was the *Gilbert* case, and dealt with pregnancy as a disability. Disabilities are covered by the company, and we had assumed that pregnancies were covered disabilities—but we can assume no longer.

In this situation of pension plans, and governmental jurisdiction, we did not make any assumptions. We did in creating ERISA, explore with the SEC their attitude on whether pension plan regulation was to be a matter for the Securities and Exchange Commission.

I thought our record was quite clear, was it not, counsel, that we had a situation that was not a matter for the SEC.

But the record evidently is not as complete or clear as I thought, at least as far as the early judicial process is concerned, because here we are. It has been found that involuntary, noncontributory situation is in SEC jurisdiction. It boggles the mind.

Why did we pass ERISA? We passed ERISA because we had a record of abuse and neglect in the most harmful personal way, including people being told things about their pension plans, and then finding out, when they reached retirement, that the facts were otherwise. They were unprotected. A whole panoply of abuses were before us, and therefore we brought these abuses under control. We defined every element that should be incorporated into a plan description so the participant, the beneficiary, will know what he had, know where he stood, know what would defeat his right to benefits, and also know if he did certain things that his benefit could not be forfeited.

That is where we thought we were, and now we have a new element added.

Earlier today it was suggested by Senator Javits that, notwithstanding the full demands that the plan need meet under ERISA, there are some areas where misrepresentations nevertheless can be made, even though the required disclosure is complete and accurate; that there might be oral misrepresentations, for example. He suggested, preliminarily, that there might be a common law area of fraud here that we should somehow incorporate.

But at any rate, that deals with only one aspect of your concern. Your concern is also with certain other provisions of these bills. These go into the areas of voluntary participation plans and collective investment media.

Your statement, and your judgment is appreciated. There are policy questions that are new.

I would suggest that we make it clear that we are considering these things ab initio. Policy decisions will be made here, and they will be made crystal clear.

Your contribution to our judgment on the policy questions is greatly appreciated, because of respect we have for the Chairman of the Securities and Exchange Commission, and the great respect we have for the Commission.

So I do not know whether we need any particular question. Let me ask the staffs of my colleagues Senator Javits and Senator Bentsen if they have any questions for the Chairman of the SEC?

Senator Javits may wish to submit some written questions and some observations in the process, I would think, and also Senator Bentsen. They may have written questions.

I think perhaps I would like to be in the same situation, to put in the record written questions for our record. It might be better to do it that way, so we are all in a position to thoughtfully propound, and I know you will give us a thoughtful reply.

[The prepared statement of Mr. Williams follows:]

STATEMENT OF HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, BEFORE THE SUBCOMMITTEE ON LABOR OF THE SENATE COMMITTEE ON HUMAN RESOURCES AND THE SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS OF THE SENATE COMMITTEE ON FINANCE, ON S. 3017, THE ERISA IMPROVEMENTS ACT OF 1978

August 15, 1978

Honorable Chairmen and members of the Subcommittees:

I appreciate the opportunity to appear before your Subcommittees today to offer the Commission's views on S. 3017, the ERISA Improvements Act of 1978. The Commission is concerned with Sections 271 and 274 of S. 3017, which would affect the applicability of the federal securities laws to employee benefit plans. Our comments are limited, accordingly, to those two sections.

To begin with, I am not here to reargue the Seventh Circuit's Daniel decision. That case, which is now pending before the Supreme Court, held that employees participating in involuntary, non-contributory pension plans are entitled to the protections of the federal securities laws. The Daniel court believed that such employees have to be protected against fraudulent pension practices. While I believe that the holding of the court in Daniel was correct as to the applicability of the antifraud provisions of the federal securities laws, I recognize that the decision has raised significant policy questions about the desirability of permitting cases to be brought under the federal securities laws for fraud in connection with the offer or sale of interests in employee benefit plans. The decision has also focused attention on the absence of antifraud remedies under ERISA. These are the questions which Congress must address in considering Section 271 and 274 of this Bill.

Although the answers to these questions are, of course, matters for legislative determination, I want to point out that Sections 271 and 274 of this Bill would eliminate valuable antifraud remedies provided by the federal securities laws to participants in employee benefit plans. Such antifraud remedies are not presently contained in ERISA, and are not added by this Bill.

Moreover, this Bill goes much further than the issues involved in the Daniel case. That case concerned the interest of an employee in an involuntary, non-contributory employee benefit plan. But, with certain narrow exceptions, this Bill would also eliminate the application of the antifraud and registration provisions of the federal securities laws to voluntary, contributory employee benefit plans. Of particular concern are voluntary, contributory plans that invest in the securities of the employer corporation. Interests in such plans have traditionally been subject to the full force of the federal securities laws because employees are, in effect, deciding whether to invest in the securities issued by their employers. We believe that these employees need the kind of detailed information about the investment risks associated with such an investment that would normally be provided by a Securities Act registration statement. ERISA does not presently provide employees with such detailed information. And, this Bill would reduce the present disclosures provided to employees under ERISA by eliminating the presently required summary annual report on the financial condition of the plan.

Similarly, this Bill would eliminate the application of the antifraud and registration provisions to certain types of Keogh plans and individual retirement accounts (IRAs). Interests in these plans have usually been protected by the federal securities laws because financial institutions offer investment vehicles for these plans to unsophisticated self-employed individuals and employees through mass marketing techniques. Again, we believe that the federal securities laws provide valuable protections in this area which are not presently afforded by ERISA and will not be afforded by the Bill.

Finally, the Bill would cover an area completely unrelated to the issues raised by the Daniel case — the applicability of the federal securities laws to purchases by pension plans of interests in certain collective investment media established by banks and insurance companies. Whatever conclusion is reached as to whether interests of employees in pension plans are or should be treated as securities, there has never been any substantial doubt that interests purchased by pension plans in collective investment media are securities. In addition, some of these collective media are presently registered and regulated under the Investment Company Act of 1940, which provides important investor protections beyond those provided by the Securities Act and the Securities Exchange Act. We believe the Bill removes these protections in a particularly inconsistent manner, without substituting equivalent protections under ERISA.

These are, in summary form, my concerns about S. 3017. The remainder of my presentation is a detailed analysis of Sections 271 and 274 of the Bill.

DETAILED TECHNICAL ANALYSIS AND COMMENTS

I. INTERESTS OF EMPLOYEES IN EMPLOYEE BENEFIT PLANS: ANTIFRAUD PROVISIONS

A. Current Law

1. Availability of Remedies For Fraud Under the Federal Securities Law

The Commission has taken the position that the interest of a participant in a pension plan is a "security" within the meaning of the definitional provisions 1/ of the Securities Act and the Securities Exchange Act. 2/

1/ The term "security" is defined in both Section 2(1) of the Securities Act and Section 3(10) of the Securities Exchange Act to include an "investment contract." An investment contract exists where there is an investment of money in a common enterprise the profits of which are derived solely from the efforts of others; Securities and Exchange Commission v. W.J. Howey Co., 328 U.S. 293 (1970); Securities and Exchange Commission v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943); or where the success or failure of the enterprise depends upon the essential managerial efforts of others. Securities and Exchange Commission v. Koscot Interplanetary Inc., 497 F.2d 473 (C.A. 5, 1973).

2/ See Testimony of Commissioner Purcell, Hearings before the House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess. 887, 895 (1941).

While the Commission has in the past concluded that, with respect to the registration provisions of the Securities Act, there are circumstances in which the disposition of such an interest to an employee does not constitute a "sale", 3/ the Commission has never taken the position that any such disposition was not a "sale" for the purpose of the antifraud provisions of the Securities Act or the Securities Exchange Act. In its brief as amicus curiae, in the Daniel case, the Commission urged, and the court agreed, that the interest of an employee in an involuntary, non-contributory pension plan was a "security" and that the disposition of such security to the employee was a "sale", for the purposes of the antifraud provisions of the federal securities laws. 4/ Under the Daniel decision, the federal securities laws apply to provide a remedy to those employees injured by deceptive or misleading statements made in connection with the offer or sale to them of interests in an employee pension benefit plan. 5/

3/ See discussion infra, at page 10.

4/ Daniel v. International Brotherhood of Teamsters, et al., 561 F.2d 1223 (C.A. 7, 1977), certiorari granted, 46 U.S.L.W. 3512 (U.S., Feb. 21, 1978).

5/ The Commission believes that the concern which has been expressed, as a result of Daniel, regarding the impact upon the soundness of plans from accrued liabilities for past conduct, is based upon a misapprehension of the nature of the scope of the duties imposed by the antifraud provisions (see note 6, infra), and the elements of a cause of action under the antifraud provisions and the measure of damages recoverable under these provisions. Any retroactive liability for violations of the antifraud provisions in connection with a noncontributory, involuntary pension plan is limited by the requirements that the private plaintiff demonstrate: (1) that he made an investment decision, in that his decision to take or retain a job was materially influenced by the existence and terms of the pension; (2) that a fraud occurred; (3) that he was injured; and (4) that his injury was causally related to the fraud. The problems inherent in establishing these requirements for relief will, no doubt, limit the number of persons able to establish a violation of the antifraud provisions. Moreover, even in those cases in which an employee is able to establish the necessary elements of his cause of action, the measure of damages may be limited to restitution. This is in keeping with a line of securities cases which allow only out-of-pocket losses, rather than the benefit-of-the-bargain.

(footnote continued)

In particular, with respect to interests in employee benefit plans regulated by ERISA, the principal application of the antifraud provisions will be to provide a remedy to those persons deceived by misrepresentations made orally or in a writing not required or regulated by ERISA. 6/ Even if the decision of

5/ (footnote continued)

See, e.g., Blackie v. Barrack, 524 F.2d 891, 909 (C.A. 9, 1975), certiorari denied, 429 U.S. 816 (1976); Foster v. Financial Technology, 517 F.2d 1068, 1071 (C.A. 9, 1975); Harris v. American Investment Company, 523 F.2d 220, 224-226 (C.A. 8, 1975), certiorari denied, 423 U.S. 1054 (1976); Madigan, Inc. v. Goodman, 498 F.2d 233, 239 (C.A. 7, 1974); Zeller v. Bogue Electric Manufacturing Corporation, 476 F.2d 795, 801-802 (C.A. 2), certiorari denied, 414 U.S. 908 (1973).

In view of the foregoing, and considering the potential impact of statutes of limitation, we believe that the amount of accrued liability on the part of plans and plan sponsors is likely to be significantly smaller than some have predicted. The finding by the Court of Appeals in Daniel — that there had been a sale of a security — was the beginning, not the end, of the question of defendants' liability under the antifraud provisions. Even in Daniel, which was decided on a motion to dismiss so that the court was required to assume the veracity of the facts alleged in the complaint, the entire substantive issue of liability remains to be tried and determined.

6/ The Commission is concerned about the apparent belief of the sponsors of the present amendments that the application of the antifraud provisions will interfere with or duplicate the regulatory provisions of ERISA. This belief may be based upon the impression that the antifraud provisions would superimpose on ERISA another set of across-the-board, uniform, affirmative disclosure requirements to be met by plans. On the contrary, in our view, the antifraud provisions essentially constitute a general direction not to be deceptive or misleading. In this regard, we note our disagreement with the dictum of the Court of Appeals in Daniel, which suggested that the antifraud provisions impose a uniform requirement of specific disclosures of various pension terms and actuarial probabilities for all pension plans. 561 F.2d 1223, 1247. The only issue before the Court in Daniel was the threshold question of whether there was a security and a sale; the question of the circumstances in which the antifraud provisions might require particular disclosures was neither before the court nor fully briefed by the parties.

In fact, where a document required by ERISA fully and fairly complies with the disclosure requirements of ERISA, such document would not, except in unusual circumstances, be violative of the antifraud provisions of the federal securities laws. Rather than duplicating the disclosure requirements of ERISA, which we recognize were carefully considered by Congress when it adopted ERISA, the principal role to be played by the antifraud provisions is in providing protection where false or misleading representations are made orally or in written materials other than those required by ERISA — areas where ERISA presently provides no protection.

the Court of Appeals in Daniel is overturned with respect to the application of the antifraud provisions to the offer or sale of interests in involuntary, non-contributory plans, we believe that these remedies would continue to be available to employees participating in voluntary or contributory pension plans.

2. Unavailability of Remedies For Fraud Under ERISA

The disclosure provisions of ERISA in Part 1 of Title I do not contain any prohibitions against the making of deceptive or misleading representations to plan participants in oral statements or in documents not required by ERISA. Thus, the civil remedy provisions of Section 502 of ERISA, which, in Section 502(a)(3), allow actions for appropriate equitable relief to remedy violations of ERISA, would not be available in such cases.

Even if these deceptive or misleading statements were made by a fiduciary, there is no clear remedy under ERISA. Section 404 sets forth the basic duties of a fiduciary under ERISA and requires fiduciaries to act "solely in the interest of the participants." Section 409 imposes liability on a fiduciary for violation of his duties and defines the measure of damages which may be recovered against him. Actions to enforce these liabilities are authorized by Section 502(a)(2), and may be brought by a participant or beneficiary. It is unclear, however, whether a false or misleading statement made to one participant would violate a fiduciary's duty to act "solely in the interest of the participants," because the loss of benefits by any one participant has sometimes been held to be in the interest of all remaining participants. 7/ Moreover, assuming that there was a cognizable breach of duty, Section 409 provides for damages measured by losses to the plan or profits to the fiduciary — both of which

7/ See, Thurber v. Western Conference of Teamsters Pension Plan, 542 F.2d 1106 (C.A. 9, 1976); but see, Burroughs v. Board of Trustees of the Pension Trust Fund for Operating Engineers, 542 F.2d 1128 (C.A. 9, 1976).

are irrelevant to losses incurred by a single participant because of a false or misleading statement by a plan official who does not profit personally from such a statement. At best, a plan participant who is deceived as to the terms of a plan by oral or written statements not required by ERISA could attempt to sue the fiduciary for damages under the "other equitable or remedial relief" clause in Section 409. At least one court, interpreting similar language contained in Section 502(a)(3), has concluded that no general damage action will lie. Bell v. Southern Oregon Log Scaling and Grading Bureau, et al., C.A. No. 76-431 (D. Ore., Aug. 5, 1976) (Slip Opinion). And, while it may be argued that there exists an implied right of action under ERISA benefiting employees who have been deceived by plans or plan fiduciaries, the outcome of such an argument is uncertain. See, Cort v. Ash, 422 U.S. 66 (1975).

B. Proposed Amendments

Proposed Section 514(d)(2) would depart from the present law, precluding prospectively the application of the antifraud provisions of the federal securities laws to the interests of nearly all employees in any employee benefit plan covered by ERISA. 8/ At the same time, by prohibiting the rendering of any money judgment against any person or plan, proposed Section 502(k) would effectively deprive employees of the right to maintain an action under the federal securities laws based upon either past or future conduct which violates those laws. 9/ These new sections would preserve the applicability of the federal

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8/ Proposed Section 514(d)(2) of ERISA would provide that no interest of any employee in an employee benefit plan covered by the provisions of ERISA, other than a voluntary eligible individual account plan, shall be characterized as a security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934 or of any State law regulating securities.

9/ Section 502(k) would limit the civil remedies available to plan participants under the federal securities laws. Paragraph (1) of this new section

(footnote continued)

securities laws only to interests in: (1) "eligible individual account plans", 10/

9/ (footnote continued)

would provide that, in the case of an employee benefit plan, other than a voluntary eligible individual account plan as defined in Section 407(d)(3) of ERISA, no person or employee benefit plan may be subject to a money judgment as the result of a cause of action alleging that the interest of an employee in such a plan is a "security" within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934 or any State securities law. Paragraph (2) of Section 502(k) would deprive the courts of the United States of jurisdiction, at law or in equity, over any cause of action, whenever instituted, alleging, either directly or indirectly, that the interest of an employee in such an employee benefit plan is a "security" within the meaning of any of those same laws.

10/ An "individual account plan", sometimes known as a "defined contribution plan", is defined in Section 3(34) of ERISA as:

> "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account."

Although generally subject to Title I of ERISA, such plans are exempt from the funding provisions of Part 3 of Title I; and such plans are also excluded from coverage under the plan termination insurance provisions of Title IV of ERISA. Section 407(d)(3) of ERISA states:

> "(A) The term 'eligible individual account plan' means an individual account plan which is (i) a profit-sharing, stock bonus, thrift, or savings plan; (ii) an employee stock ownership plan; or (iii) a money purchase plan which was in existence on the date of enactment of this Act and which on such date invested primarily in qualifying employer securities. Such term excludes an individual retirement account or annuity described in Section 408 of the Internal Revenue Code of 1954.
>
> "(B) Notwithstanding subparagraph (A), a plan shall be treated as an eligible individual account plan with respect to the acquisition or holding of qualifying employer real property or qualifying employer securities only if such plan explicitly provides for acquisition and holding of qualifying employer securities or qualifying employer real property (as the case may be)."

in which participation is voluntary, 11/ (2) plans exempted from coverage under ERISA by Section 4(b), 12/ and by inference, (3) plans which are defined by the Department of Labor as not being employee benefit plans. 13/

As was said above, we believe that the antifraud provisions of the federal securities laws do apply to interests of employees in employee pension benefit plans. Furthermore, we believe that these provisions afford participants valuable rights and protections against fraudulent conduct on the part of plans and persons associated with plans - - rights which are not duplicated under ERISA. The Commission is aware that the choice of whether to continue the application of the antifraud provisions in this area is one for Congress to make. In commenting on this Bill, however, we wish to point out that the present proposals, if adopted could leave plan participants without adequate protection against fraud.

11/ Proposed Section 502(k)(2) would provide, generally, that participation is not "voluntary" if a person becomes a participant as an incident of employment, or as an incident in membership in a union, even though the employee may, with the consent of the plan administrator, waive participation.

12/ Section 4(a) of ERISA generally applies the coverage of that Act to any employee benefit plan established or maintained by any employer engaged in commerce, or by any employee organization or organization representing employees engaged in commerce. Section 4(b), however, generally excludes from coverage under ERISA five types of plans: (1) governmental plans, see Section 3(32) of ERISA, (2) church plans, see Section 3(33) of ERISA, (3) plans maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws, (4) plans maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens, and (5) unfunded excess benefit plans, see Section 3(36) of ERISA.

13/ These include Keogh plans having no common law employees (29 CFR §2510.3-3) and individual retirement accounts not sponsored by an employer or an employee organization (29 CFR §2510. 3-2).

II. INTERESTS OF EMPLOYEES IN EMPLOYEE BENEFIT PLANS - REGISTRATION PROVISIONS

A. Current Law

As mentioned before, the Commission has traditionally taken the position that the interest of a participant in a pension plan is a "security" within the meaning of the definitional provisions of the Securities Act and the Securities Exchange Act. At the same time, however, the Commission has not, generally, required that a registration statement under the Securities Act be filed with respect to such a security. In the case of non-contributory plans, the Commission has taken the position that the distribution of interests in such plans does not involve a "sale" or "offer of sale" of a security, for the purposes of the registration provisions of the Securities Act. 14/ In the case of contributory plans, even though the disposition of an interest to an employee may involve a "sale," the Commission has required the filing of a registration statement only where the terms of the plan permit the investment of any part of the employees' contributions in securities issued by the employer.

These administrative practices of the Commission were codified by amendments to Section 3(a)(2) of the Securities Act in the Investment Company Amendments Act of 1970. 15/ As amended, Section 3(a)(2) exempts from

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14/ *See* Op. Assist. General Counsel [1941-1944 Transfer Binder] CCH Fed. Sec. L. Rep. ¶75,195; *see*, generally, 1 L. Loss, Securities Regulation 506-11 (2d ed. 1961).

15/ Pub. L. 93-547, 84 Stat. 1413 (Dec. 14, 1970). The defendants in the *Daniel* case unsuccessfully argued that the 1970 amendments to Section 3(a)(2) of the Securities Act related only to interests of employee benefit plans in certain collective investment media. The Commission maintained that the amendments also related to interests or participations of employees in plans themselves. The Court of Appeals agreed with the Commission's analysis of the amendment. 561 F.2d 1223, 1240.

registration:

> "* * * any interest or participation in a single [trust] * * * which participation or interest is issued in connection with (A) a stock-bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954, or (B) an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of such Code * * *."

This exemption does not apply, however, to plans described in (A) or (B):

> "* * * the contributions under which are held in a single trust fund maintained by a bank or a separate account maintained by an insurance company for a single employer and under which an amount in excess of the employer's contribution is allocated to the purchase of securitites * * * issued by the employer * * *."

As a result of these amendments, all non-contributory plans which are established by corporations and which qualify under Sections 401 or 404 of the Code are exempt from registration under the Securities Act. 16/

On the other hand, the registration requirements of the Securities Act do apply to interests in certain non-corporate plans, such as "Keogh" plans for self-employed individuals and their employees, individual retirement account plans ("IRAs") and plans qualifying under Section 403(b) of the Code established for public school teachers and employees of certain charitable or educational organizations. These registration requirements also apply to a variety of corporate, contributory, individual account plans such as employee stock ownership plans ("ESOP"s) and employee stock-bonus plans.

16/ See, Letter from Securities and Exchange Commission, Division of Corporate Finance, to Gilbert Associates, Inc.; GAI-Tronics Corp., (Oct. 31, 1977), [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶81,406.

Although Keogh plans are covered by and may qualify under Section 401 of the Code, the amendments to Section 3(a)(2) of the Securities Act specifically excluded interests in Keogh plans from the exemption from the registration provisions contained therein. Such plans are established by self-employed individuals for themselves and their employees, and typically cover only a small number of participants. The legislative history of the 1970 Amendments indicates that the decision not to exempt Keogh plans was reached because of "* * * their fairly complex nature as equity investments and because of the likelihood that they could be sold to self-employed persons unsophisticated in the securities field." 17/ While sales of interests in Keogh plans are not exempted from registration under Section 3(a)(2), sales of such interests may be exempt from the registration requirements of the Securities Act as either private offerings under Section 4(2) of the Securities Act, or intrastate offerings under Section 3(a)(11) of that Act.

Furthermore, Section 3(a)(2), as amended in 1970, gives the Commission the authority to exempt offers and sales of interests in Keogh plans from those registration provisions:

> "* * * if and to the extent that the Commission determines this to be necessary or appropriate in the public interest and consistent with the protection of investors * * *."

The Commission has granted a number of exemptions by order. 18/ In these cases, the plans involved were established and maintained by large partnerships and covered a considerable number of persons. The applicants argued,

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17/ S. Rep. No. 184, 91st Cong., 1st Sess. 27, 28 (1969).

18/ See, e.g., In the Matter of Laventhol & Horwath Pension Plan for Clerical Employees and Profit Sharing Plan for Partners and Professional Staff, Securities Act Release No. 5941, 15 SEC Docket 178 (June 30, 1978); In the Matter of the Retirement and Service Staff Pension Plan of Cravath, Swaine & Moore, Securities Act Release No. 5759, 10 SEC Docket 893 (Nov. 18, 1976).

in support of the requested exemption, that their plans were indistinguishable from small corporate plans which are exempt from registration under Section 3(a)(2), and that plans such as theirs were not the kind of plans that concerned Congress when it amended Section 3(a)(2) of the Securities Act. In addition to these orders, the Commission's staff is presently drafting a rule, pursuant to the authority granted under Section 3(a)(2), to exempt from the registration provisions, interests of employees in certain Keogh plans. These actions have been influenced, to some extent, by the fact that, in cases where the Keogh plan is defined by Department of Labor regulations as an employee benefit plan, 19/ ERISA now provides some of the information to persons acquiring interests in the plan which would be included in a registration statement. 20/

Section 3(a)(2) of the Securities Act does not exempt the sale of interests in IRA's from the registration provisions of that Act, as IRA's qualify for tax deferred treatment under Section 408 of the Code, rather than Section 401. Nor does the provision of Section 3(a)(2) which gives the Commission the authority to exempt interests in Keogh plans from the registration provisions of the Securities Act extend to interests in IRAs, as that provision refers only to interests in plans having one or more Section 401(c)(1) employees (i.e., Keogh plans). The policy underlying this treatment of sales of interests in IRAs is essentially the same as that which requires special consideration

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19/ 29 CFR §2510.3-3 defines "employee benefit plan" for the purposes of Title I of ERISA to include all Keogh plans other than those having no common-law employees as participants.

20/ See, In the Matter of the Retirement and Service Staff Pension Plan of Cravath, Swaine & Moore, supra. Of course, neither the exemptive orders nor the proposed rule would exempt the interests in the Keogh plan from the antifraud provisions of the federal securities laws.

for interests in Keogh plans — that banks and others will engage in mass merchandizing of such interests directed at the large class of unsophisticated persons qualified to establish IRAs. But, it appears that bank sales of interests in IRA's are often made in connection with offerings of interests in savings accounts exempt from registration as securities issued by a bank.

More significantly, the amendments to Section 3(a)(2) preserved the registration requirements with respect to contributory, corporate plans qualifying under Sections 401 or 404 of the Code, under the terms of which an amount in excess of the employer's contribution may be allocated to the purchase of securities issued by the employer. The same registration requirements also apply to contributory corporate plans not qualifying under Section 401 of the Code whether or not the terms of such plans permit the investment of employee contributions in such securities. A number of corporate-sponsored individual account plans, such as ESOPs, are established for the purpose of acquiring securities from the employer and, to the extent that employee contributions may be devoted to this purpose, are required to file a registration statement with respect to the interest offered or sold to employees, unless some other exemption from registration is available. Registration is required in these cases because it is felt that employees are acquiring an interest in securities issued by their employer and are, therefore, entitled to the same disclosures which would be provided to other persons purchasing such securities in a public offering. 21/

21/ The Commission has tried to simplify the registration process for those employee benefit plans which are also subject to the reporting and disclosure requirements of ERISA. A major step in this direction was the revision of Form S-8, the registration form used by issuers selling securities to their employees pursuant to certain employee benefit plans. The form now provides that issuers may include, as part of the S-8 prospectus, a copy of the summary plan description prepared for ERISA, in lieu of all or part of certain items of information required by the form.

B. Proposed Amendments

As noted above, the Bill would add new Section 514(d)(2) of ERISA which would, generally speaking, provide that no interest of any employee in an employee benefit plan covered by the provisions of ERISA shall be considered to be a security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934 or of any State law regulating securities. This provision would, of course, preempt the application of the registration provisions of the Securites Act to the extent that they now apply to any such interests. The only exceptions explicitly recognized in Section 514(d)(2) are for interests in: (1) plans excluded under Section 4(b) of ERISA, 22/ and (2) voluntary eligible individual account plans. Thus the proposal would effectively amend present registration requirements to exclude all contributory plans investing in employer securities other than voluntary eligible individual account plans, and to exclude all those Keogh plans and IRAs which are defined as employee benefit plans under Department of Labor regulations. 23/ These proposals bear no relation to the issues involved in the Daniel case, and they exclude the

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22/ See note 12, supra.

23/ A limited class of Keogh plans and IRAs are not, under regulations promulgated by the Labor Department, deemed to be "employee benefit plans" within the meaning of ERISA and will not, therefore, be treated as "employee benefit plans" under the terms of proposed Section 514(d)(2). Broadly speaking, these plans include Keogh plans having no common law employees as participants, 29 CFR §2510.3-3, and individual retirement accounts ("IRAs") qualifying under Sections 408(a) or (b) or 409 of the Internal Revenue Code ("Code"), 29 CFR §2510.3-2. IRAs organized and maintained by employers or employee organizations pursuant to Section 408(c) of the Code are not excluded from the definition of "employee benefit plan," nor are IRAs otherwise qualifying under Section 408(a) or (b) or 409 of the Code to the extent that employers or employee organizations contribute to or otherwise sponsor or establish the plans, 29 CFR §2910.3-2. To the extent that the registration and/or antifraud provisions of federal securities laws presently apply to those Keogh plans or IRAs not deemed to be employee benefit plans, that application will not be changed by the Bill.

registration provisions of the securities laws from areas in which they have traditionally provided important protections for investors, while providing no correlative safeguards.

As noted above, the Commission has generally required registration under the Securities Act of interests in employee benefit plans where employee contributions may be used to purchase securities issued by the employer. Where an employee contributes his funds to a plan that uses such funds to purchase securities issued by the employer, the employee is deciding to make an indirect investment in the employer's securities. An employee in these circumstances is no different from any other investor, and his employee status should not deprive him of all material information concerning the issuer which would be included in a registration statement. 24/

The narrow exclusion from preemption accorded by Section 514(d)(2) for interests in voluntary eligible individual account plans 25/ does not, we believe, adequately preserve the application of the securities laws with respect to contributory plans which invest in employer securities. Section 407(a) of ERISA, part of the fiduciary duty provisions of that Act, generally permits the investment of plan assets in securities and real property of the employer, to a limit of ten percent of the fair market value of plan assets. Section 407(d)(3) creates an exception to this rule and allows a plan meeting the definition of an "eligible individual account plan," whether voluntary or not, to invest in such securities or real property to the extent explicitly provided for under the terms of the plan, without regard to ten percent limitations.

24/ Cf. Securities and Exchange Commission v. Ralston Purina Co., 346 U.S. 119 (1953) and see note 21 supra.

25/ See notes 10 and 11 supra, for definitions of voluntary eligible individual account plans.

Section 407(a), however, makes no distinction between employer and employee contributions. It was, presumably, enacted to reduce conflicts of interest by reducing the dependence of the plan on the fortunes of the employer, a purpose generally different from the registration provisions of the Securities Act.

While proposed Section 514(d)(2) would preserve the application of the registration provisions to voluntary eligible individual account plans, these plans represent only a small portion of the circumstances in which the fiduciary provisions of ERISA permit the use of employee contributions to purchase employer securities. The potential for abusive practices will be significant with respect to contributory plans not meeting the definition of "eligible individual account plan" contained in Section 407(d)(3), which are, nonetheless, permitted to invest up to ten percent of the fair market value of plan assets in employer securites. Moreover, the potential for abuse is particularly significant in the case of eligible individual account plans, participation in which is not deemed voluntary by the Bill, 26/ but considered voluntary for the purposes of the securities laws. All the assets of these plans may, if the plan so provides, be invested in such securities.

In addition, Section 514(d)(2) eliminates the registration requirements with respect to those Keogh plans and IRAs deemed to be employee benefit plans under the regulations of the Department of Labor. These include Keogh plans having one or more common law employees as participants and corporate or union sponsored IRAs. Although interests in small Keogh plans and IRAs may now be sold under one or more of the general exemptions from registration provided by the

26/ See note 11, *supra*, for the definition of "voluntary" contained in Section 271 of the Bill. This definition excludes some plans in which a participant does make an investment decision to contribute his own money to a plan.

Securities Act, registration may still be required with regard to interstate offerings made by banks or other financial institutions. This is the area in which the greatest need exists for the registration of such interests with the Commission, for it is in this area that the purchasers of interests in Keogh plans and IRAs are most likely to be faced with mass marketing techniques and are least likely to be able to fend for themselves.

In short, the proposed amendments to the registration provisions are in no way related to the issues raised by the Daniel case, which concerned only the application of the antifraud provisions of the federal securities laws to the interests of employees in non-contributory, involuntary pension plans. Even if Congress should determine, in response to Daniel, to deal separately with the issue of fraud in connection with involuntary, non-contributory pension plans, it should not, we believe, interfere with the present registration provisions. In the case of corporate plans, the registration provisions have traditionally been applied in a relatively narrow range of situations in which employees have, in effect, been offered and sold securities issued by their employers. For that reason, the Commission and the Congress have determined that it was appropriate to provide prospective participants with detailed information concerning the provisions of the plan or concerning the corporation establishing the plan. In the case of Keogh plans and IRAs, these provisions have usually been applied where interests in these plans are mass marketed to unsophisticated investors by banks or insurance companies. In these situations, where the provisions of ERISA do not provide an adequate substitute for the registration provisions of the Securities Act, we know of no valid reason to deprive investors of the right to adequate information necessary to an informed investment decision.

III. PROPOSED SECTION 514(d)(3): COLLECTIVE INVESTMENT MEDIA

The provisions of the Bill discussed above concern the application of the Securities Act and the Securities Exchange Act to the interests of employees in an employee benefit plan. In addition, other provisions of the Bill would substantially reduce the application of the federal securities laws to the interests of employee benefit plans in collective investment media. These proposals bear no relationship to the Daniel case, or to the issues concerning the relationship between the federal securities laws and the regulatory provisions of ERISA raised by that case.

These proposals would exempt from the definition of "security" under the Securities Act and the Securities Exchange Act interests of employee benefit plans in certain collective investment media maintained by banks and insurance companies, and would preclude the application of the Investment Company Act of 1940 to such media. These provisions are set forth in proposed Section 514(d)(3) of ERISA:

> "(3) Notwithstanding any provision of law to the contrary, an interest or participation —
>
> "(A) in a single or collective trust maintained by a bank or in a separate account maintained by an insurer, and
>
> "(B) issued to an employee benefit plan or plans described in section 4(a) and not exempt under section 4(b)
>
> is not, and shall not be characterized as or deemed to be, a security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934, or any law or any State which regulates securities, and such a single or collective trust or separate account is not, and shall not be characterized as or deemed to be, an investment company within the meaning of the Investment Company Act of 1940 or any law of any State which regulates investment companies.

The Commission is opposed to adoption of proposed Section 514(d)(3) since it would seriously disserve the policies underlying the federal securities laws, by depriving employee benefit plans, in their purchases of interests in collective investment media maintained by banks and insurance companies, of the important protections afforded by those laws. 27/ Since the proposal raises distinct issues under (1) the Securities Act and the Securities Exchange Act, and (2) the Investment Company Act, we will discuss the application of the proposals to these two areas separately.

A. Application to the Securities Act and the Securities Exchange Act

As a preliminary matter, it is important to note the distinction between interests of an employee in an employee pension benefit plan, on the one hand, and interests of pension plans in collective investment media in which pension plan managers invest plan assets on the other hand. 28/ Whatever conclusion is reached as to whether the interests of employees in pension plans are or should be treated as securities, there has never been any substantial doubt that interests of plans in collective investment media are securities.

27/ We note that proposed Section 514(d)(3) refers to "single" trusts. For the purpose of this discussion, however, we do not regard such trusts as collective investment media, since we read the exemption in proposed Section 514(d)(2) for interests of employees in employee benefit plans to extend to interests of employees in a related single trust (including a multi-employer trust) established for such plans.

28/ ERISA itself recognizes the distinction between pension plans and the media in which they invest in Sections 3(21)(B) and 401(b)(1). Section 3(21)(B) specifies that if a plan invests in any security issued by an investment company registered under the Investment Company Act of 1940, such investment shall not by itself cause the investment company or the investment company's investment advisor or principal underwriter to be deemed a fiduciary or a party in interest as those terms are defined in ERISA. Section 401(b)(1) provides that in the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of the plan shall be deemed to include such security but shall not, solely by reason of such investment, be deemed to include any assets of such investment company.

Congress recognized this in 1970 when it amended Section 3(a)(2) of the Securities Act to exempt from the registration provision of that Act interests in collective trust funds maintained by banks or in separate accounts maintained by insurance companies where the interest or participation is issued in connection with a stock bonus, pension or profit-sharing plan which meets the requirements for qualification under Section 401 of the Internal Revenue Code. In doing so, Congress stated that "as with other securities exempted under Section 3 of the Act, the amendment would not exempt the securities from the antifraud provisions of Section 17." 29/

Beyond recognizing that the sales of interests in collective investment media are securities, Congress further determined that it is not always appropriate to exempt sales of such interests to pension plans from the registration requirements of the Securities Act. The Commission had argued at Congressional hearings in 1963 and 1964 that the proposed methods for the offer and sale of interests in Keogh plan collective investment trust funds would involve a public offering of securities and thus would require registration under the Securities Act. As mentioned above, Congress accepted this view in 1970, in the amendments to Section 3(a)(2) of the Securities Act, by leaving interests in Keogh plans fully subject to the registration provisions of the Securities Act, although the Commission was given rulemaking authority to exempt such interests as it deemed necessary or appropriate in the public interest and consistent with the protection of investors. 30/ The Senate Committee, reporting out the bill which became the 1970 amendments, explained this treatment as follows:

29/ S. Rep. No. 184, 91st Cong., 1st Sess. 27 (1969).

30/ *Ibid.*

> "the amendment does not exempt interests or participations issued by either bank collective trust funds or insurance company separate accounts in connection with 'H.R. 10 plans,' because of their fairly complex nature as an equity investment and because of the likelihood that they could be sold to self-employed persons, unsophisticated in the securities field * * *." 31/

Moreover, as amended in 1970, Section 3(a)(2) of the Securities Act provides a specific, limited exemption from the registration provisions of that Act for interests in single trusts or collective trusts maintained by a bank issued in connection with a stock-bonus, pension, or profit sharing plan qualified under Section 401 of the Code, and for all interests in a separate account maintained by an insurance company issued in connection with an annuity plan qualified under Section 404 of the Code. Section 3(a)(2), however, does not exempt from the registration provisions: (1) interests issued to such plans the assets of which are held in a single trust fund or a single separate account for a single employer, under the terms of which plan an amount in excess of the employer's contribution may be invested in securities issued by the employer; (2) interests in Keogh plans; (3) interests in annuity contracts or mutual fund shares used to fund plans qualified under Section 403(b) of the Internal Revenue Code; and (4) interests in collective investment media issued to IRAs. 32/ A parallel provision is found in Section 12(g)(2)(H) of the Securities Exchange

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31/ Id. at pp. 27-28.

32/ Interests in commingled bank funds derived from IRAs are not entitled to the 3(a)(2) exemption because that section refers to plans qualified under Section 401 of the Internal Revenue Code; IRAs are given special tax treatment by Section 408 of the Code. The legislative history of ERISA supports the applicability of the federal securities laws to collective funds derived from IRAs. (See page 31 infra.)

Act, 33/ and exempts interests in such plans from the registration and reporting provision of that Act. These exemptions from registration, it must be stressed, do not apply to the antifraud provisions of the securities laws. Similarly, sales of interests in collective investment media made in reliance upon some other exemption from registration, nevertheless, are and should continue to be subject to the antifraud provisions.

Despite the basic distinctions drawn by Congress in 1970, the current proposals would preempt the operation of both the registration and antifraud provisions of the Securities Act and the Securities Exchange Act with respect to sales to all employee benefit plans covered by ERISA of interests in collective investment media. 34/ The only plans which do not fall within this class are those excluded by Section 4(b), 35/ including certain annuity plans qualified under Section 403(b) of the Internal Revenue Code, 36/ and those which do not

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33/ The exemption from registration and reporting under the Securities Exchange Act is different from the exemption contained in Section 3(a) of the Securities Act in that Section 12(g)(2)(H) omits any reference to Keogh plans and plans in which employee funds are used to purchase employers' securities.

34/ Unlike proposed Section 514(d)(2), which excludes voluntary participations in individual account plans described in Section 407(d)(3) of ERISA, from its general preemption of the federal securities laws, proposed Section 514(d)(3) contains no such exclusion from its preemption provisions.

35/ See note 12 supra. Plans exempted thereunder are: (1) governmental plans, (2) church plans, (3) workers' compensation plans, (4) certain plans maintained outside the United States, and (5) unfunded excess benefit plans.

36/ Section 403(b) of the Internal Revenue Code allows employees of public school districts and charitable organizations qualifying under Section 501(c)(3) of the Code the benefits of a special form of deferred compensation. Section 403(b) allows an employee to elect to have a portion of his income paid directly by the employer to an insurance company selling annuity contracts or to a mutual fund. The amount thus paid is not included in the employee's income for the year in which it was paid. We understand, from our reading of the provisions of ERISA defining "employee benefit plan," Section 3(3), and "employee pension benefit plan," Section 3(2), and our reading of the regulations of the Department of Labor, 29 CFR §2510.3-2 and 3-3, that some of such plans are employee benefit plans,

(footnote continued)

qualify, under Department of Labor regulations, as employee benefit plans. 37/

The enactment of proposed Section 514(d)(3) would lead to inconsistent results. First, as noted above, Congress determined to codify the Commission's view that mass merchandized interests in bank collective funds for Keogh plans are not only securities subject to the antifraud provisions of the Securities Act and the Securities Exchange Act, but also that such securities, if publicly offered and not subject to some other exemption, must be registered under the Securities Act. We do not know of any reason, related to the Daniel case or otherwise, for Congress to change that determination. Moreover, with respect to registration under the Securities Act, it is important to note that, while ERISA requires pension plans to make disclosures to their participants, ERISA generally does not regulate the disclosures which a bank or insurance company makes to a self-employed individual who wishes to establish a Keogh Plan or to a person who wishes to establish an IRA. 38/

36/ (footnote continued)

insofar as they are "established or maintained" by the public school district or the qualifying charitable organization. Depending on the extent of employer sponsorship, such plans may or may not be "established or maintained" by the employer within the meaning of these definitional provisions. See 29 CFR 2510.3-2(f); 42 Fed. Reg. 61258 (Dec. 2, 1977). In addition, many of these plans are exempted from the coverage of ERISA by virtue of Section 4(b) which exempts governmental plans, defined in Section 3(32), and church plans, defined in Section 3(33).

Under present federal securities law, insurance companies seeking to sell interests in separate accounts for variable annuity contracts in connection with Section 403(b) plans register the interests sold under the Securities Act and register the related separate account under the Investment Company Act. To the extent that the underlying Section 403(b) plans are exempt from ERISA, it is our understanding that proposed Section 514(d)(3) would preserve the present operation of the federal securities laws.

37/ See note 23 supra. These plans are, generally, Keogh plans having no common law employees and IRAs not sponsored or established by employers or employee organizations. 29 CFR §§2510.3-2 and 3-3.

38/ See discussion page 27, infra.

Second, as noted above, only certain IRAs — those organized or merchandized with the aid of an employer or an employee membership group — are deemed to be employee benefit plans within the meaning of ERISA. Section 514(d)(3) would permit banks to establish collective trust funds for assets of such IRAs, and those collective trusts would be functionally indistinguishable from conventional investment companies. Section 514(d)(3) would then permit banks to mass merchandize interests in these collective trusts without registering those interests under the Securities Act. Thus, unsophisticated persons, at whom the sales efforts of the banks would be directed, would be faced with the prospect of making perhaps the most important investment decision of their lives without the protection of the disclosure in a statutory prospectus and without the benefit of the antifraud provisions of the securities laws.

Third, Section 514(d)(3) would have particularly inconsistent results with respect to interests in separate accounts set up by insurance companies to fund employee benefit plans. As explained above, interests in separate accounts derived solely from pension plans qualified under Section 401 of the Internal Revenue Code are exempt from registration under the Securities Act by Section 3(a)(2) of that Act. Interests in such separate accounts usually consist of variable annuities, determined by the Supreme Court to be securities. 39/ Historically, most assets held by insurance companies in such separate accounts have been derived from interests sold to public school teachers plans qualified under Section 403(b) of the Internal Revenue Code, corporate pension plans and Keogh plans. The same objections, set forth above, to the exclusion of interests in Keogh plans and IRAs issued in relation to bank collective funds

39/ Securities and Exchange Commission v. Variable Annuity Life Insurance Co., 359 U.S. 65 (1959); Securities and Exchange Commission v. United Benefit Life Insurance Co., 387 U.S. 202 (1967).

from the definition of security under the federal securities laws, apply with equal force to insurance company separate accounts. That is, the interests in these separate accounts will be mass marketed to unsophisticated investors who need the protections of the federal securities laws.

Moreover, because of the way proposed Section 514(d)(3) is drafted, insurance companies could sell interests in a separate account to persons unrelated to an employee benefit plan, for which registration under the Securities Act would still be required, but interests in the same separate account if sold to an employee benefit plan would not be treated as securities, even though all the expenses of registration have been incurred and even though other purchasers are being given a statutory prospectus. A similar anomaly arises with respect to insurance company sales of variable annuities to participants in plans qualifying under Section 403(b) of the Internal Revenue Code. An insurance company may maintain one separate account for the funding of all variable annuity contracts sold to participants in such plans. It would appear that under proposed Section 514(d)(3) those interests sold to participants in plans not defined as employee benefit plans under Department of Labor regulations 40/ or in plans established or maintained by public school districts and churches would continue to be securities and, with respect to those participants, the separate account would continue to be an investment company. At the same time, however, the same interests sold to participants in a 403(b) plan established by a charitable or educational organization other than a church would not be securities and, with respect to those persons, the account would not be an investment company. 41/

40/ *See* note 23 *supra*.

41/ *See* note 43 *infra*.

The section would also to grant such collective investment media an exemption from the antifraud provisions of the Securities Act and the Securities Exchange Act. With respect to such collective investment media, ERISA provides no adequate substitute for the antifraud provisions of the Securities Act and the Securities Exchange Act. The general disclosure provisions of Part 1 of Title I of ERISA do not apply at all to the relationship of employee benefit plans to banks or insurance companies selling interests in collective investment media. That is, the provisions of Part 1 impose no disclosure requirements on banks or insurance companies at the time of such sales. Therefore, no cause of action could lie against such bank or insurance company, under Section 502 of ERISA for violation of any of the provisions of Part 1.

Moreover, at the time of the sale of an interest in a collective trust fund, a bank does not appear to be in a fiduciary relationship with the employee benefit plan, although after the consummation of the sale, the bank, as trustee, may occupy such a position. Accordingly, it does not appear that a bank may be held liable under Sections 405 and 409 of ERISA for a violation of any of the fiduciary obligations created by Part 4 of ERISA. As Section 409(b) states,

> "No fiduciary shall be liable with respect to a breach of fiduciary duty under this title if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary."

Similarly, it does not appear that the fiduciary provisions apply, at the time of sale, to insurance companies marketing interests in separate accounts to employee benefit plans.

B. Investment Company Act of 1940

Proposed Section 514(d)(3), as it relates to the status of collective investment media under the Investment Company Act of 1940, presents additional difficulties.

Under present law, an employee stock bonus, pension or profit-sharing trust which meets the requirements for qualification under Section 401 of the Internal Revenue Code, or a collective trust fund maintained by a bank consisting solely of assets of such trusts, and any separate account the assets of which are derived solely from contributions under pension or profit-sharing plans which meet the requirements of Section 401 or the requirements for deduction of the employer's contribution under Section 404(a)(2) of the Code, are excluded from the definition of "investment company" by Section 3(c)(11) of the Investment Company Act. Thus, to the extent that Section 514(d)(3) excludes from investment company status qualified single trusts or collective trusts maintained by banks, or separate accounts maintained by insurers issued to employee benefit plans qualifying under Section 401, it makes no change in present law and is superfluous. 42/

42/ There is an apparent drafting ambiguity in the construction of Section 514(d)(3). Subparagraph (A) of that section refers to an interest or participation in a single or collective trust fund maintained by a bank or in a separate account maintained by an insurer. Subparagraph (B) refers to such a participation issued to employee benefit plans described in Section 4(a) and not exempt under Section 4(b) of ERISA. However, the remainder of the sentence in the section, in effect, provides that "such a single or collective trust or separate account" is not to be treated as an investment company. Since qualified single trusts, collective trusts maintained by banks, and separate accounts maintained by insurers are mentioned only in subparagraph (A), a strictly grammatical reading would result in any single or collective trust or separate account, regardless of whether its interests are issued to employee benefit plans, being encompassed in the exclusion from investment company status in the latter part of the sentence. We do not believe that this is the intention of the drafters. We read the exclusion from investment company status proposed to be afforded by Section 514(d)(3) as applying only to qualified single and collective trusts and separate accounts which issue their interests or participations to employee benefit plans described in Section 4(a), and which are not exempt under Section 4(b).

Certain difficulties are presented, however, by the broad language of the proposed section. For example, as mentioned above, bank collective funds and insurance company separate accounts for the funding of IRAs are not presently excluded from the definition of investment company in the Investment Company Act. If a bank or insurance company offered interests to the public at large in a collective trust or a separate account for the purpose of funding IRAs, neither the individual IRA trust nor the bank collective fund would appear to be an employee benefit plan, and thus the exclusion from investment company status afforded by proposed Section 514(d)(3) would not be available. On the other hand, there are situations in which an employer may facilitate his employees' participation in IRAs, such as by means of payroll deductions. In such cases, there could be an employee benefit plan, but the only substantial legal relationships would be between the employees and the bank or the insurance company. We believe that these employees need the protections of the Investment Company Act as much as the employees who establish their own IRAs through collective investment media offered by a bank or insurance company. 43/

43/ Those protections are extensive and go far beyond the disclosure and antifraud provisions of the Securities Act and the Securities Exchange Act. For example: Section 10 of the Investment Company Act prescribes the composition of the board of directors; Section 12 restricts the ownership of certain types of securities as well as pyramiding of ownership of investment companies; Section 15 governs the approval by boards of directors and shareholders of investment advisory and underwriting contracts; Section 17 prohibits certain types of self-dealing by officers, directors, employees and certain affiliated persons; Section 18 governs capital structure; Section 22 regulates the pricing of fund shares and sales commissions charged for those shares, and Section 36 prohibits certain types of breaches of fiduciary duty.

The manner in which Section 514(b)(3) is drafted raises additional troublesome problems with respect to the investment company status of insurance company separate accounts, because that section's exclusion from investment company status is not limited to separate accounts

(footnote continued)

To the extent that banks and insurance companies, in maintaining collective investment media for IRAs, are unable to comply with particular provisions of the Investment Company Act, the Commission has full authority, pursuant to Section 6(c) of that Act to exempt them from the application of those provisions if it is necessary or appropriate in the public interest and consistent with the policy and provisions of the Act. To date, however, only two such applications, filed by banks, have been received by the Commission, and both of those applications were withdrawn before consideration by the Commission. 44/ Notably, insurance companies are presently marketing interests in collective investment media for IRAs and are conforming with the provisions of the Investment Company Act.

43/ (continued)

derived solely from assets of employee benefit plans qualified under Section 401 of the Internal Revenue Code. It is likely that banks would be prevented by the Glass-Steagall Act (12 U.S.C. 24), as interpreted by the Supreme Court, from mass merchandizing interests in their collective trust funds to the public at large. See Investment Company Institute v. Camp 401 U.S. 617 (1971). On the other hand, however, insurance companies currently mass merchandize to the general public variable annuities and variable life insurance contracts which are funded by separate accounts required to be registered under the Investment Company Act of 1940. Since Section 514(d)(3) does not, by its terms, require the separate account to be solely derived from assets of employee benefit plans, the section, read literally, would exempt from the applicability of the Investment Company Act a separate account used to fund variable annuities and variable life insurance contracts sold to the public at large, merely because some of the interests in the account are sold to employee benefit plans. Another possible reading of this section, which is equally unsatisfactory, would treat purchasers of interests in a separate account who are not employee benefit plans as investors in a registered investment company, and purchasers which are employee benefit plans as not investors in a registered investment company, even though the separate account is the same. This anomaly should be corrected; even if the Committee does not adopt the Commission's other proposals, the only separate accounts which should be excluded from the definition of investment company are those whose assets are derived solely from employee benefit plans described in Section 4(a) of ERISA and not exempt under Section 4(b).

44/ See, In the Matter of Continental Illinois Retirement Trust, Investment Company Act Release No. 9462, 10 SEC Docket 619 (Sept. 29, 1976); Colorado State Bank of Denver, File No. 812-4266.

Congress specifically considered the question of the applicability of the federal securities laws to collective investment media for IRAs when it enacted ERISA. The Conference Report accompanying H.R. 2, which was enacted into law as ERISA, stated:

> "The conferees intend that this legislation with respect to individual retirement accounts is not to limit in any way the application of the Federal securities laws to individual retirement accounts or the application to them of the laws relating to common trusts or investment funds maintained by any institution. As a result, the Securities and Exchange Commission will have the authority to act on the issues arising with respect to individual retirement accounts independently of this legislation." 45/

The Commission knows of no reason why that conclusion should now be reconsidered.

V. CONCLUSIONS

Thus, the Commission recognizes that the policy questions raised as a result of the Daniel decision, are substantial. However, with regard to the application of the antifraud provisions of the federal securities laws, the subject of Daniel, the Bill would eliminate the protections afforded by these provisions without amending ERISA to provide comparable substitutes. Moreover, the Bill would eliminate the protections afforded by the federal securities laws in areas having no relation to the Daniel decision — interests of employees in contributory and voluntary employee benefit plans, and interests of such plans in collective investment media offered by banks and insurance companies — again without providing comparable substitutes in ERISA.

Senator WILLIAMS. Thank you very much.

[Whereupon, at 12:56 p.m., the subcommittees adjourned, to reconvene at 9:30 a.m., Wednesday, August 16, 1978.]

45/ H.R. Rep. No. 93-1280, 93d Cong., 1st Sess. at p. 338.

ERISA IMPROVEMENTS ACT OF 1978

WEDNESDAY, AUGUST 16, 1978

U.S. SENATE, SUBCOMMITTEE ON LABOR OF THE COMMITTEE ON HUMAN RESOURCES, AND SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS OF THE COMMITTEE ON FINANCE,

Washington, D.C.

The subcommittees met in joint hearing in room 4232, Dirksen Senate Office Building, Senator Harrison A. Williams, Jr. (chairman, Subcommittee on Labor of the Committee on Human Resources) and Senator Lloyd Bentsen (Chairman, Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Committee on Finance) presiding.

Present: Senators Williams, Long, Bentsen, and Javits.

Senator WILLIAMS. We will come to order.

I guess everyone knows that the confusion in the room is not generated by the Human Resources Committee or the Finance Committee.

All the confusion arises out of this hearing being covered live at noon on the America Alive television show.

Our first witness this morning is the AFL–CIO represented by Bert Seidman, director, Department of Social Security.

We have an ambitious day ahead of us with many witnesses, and I know that you, Bert, were well advised of that. We hope all witnesses can keep their testimony within fairly good time limits so that everybody can be heard today.

We are grateful that you will lead off this second day of our joint hearings.

STATEMENT OF BERT SEIDMAN, DIRECTOR, DEPARTMENT OF SOCIAL SECURITY, ACCOMPANIED BY KENNETH A. MEIKLEJOHN, LEGISLATIVE REPRESENTATIVE, AFL–CIO; AND LAWRENCE T. SMEDLEY, ASSOCIATE DIRECTOR, DEPARTMENT OF SOCIAL SECURITY, AFL–CIO

Mr. SEIDMAN. Thank you, Senator.

We will indeed be brief.

With me this morning are Kenneth Meiklejohn, legislative representative, Department of Legislation of the AFL–CIO, and Lawrence Smedley who is associate director of the Department of Social Security of the AFL–CIO.

My name is Bert Seidman, and I am director of the Department of Social Security of the AFL–CIO.

On behalf of the AFL–CIO, I wish to thank you for the opportunity to present our views on various bills that would amend the Employee Retirement Income Security Act (ERISA). A longer, detailed statement is appended as well as other relevant material. I respectfully request they be included in the record of the hearings.

Senator BENTSEN. Without objection they will be included.

Mr. SEIDMAN. Most of our comments will pertain to S. 3017, a comprehensive bill that attempts to deal with many of ERISA's problems. Though we are not satisfied with some of its provisions, the bill would resolve many of the problems that have developed in the administration of the pension reform law.

Both subcommittees should take particular satisfaction in their contribution to the enactment of this landmark legislation. The AFL–CIO supported enactment of ERISA because we thought it would be beneficial to workers and their families. Like most laws, it is not perfect and does require change. Though we are dissatisfied with a number of its provisions and, particularly with some important aspects of its administration, we still feel the law is beneficial and support its basic provisions.

Let me mention some of the labor movement's concerns with the law and its administration.

ADMINISTRATION AND ENFORCEMENT

A major issue during deliberations on the ERISA legislation was whether the Labor or Treasury Department was to administer the law. The AFL–CIO strongly supported administration by the Labor Department since the law concerned itself with employee rights and benefits and only peripherally with taxes. The end result, however, was a division of responsibility between the two Departments and also establishment of the autonomous Pension Benefit Guaranty Corporation. Thus, there are and have been numerous possibilities for duplication and overlapping authority.

Actual experience under the law has shown that dual administration is not working well. Matters frequently must be redone, often several times, as the Labor and Treasury Departments attempt to resolve their differences. There is an urgent need to break the logjam in the issuing of both initial and final regulations to interpret and clarify important provisions of the law.

The Departments have made considerable progress in improving the administration of the law during the last 18 months and have recently concluded a reorganization agreement which it is hoped will improve matters even more. But there can be no real solution to the dual administration problem except administration by one agency or department of government and, in our view, ideally that agency should be the Department of Labor.

S. 3017 does not put administration in the Labor Department but it does consolidate the functions of the Labor Department, the Pension Benefit Guaranty Corporation, and most of the ERISA functions of the Internal Revenue Service into a single agency—a new Employee Benefit Commission.

We would have preferred that the consolidation take place within the Department of Labor. Nevertheless, we are prepared to go along with the bill's approach because it will do much to resolve existing problems and because it is preferable to the problems inherent in dual administration.

DANIEL CASE

We support those provisions of the bill that make clear that ERISA supersedes Federal and State securities laws to the extent that such laws are interpreted to be applicable to an employee's interest in an employee benefit plan. If the *Daniel* decision were to stand, pension plans would be subjected to still another regulatory agency, the Securities and Exchange Commission (SEC), and a new body of regulatory law. This at best would create overlapping jurisdiction with additional costs, confusion, and uncertainty and inevitably would conflict with congressional policy judgments reflected in ERISA. The result would be less, not more, effective regulations.

More importantly, the *Daniel* case would threaten to undermine the financial soundness of plans by imposing liability for retroactive compliance with ERISA standards. In short, the decision apparently would require plans to grant benefits retroactively if disclosure prior to ERISA were found to be inadequate by today's standards. The *Daniel* case also threatens existing pension plans with much litigation and large liabilities because they have made the disclosures required by ERISA but not those which the securities laws may require.

The AFL-CIO supported ERISA because we are convinced that legislative protection of pension plan participants is necessary. The injustice in the *Daniel* case could not have happened had ERISA been in effect at that time. SEC jurisdiction is unnecessary. We urge the subcommittee to approve those provisions of S. 3017 which would remove the threat of Securities Act jurisdiction.

TAX INCENTIVES

S. 3017 would permit a deduction from taxable income for employee contributions to a qualified pension plan which the plan would be required to accept. In general, the maximum allowable deduction is the smaller of 10 percent of compensation or $1,000. The allowable deduction is reduced by 20 percent of the amount by which adjusted gross income exceeds $30,000 per year.

The proposal would help very few low- or middle-income workers since most of them live so close to the margin that they would be unable to save anything or they could, at best, save very little out of their incomes for this purpose. Even if they did, they do not pay taxes or the tax rate is so low at their level of income that the deduction is of little value to them. Clearly, the percentage of families which will be able to take full advantage of this deduction will rise with income. Thus, the effect of this provision will be regressive, largely benefiting the better off who will be able to take advantage of it. Limiting the full advantage of the deduction to annual incomes of $30,000 a year or less does slightly lessen its regressive aspect. But the fact remains it will do little or nothing for the average worker.

The bill also grants tax credits to employers who initiate or improve pension plans. Only small employers are eligible for the tax credit for initiating new plans. We oppose this proposal. It would penalize those employers who have done a good job of providing pension protection for their employees and reward those employers who have done a poor job or have provided no pensions at all. The proposal also would be extremely difficult to administer for it would be virtually impossible to write regulations defining what kind of improvements would qualify for a tax credit.

In addition, both proposals would result in substantial revenue loss running into billions of dollars. Proponents of these proposals should show how this lost revenue is to be recovered or should demonstrate that the loss in revenue will not come at the expense of other more important programs.

CONCLUSION

There are many other provisions of S. 3017 which we support and some, particularly in the reporting and disclosure area, which we object to. We also have made a number of suggestions for improving the law which we would like to see included in the bill. Unfortunately, the time does not permit discussing them in this oral presentation but we urge the subcommittee to act favorably on our recommendations.

In our opinion, ERISA was landmark legislation and 4 years after its passage still stands as a major achievement. A law as complex as ERISA would be difficult to administer under the best of circumstances and problems in implementation and administration were anticipated. Divided administrative responsibility among several agencies has created serious additional difficulties. Followup legislation to deal with these problems was to be expected. Enactment of S. 3017 with the modifications we have suggested would permit major progress toward a resolution of these problems.

Thank you.

[The prepared statement of Mr. Seidman follows:]

Statement by Bert Seidman, Director, Department of Social Security, American Federation of Labor and Congress of Industrial Organizations Before the Subcommittee on Labor of the Senate Human Resources Committee and the Subcommittee on Private Pension Plans and Fringe Benefits of the Senate Finance Committee, on Proposed Amendments to The Employee Retirement Income Security Act

August 16, 1978

On behalf of the AFL-CIO, I wish to thank you for the opportunity to present our views on various bills that would amend the Employee Retirement Income Security Act (ERISA). Most of our comments will pertain to S. 3017, a comprehensive bill that attempts to deal with many of ERISA's problems. Though we are not satisfied with some of its provisions, this bill would resolve many of the problems that have developed in the administration of the pension reform law.

Both subcommittees should take particular satisfaction in their contribution to the enactment of this landmark legislation. The AFL-CIO supported this legislation because we thought it would be beneficial to workers and their families. Like most laws, it is not perfect and does require change. Though dissatisfied with a number of its provisions and, particularly with some important aspects of its administration, we still feel the law is beneficial and support its basic provisions.

Let me mention some of the labor movement's concerns with the law and its administration.

<u>Administration and Enforcement</u>

A major issue during deliberations on the ERISA legislation was whether the Labor or Treasury Department was to administer the law. The AFL-CIO strongly supported administration by the Labor Department since the law concerned itself with employee rights and benefits and only peripherally with taxes. The end result, however, was a division of responsibility between the two Departments and also establishment of the autonomous Pension Benefit Guaranty Corporation. Thus, there are numerous possibilities for duplication and overlapping authority.

Actual experience under the law has shown that dual administration is not working well. Matters frequently must be redone, often several times, as the Labor and Treasury Departments attempt to resolve their differences. There is an urgent need to break the log jam in the issuing of both initial and final regulations to interpret and clarify important provisions of the law. Important discussions have not yet been made on a number of issues many of which could have a major impact on pension funding, benefits and collective bargaining.

The Departments have made considerable progress in improving the administration of the law during the last 18 months and have recently concluded a reorganization agreement which it is hoped will improve matters even more. But there can be no real solution to the dual administration problem except administration by one agency or department of government and, in our view, ideally that agency should be the Department of Labor.

S. 3017 does not put administration in the Labor Department but it does consolidate the functions of the Labor Department, the Pension Benefit Guaranty Corporation and most of the ERISA functions of the Internal Revenue Service into a single agency - a new Employee Benefit Commission. The Commission would have the power to certify to the Treasury Department that a plan is eligible for tax qualified status and would develop policy respecting all federal laws which relate to all employee benefit plans.

We would have preferred that the consolidation take place within the Department of Labor. Nevertheless, we are prepared to go along with the bill's approach because it will do much to resolve existing problems and because it is preferable to the problems inherent in dual administration. We oppose the approach contemplated by S. 901 which would not resolve the problems of dual jurisdiction and, in addition, would give the Treasury Department responsibility over matters that properly belong within the jurisdiction of the Department of Labor.

Daniels Case - We support those provisions of the bill that make clear that ERISA supercedes federal and state securities laws to the extent that such laws are applicable to an employee's interest in an employee benefit plan. If the Daniels decision were to stand pension plans would be subjected to still another regulatory agency, the Securities Exchange Commission (SEC), and a new body of regulatory law. More importantly, it would threaten to undermine the financial soundness of plans by imposing liability for retroactive compliance with ERISA standards. In short, the decision apparently would require plans to grant benefits retroactively if disclosure prior to ERISA were found to be inadequate by today's standards. The Daniels decision also threatens existing pension plans with much litigation and large liabilities because they have made the disclosures required by ERISA but not those which the securities laws may require.

The SEC is evidently proceeding on the theory that the greater the number of laws that are piled on the other the more protection is afforded employees. To superimpose the securities laws on the regulatory scheme provided in ERISA would at best create overlapping and duplicative jurisdictions with attendant costs in confusion and uncertainty, and would result in conflicts with basic Congressional policy judgments reflected in ERISA. The result would be less, not more, effective regulation.

An actuarial study, prepared by the Labor Department on the potential liability upon pension plans which might result if the decision is upheld by the Supreme Court, estimates potential liability for all pension and profit sharing plans, depending on assumptions, at between $3.5 billion and $39.6 billion.

The AFL-CIO supported ERISA because we are convinced that legislative protection of pension plan participants is necessary. The injustice in the Daniels case could not have happened had ERISA been in effect at that time. SEC jurisdiction is unnecessary. Little good and much harm would result. We urge the Subcommittee to approve those provisions of S. 3017 which would remove the threat of Securities Act jurisdiction.

Right of Unions to Sue - Part 5, Title I of ERISA provides for enforcement by a participant, beneficiary or by the Secretary of Labor of certain rights under ERISA and/or the pension plan. It is not entirely clear, however, whether a union may sue in its own name to enforce such rights where it represents the employees involved. The right of a union to sue in its own name is extremely important since many employees would be reluctant for fear of retaliation to be named plaintiff in such a law suit. The bill should include a provision to insure that a union may sue in its own name to enforce employee rights under ERISA.

Fiduciary

Within the area of fiduciary responsibility, problems relating to prohibited transactions have been the most troublesome. Such problems are particularly difficult for multiemployer plans because there are so many parties involved and they are constantly changing.

Congress could not deal with all the existing arrangements in the employee benefits field and thus made provisions for liberal use of exemptions. Congress obviously wanted to protect legitimate actions engaged in by plans which would technically be prohibited by the Act but which could be dealt with under the exemption process. As things now stand, a myriad number of legitimate transactions prohibited by ERISA require individual exemptions. The exemption process is slow and has resulted in a backlog of exemption requests.

S. 3017 helps by narrowing the definition of party in interest to remove from that status those persons who are highly unlikely to be in a position to influence the actions of a plan or of plan officials. Though not resolving the problem, these modifications would help and we urge their adoption

Multiple Employer Trust - This provision of the bill deals with an issue which exists with respect to the scope of ERISA's preemption provision - control of uninsured Multiple Employer Trusts (METS). These organizations offer to provide employers with health and welfare benefit plans without being subject to state insurance laws. They claim to be immune from state regulation and subject only to ERISA regulation. ERISA requires funding standards for pension plans but has no such provisions for welfare plans. Thus, there has been a legal vaccum which has led to the unregulated growth of the so-called METS, a number of which went bankrupt leaving millions in unpaid claims and leaving tens of thousands of participants without coverage.

S. 3017 imposes on Multiple Employer Trusts solvency and reserve standards which the Secretary of Labor shall require by regulation. The existing situation has led to abuses and such regulation is needed.

<u>Delinquent Contributions</u> - Another needed provision would make the failure to contribute to a pension or welfare fund in accordance with the provisions of a collective bargaining agreement a violation of the law. A fiduciary, who acts in behalf of a plan and brings a successful action under this provision, would be entitled to recover lawyer's fees and other costs from the defendant. We recommend enactment of this provision which would help multiemployer plans with their frequent and difficult task of collecting delinquent contributions.

<u>Socially Useful Investment</u> - ERISA's fiduciary requirements relating to prudent investment has created a substantial amount of uncertainty regarding investment decisions and remains a serious obstacle to investment of pension funds for socially useful purposes. The AFL-CIO has long encouraged union pension funds to invest in socially useful purposes such as health facilities, housing projects, etc. We feel that even if there is a slight sacrifice in yield, it can be outweighed by the desirable social and economic benefits of such investment.

Because most pension funds are run by employers and/or delegate investment functions to bankers, investment trusts and other conservatively managed financial institutions, a somewhat anomalous situation has developed. Workers' money is being channeled into all sorts of investments which do not benefit workers or their families. While such projects may be sound from an investment standpoint, pension plan money could be utilized to provide a double benefit - income to the pension fund and investment in projects and institutions that will be to the benefit of workers and their families.

The passage of ERISA has aggravated this problem by creating a potentially serious adverse impact on socially useful investments and has made efforts to encourage this kind of investment extremely difficult. The

Labor Department has recently issued regulations which have helped clear up some of the confusion surrounding the investment of assets under the prudent man rule but which, in our opinion, do not deal adequately with this problem. The only satisfactory way to deal with it is for Congress to amend ERISA to make clear such investment is not a violation of the law.

Tax Incentives

S. 3017 would permit a deduction from taxable income for employee contributions to a qualified plan which would be required to be accepted by the plan. In general, the maximum allowable deduction is the smaller of 10 percent of compensation or $1000. The allowable deduction is reduced by 20 percent of the amount by which adjusted gross income exceeds $30,000 per year.

The proposal would help very few low or middle income workers since most of them live so close to the margin that they would be unable to save anything or very little out of their incomes for this purpose. Even if they did, they do not pay taxes or the tax rate is so low at their level of income that the deduction is of little value to them. Clearly, the percentage of families which will be able to take full advantage of this deduction will rise with income. Thus, the effect of this provision will be regressive, largely benefiting the better off who will be able to take advantage of it. Limiting the full advantage of the deduction to annual incomes of $30,000 a year or less does slightly lessen its regressive aspect. But the fact remains it will do little or nothing for the average worker.

Furthermore, this proposal would present pension funds, particularly multiemployer plans, with formidable administrative problems. The resulting cost would be at the expense of employee benefits. These administrative problems would come at the very time these funds are confronted with all the other problems of ERISA compliance.

The bill also grants tax credits to employers who initiate or improve pension plans. Only small employers are eligible for the tax credit for initiating new plans. The allowable tax credit which is on top of the normal deductions for contributions to a plan would be 5 percent of the first year cost, 3 percent of each of the following two years, and 1 percent for each of the next two years.

We oppose this proposal. It would penalize those employers who have done a good job of providing pension protection for their employees and reward those employers who have done a poor job or have provided no pensions at all. The proposal also would be extremely difficult to administer for it would be virtually impossible to write regulations defining what kind of improvements would qualify for a tax credit.

In addition, both proposals would result in substantial revenue loss running into billions of dollars annually. Proponents of these proposals should show how this lost revenue is to be recovered or should demonstrate that the loss in revenue will not come at the expense of other more important programs.

We do support the provision which forbids an Individual Retirement Account (IRA) for an owner, corporate official or stockholders with significant stock holdings. Under ERISA, employees not covered by a qualified plan have the right to set aside up to 15 percent of their earnings (but not in excess of $1500 a year) for an IRA. Such income is tax-exempt. Moreover, the employer can establish an IRA for an employee and make the contribution in the employee's behalf with the same effect. In a real sense, employers have now been given the authority to establish pension plans for themselves and favored employees without any of the safeguards against discrimination that have been a basic purpose of the Internal Revenue Code with respect to pension plans. This proposal will remove a strong incentive for a small employer to put money into IRAs in preference to establishing pension plans and to discontinuing pension plans for the same reason

Funding

Section 303 of ERISA provides for the waiver of minimum funding standards by the Secretary of Treasury. Section 304 of ERISA further provides that if such a variance is granted, "no amendment of the plan which increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits or any change in the rate at which benefits become nonforfeitable under the plan shall be adopted. . ." Thus, the granting of a variance could give an employer a "lawful" justification for refusing to bargain with the union on pension improvements and it is therefore extremely important that the collective bargaining representative of the employees involved be given notice of and the right to participate in the variance process. In this manner the interests of participants and all beneficiaries will be protected. The Subcommittee should include such a requirement in the bill.

Reporting and Disclosure

The bill revises the reporting and disclosure provisions of the law with the laudable objective of simplifying and reducing the reporting requirements of ERISA. We commend and support this effort. Unfortunately, in the attempt to achieve this objective, the bill eliminates the Summary Annual Report and allows employers to distribute updated Summary Plan Discriptions only every 10 years rather than every fifth year.

Employees who are not provided full information concerning their pension rights more often than every 10 years are simply not going to be adequately informed about their rights. We do not think it too much of a burden for employers, even very small employers, to provide employees a summary of their pension plan every 5 years. Similarly, the filing of the Summary Plan Description should be continued. It is essential that true copies of such reports be available for scrutiny by the Department of Labor and the public. Otherwise, information or materials given to participants such as the Summary Plan Description may be erroneous or deficient and possibly deprive the participants of benefits guaranteed by law.

A major purpose of this section is to reduce the paperwork of small business and we have no objection to that. But our experience suggests that it is the smaller plans that are most in need of monitoring which cannot be done effectively in the absence of such filings with the Labor Department. We suggest an alternative to the filing of the Summary Annual Report and the Summary Plan Descrpition which may be less of a burden for employers. Simply require that employers file copies of their pension and welfare plan and amendments with the Department and that such documents be made available for public scrutiny within 120 days of the statutory filing date.

The AFL-CIO is concerned that S. 3017 authorizes the Secretary of Labor to drop almost any reporting requirement at any time with the most minimal of justification. Though we are confident that the present Secretary of Labor and his staff would use this section wisely, no one can foresee what the future may bring in the way of Secretaries and Administrators. Thus, in the interest of participant protection, the Secretary should be denied this kind of blanket authority.

The AFL-CIO believes that the simplification of ERISA requirements and the reduction of burdens on plan administrators and employers should be a continuing goal of the Congress and the Department of Labor. However, lessened administrative burdens should not be accomplished by compromising participant protection.

Minimum Standards

S. 3017 makes revisions in the minimum participation and vesting rules in order to clarify and resolve some of the difficulties experienced with the minimum standards provisions of the law. These proposed changes would relieve many plan problems and help improve administration as well as expand certain participant protections. We particularly urge the Committee to act favorably on those provisions which do the following:

- Prohibits reduction in disability benefits paid under a welfare plan because of an increase in social security benifits. This prohibition already applies to retirement and disability benefits paid through a pension plan and fairness requires that this prohibition also apply to disability benefits paid through a welfare plan. This section also prohibits a reduction in pension benefits as the result of a workers compensation award. We believe such an offset violates current provisions of ERISA but believe clarification is necessary to avoid the litigation that is now developing in the courts over the issue.

- Expand joint and survivors annunity benefits by requiring either an annuity or a lump sum payment for the surviving spouse of a participant who is at least 50 percent vested and who dies before the annuity starting date. This proposal would resolve the complications caused by the present rules on electing joint and survivor coverage at the early retirement age and would improve somewhat the protection for a surviving spouse. We urge broadening of this proposal to include disabled participants who are 50 percent vested when disability occurs.

- Modify provisions covering the transfer of contributions from the jurisdiction in which the employee is currently employed to the pension and/or welfare fund in which the employee previously participated. Clarification in ERISA is needed so that such arrangements are not considered violations of the law.

- Permit plan participation on a plan year basis. Most multiemployer plans can function efficiently only if the plan computes services on the basis of plan computation years. Current regulations allow this for all purposes except for determining initial date of participation. This change allows the plan to measure a year of service for purposes of initial participation to use the first day of the plan year so long as rights and benefits are determined on the basis of all of an employee's service regardless of the date on which the employee commenced participation. The purpose is to relieve plans of the record-keeping burden which arises when participation must be measured from different dates for employees.

- Establish 125 days of service in the maritime industry as a year of service. This conforms to existing regulations but the present law has a technical error which could subject the regulations to possible legal challenges.

- Allow use of elapsed time method of measuring the year of vested service instead of 1000 hours. This service computation method is commonly used by both single and multiemployer plans and current regulations permit its continued use. However, pension lawyers feel this could be subject to challenge in the courts unless the law is clarified.

- Allow plans to use the average of several accrual rates in determining retirement benefits when more than one applies. The purpose is to tie a participant's benefit accrual for a given year of service to the maximum retirement benefit in effect during that year rather than to any one benefit formula.

- Eliminate one of the tests for determining whether multiemployer plans may stop benefits when an employee starts working again. Plans are permitted to suspend the payment of benefits while an employee is reemployed in the same industry, trade or craft and the same geographic area covered by the plan. The revision eliminates "industry" as an element separate from the other criteria to avoid difficulties which have arisen in the application of the existing rule.

Conclusion

In our opinion, ERISA was landmark legislation and four years after its passage still stands as a major achievement. A law as complex as ERISA would be difficult to administer under the best of circumstances and problems in implementation and administration were anticipated. Divided administrative responsibility among several agencies has created serious additional difficulties. Follow-up legislation to deal with these problems was to be expected. Enactment of S. 3017 with the modifications we have suggested would permit major progress toward a resolution of these problems.

Thank you very much for the opportunity to testify on this important legislation.

Statement by the AFL-CIO Executive Council

on

Pension Legislation

February 21, 1977
Bal Harbour, Fla.

The 1974 pension reform law (Employee Retirement Income Security Act), which the AFL-CIO supported, has proven beneficial to workers and their families, but it is in need of improvement. Some provisions have proven unworkable and some important aspects of its administration badly need correction.

The current dual administration by the Labor and Treasury Departments is not working well. Matters frequently must be redone, often several times, as Labor and Treasury attempt to resolve their differences.

There is an urgent need to break the log jam in the issuing of vital regulations to interpret and to clarify key provisions, which have a major impact on pension funding, benefits and collective bargaining.

Another major difficulty is that a great many legitimate and necessary practices of pension plans for the benefit of plan participants are being called into question. The law prohibits all transactions of certain kinds, but the Labor and Treasury Departments were given joint authority to grant exemptions for those legitimate practices of value to the pension plan beneficiaries.

Unfortunately, the exemption procedure is not working. Many plans are required to make painstaking, detailed, costly requests for exemptions for long standing beneficial practices. Both departments are presently bogged down with hundreds of exemption requests pending since ERISA requires individual exemptions, unless and until general regulations are issued. The net result is tremendous confusion, uncertainty and insecurity.

We are concerned about recent and expected future termination of many pension plans in declining industries. Efforts should be made in these cases for partial termination where the Pension Benefit Guaranty Corporation would assume the past service liability for workers not currently employed in order to allow the plan to continue protection for active employees and beneficiaries.

The AFL-CIO believes these problems should be dealt with as soon as possible and therefore urges the Congress to make appropriate amendments, including:

1. Placing the administration of the law solely in the Department of Labor. The Labor Department has the responsibility for protecting the welfare of workers which must be the major goal in the administration of ERISA.

2. Revising existing cumbersome machinery and authority to the Secretary of Labor to permit beneficial transactions and, at the same time, to effectively enforce prohibitions of abusive transactions.

3. Amending the law to allow for PBGC insurance for partial terminations in appropriate cases so that pension plans would continue to protect active employees and beneficiaries.

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AFL-CIO Convention Resolution

on

Pensions

Adopted December, 1977

The Employee Retirement Income Security Act (ERISA) has given workers covered by pension and welfare plans important new protections. But over three years experience has revealed the need for important changes.

Dual administration by the Labor and Treasury Departments is simply not working. Matters frequently must be redone, often several times, as the two departments attempt to resolve their differences. The result has been unsatisfactory administration and delay in issuing regulations to interpret and clarify some of the most important provisions of the law.

Studies of the Pension Task Force and recent reports have made clear the need to protect state and local government retirement systems. There are no prospects that current inadequate protection of the pension rights of state and local government employees will improve without effective federal action. Congress should provide for public employees the same range of pension protection it has given to employees in private industry.

In order to assure equitable and effective pension protection for all workers, we urge appropriate amendments, including:

1. Major responsibility for the administration of the law should be placed solely in the Department of Labor.

2. Existing cumbersome administrative machinery should be revised to provide the Secretary of Labor with authority to permit beneficial transactions, and, at the same time, to effectively enforce prohibitions of abusive transactions.

3. Legislation should be enacted by Congress to provide effective protection for the pension rights of state and local government employees.

4. The law should be amended to correct statutory defects revealed during the implementation period and to clarify ambiguous language which pose the danger of harmful interpretations and court decisions.

5. Termination insurance should be changed to expand the benefits guaranteed to include partial terminations, and to encourage the continuation of plans.

Congress should exercise care to insure that controversy over regulatory, administrative and legislative problems does not serve as a smokescreen for those who would try to undo the important gains of pension reform.

AFL-CIO Convention Resolution

On

Investment Programs for Union Pension Funds

Adopted December, 1977

WHEREAS, Pension funds are the single largest holders of corporate stocks and bonds, and the assets of pension funds are measured in billions of dollars, and

WHEREAS, Two-thirds of all workers in the private sector who have pension plans are covered by negotiated plans, and

WHEREAS, The cyclical swings of the construction industry, which impose a severe hardship on members of the building trades, are intensified by government fiscal and economic measures which artifically reduce the capital funds required to finance needed housing, social, commercial and industrial building, and

WHEREAS, To offset such government action requires that there be a large and steady flow of capital into the mortgage investment field, and

WHEREAS, It has been the policy, throughout the years of many labor organizations to invest their funds and to encourage the investment of funds by related Pension Plans in construction and mortgage loan programs. This investment has historically given to such funds both an adequate return by way of income and the required high degree of protection and security found in conventional guaranteed mortgages; therefore, be it

RESOLVED: That the substantial financial power of AFL-CIO unions and negotiated pension plans be entrusted to financial institutions whose investment policies are not inimical to the welfare of working men and women, and be it further

RESOLVED: That to vitalize national programs to provide U.S. and Canadian citizens with the houses, schools, hospitals, factories, stores and other construction needs for a growing population -- and at the same time consistently provide jobs for our members -- we urge the AFL-CIO and its affiliated unions when

Page 2

investing their funds to consider participation in guaranteed mortgage funds which are designed to stimulate union construction, and further urge the trustees of related pension funds to allocate at least ten percent (10%) of the monies available for investment in appropriate government guaranteed mortgage investment portfolios or individual regular guaranteed mortgages, and be it further

RESOLVED: That at the same time we recognize that many local unions and their related funds do not have the financial resources to meaningfully participate in or administer mortgage investments on an individual basis. We, therefore, particularly recommend to these organizations such programs as the AFL-CIO Mortgage Investment Trust, established by the Executive Council of the Federation in 1964, to provide a secure investment program for all affiliates and qualified labor-management pension plans. The trust is a fund for investment in federally-insured or guaranteed construction loans and term mortgages. All of the trust's investment activity has been in projects built by union craftsmen, be it further

RESOLVED: That the AFL-CIO consider the enunciation of such a policy for all of organized labor and explore the feasibility of legislation which would achieve the intent of this resolution.

Senator WILLIAMS. Thank you very much, Mr. Seidman.

We are now in a period where the rate plan of terminations has slowed, is that right?

Mr. SEIDMAN. I believe it has slowed somewhat from what is was a year or so ago.

Senator WILLIAMS. A couple of years ago, last year, we had what appeared to be to some an alarming rate of terminations.

What do you think was the basic reason for the higher rates of termination of pension plans?

Mr. SEIDMAN. The studies showed that the basic reason for termination of pension plans was the very severe recession that took place during the period that just came after the law got underway. There were other reasons, of course, sometimes in combination with that fundamental reason, sometimes alone, but that was the most important reason for these terminations.

There were some plans undoubtedly that terminated because of the additional expenses involved in ERISA, particularly in light of the economic situation.

Senator WILLIAMS. What were the basic problems with ERISA that led to terminations, in your judgment?

Mr. SEIDMAN. The basic problems with ERISA were twofold. First, the additional problems and expenses involved in reporting and disclosure and, second, the additional expenses involved in meeting the standards of ERISA.

Senator WILLIAMS. Now in S. 3017, we are seeking ways to make the creation of private pension plans more desirable, more attractive. That is why we, for openers, really included these tax incentives.

You have reservations about them?

Mr. SEIDMAN. We have reservations about them. We think they would create inequities which we would find it very difficult to justify.

After all, what this means is that a firm which established a pension plan, which did not have one before, would have certain tax advantages over a firm with practically the same economic circumstances, which already had a pension plan, and therefore would not be eligible for credit.

Take another example. A plan which existed, but was at a very low level, put in some improvements. They get the tax credit. Under the very same economic circumstances, another firm did not have those benefits already in its program and it would not get a tax advantage.

So it seems to us that this would create inequities and generally speaking we are opposed to using the tax laws in those directions.

If there were reasons why there should be subsidies, then they ought to be out in the open, and they should be made through the ordinary expenditure route rather than through a tax credit.

Senator WILLIAMS. Have you and the people in your department been thinking of ways to make the creation of a private pension plan desirable so that we could create an atmosphere that will see more coverage through private pension plans?

Mr. SEIDMAN. Well, in the first place, we think that if we have overall economic prosperity and full employment, that this will encourage the development of pension plans.

Second, when workers organize into unions they generally negotiate with employers for pension plans, and we think that anything that will encourage the organization of workers into unions will result in more workers being covered by pension plans.

Senator WILLIAMS. Thank you.

Senator Bentsen?

Senator BENTSEN. Mr. Seidman, I appreciate your testimony this morning.

My concern is that we end up with triple jurisdiction if we go to a new agency to administer ERISA. In the survey of the General Accounting Office as to the reasons why pension plans went out of existence after the enactment of ERISA, I think that the things that you have cited were proven to be the case.

A primary reason was the recession.

Another reason was the increase in cost of funding.

The one you did not cite was the great increase in paperwork.

Now through our Subcommittee on the Finance side we passed legislation through that committee—S. 2352. The administrative has now presented a reorganizational proposal that would accomplish much of that which we have in S. 2352 in dividing that jurisdiction.

My hope would be that we give a serious effort to seeing if we cannot continue to use the experienced personnel that we have in the Labor Department and the Treasury Department.

I would hope that we give the reorganization a fair trial. If that does not work, then give consideration to a single agency to accomplish it.

I am afraid if you establish a new agency, you must set up many district offices across the country and start out with new employees. We would create a lot of confusion again that we had with the orgination of ERISA.

Would you care to comment on that?

Mr. SEIDMAN. Yes; I would like to comment on it.

In the first place, I think we are going to have the trial you suggest in any case, because if the reorganization plan does go into effect, and we have incidentially endorsed that reorganization plan as an interim measure, then we will have a trial of the division somewhat along the lines of what you recommended.

Senator BENTSEN. I just do not want to condemn the trial ahead of time.

Mr. SEIDMAN. At the same time we do not see that as being a long-term solution. If it turns out to be much better than we have any reason to anticipate, we will be the first to be very happy about it.

This is not what we would expect. We do not expect the legislation to establish the single agency will be enacted at the present time. I think everybody agrees that if it is enacted, it will be enacted in the next Congress, and therefore there will be a trial for the continued dual jurisdiction with a new division of responsibilities.

Congress can take account of that, and all the rest of us can when the legislation really comes to a head in the next Congress.

Senator BENTSEN. I do not see anyone suggesting that we take away from the IRS the responsibility of checking into the reasonableness of tax deductions made by business to the pension system. By the same token, we should not take away from the Labor Department, the responsibility to see that we do not have any union abuses in that kind of situation.

I think you would end up, if you created a new agency with triple jurisdiction and have even more problems than you have now.

My concern is that we do not condemn ahead of time this trial period, that we give it a full effort and a bonafide effort, and I so advised Treasury and Labor yesterday that they are on trial, and they come up with a number of things that they are doing in trying to cut back on competing jurisdictions, and amount of paperwork that is involved.

Mr. SEIDMAN. As I said, we have endorsed the reorganization plan as an interim measure, and as far as the proposal in S. 3017 is concerned, we think it is an imaginative approach which would set up a single agency, but in a way in which the other two departments would be involved, in ways that we think would be appropriate, through the liaison that it establishes, and therefore we think this is an approach that as of the present time, is the best one.

We are prepared to see how the reorganization plan turns out.

Senator BENTSEN. I have no further questions at this time.

Senator WILLIAMS. Thank you.

Senator Javits?

Senator JAVITS. Is it not a fact that we do not want to prejudge our scheme either in S. 3017?

That is our plan. An alternative is essential. This is a divided and somewhat contentious jurisdiction, and therefore we do not want to prejudge the plan which we have proposed.

Mr. SEIDMAN. Senator, we have been skeptical about the idea of dual jurisdiction even before the enactment of the law. We would have preferred, as we said in our testimony, that the Labor Department be the single agency which administered the law.

But we do not think that that is feasible. We agree with the conclusion that you and Senator Williams have reached and at the moment we think that the approach which you have suggested is the best feasible one, and we have so indicated in our testimony.

At the same time, we have endorsed the reorganization proposal as an interim measure, and we are prepared to see how it works out.

Senator JAVITS. That has been our policy, too.

Senator Williams and I have accepted the interim proposal and allowed the administration to give us its long-term recommendations based on experience.

But I wish to be wary of being bound by what the Finance Committee does. I cannot forget that the Finance Committee completely gutted and dismantled ERISA until our savior, Lloyd Bentsen, came along and with some allies, like Senator Nelson and others, finally persuaded Chairman Long that this was the way to go.

I am grateful for that intercession. But I cannot forget what we have been through. Therefore, I do not want the situation crystallized either way.

I am very grateful for the support of the AFL-CIO.

Would you agree with me that a retirement income policy for the United States which will include every aspect of retirement, to wit, social security, private pensions, health insurance, and any other aspect of the comfort and security of retirement should be one of the proper objectives of this Committee and of our country?

Mr. SEIDMAN. We certainly do.

We think that the approach with the modifications that we have suggested on the bill which you have put before us is one which we support.

Senator JAVITS. Would you agree with me that it is highly significant that whereas the reports were that we had 35 million workers subject to private pension plans with about $200 million in assets when this law began to take effect almost 4 years ago, we now have, according to the Labor Department yesterday, 39 million workers with $264 billion in assets. Does this not go a long way to counter the propaganda that ERISA had been a disaster to workers covered by pension plans, that pension plans have been terminated, and that we have gone backward instead of forward?

Mr. SEIDMAN. We have never given credit at all to that propaganda, Senator. We have felt right from the start that there was a great exaggeration of the effect of ERISA on pension plans in the negative sense.

We thought there was a very good impact in the positive sense.

The benefits to workers under ERISA even during this early stage, and this will be much more true as time goes on, far outweighed the problems that arose which as I have already indicated, we think arose primarily because of economic conditions of the country, and not because of the provisions of ERISA.

Senator JAVITS. Nonetheless, plans have overall grown greater in terms of people covered and resources involved. Is that not so?

Mr. SEIDMAN. That is correct.

Senator JAVITS. Now, is it the policy of the AFL-CIO that private pension plans are to be encouraged, that business is to be encouraged to bring in more workers under them, and that they are to remain private?

Mr. SEIDMAN. Our policy is that we would like to see as many workers as possible covered by pension plans and that the pension plans would remain private.

At the same time, we are also in favor of certain improvements in social security which covers most of the population.

Senator JAVITS. I see nothing whatever inconsistent in that policy.

Mr. SEIDMAN. Nor do we, Senator.

eSnator JAVITS. Last, and very importantly to me, 's the Federation, generally speaking, satisfied with the ways in which the management and direction of private pension plans are now set up where there are workers and management or management alone, or whatever the case may be based upon the origin of the plan?

Generally speaking, does the Federation feel there are any major deficiencies which have shown up in the way in which pension plans are being managed?

Mr. SEIDMAN. Well, of course, it varies a great deal from one plan to another. It is very difficult to draw generalizations, but there are problems that we see in the offing in terms of the adequate funding of plans, in the light of demographic changes that are taking place in the country and so on, and therefore we think we have to be very watchful over this whole area, as any area which relates to retirement, because we do think that the problems are very complex and some of them are already being manifested in some plans.

Senator JAVITS. I realize that is so for any organic and living enterprise like this; but generally speaking, do we need to change any laws about that in your judgment?

Mr. SEIDMAN. No. We are not advocating any change in ERISA, which is the fundamental law governing the pension plans, other than those which you have included in the legislation.

Senator JAVITS. Now, one other thing that Senator Bentsen is very interested in and which I am interested in. You are probably not in a position to reply now, but I would like a considered reply.

There has been considerable discussion about whether there should be some standard of social usefulness with respect to private pension plan investments, as for example in housing.

That is a very serious question. It also involves questions of concentration. Senator Bentsen will correct me, but as I recollect, one of his measures relates to a limitation on the percentage of resources which a pension manager may put into any one enterprise. Is that correct?

Senator BENTSEN. That is correct.

Senator JAVITS. I think it would be very useful if you would be kind enough to study that situation, what Senator Bentsen and others have recommended, and give us the considered view of the Federation on that subject.

Mr. SEIDMAN. We have included in our longer statement, Senator, some comments which go to at least some of the questions you are raising.

That is to the whole question of social investment, whether it is appropriate for pension plans. I believe that it is.

At the last day of the AFL-CIO convention last December the convention adopted a resolution which called upon our affiliates to do what they could to invest in ways which as the convention put it, were not inimical to the interest of workers and specifically urged that additional investment, when appropriate in housing for low- and middle-income workers, and support for our own AFL-CIO mortgage investment trust, which is aimed at precisely that direction.

So that generally speaking, we are sympathetic to that approach, and we are, as a matter of fact, asking that you consider the inclusion of appropriate provisions in the legislation along those lines.

Senator JAVITS. Would you have a look at Senator Bentsen's bill——

Senator BENTSEN. S. 285.

Senator JAVITS. And let us have any views on that, or in both matters, your pragmatic suggestions, whatever you would like to see written into legislation. Would you do that?

Mr. SEIDMAN. We would be glad to do that.

Senator JAVITS. Say in 10 days.

Mr. SEIDMAN. Yes.

Senator JAVITS. Thank you very much.

Senator WILLIAMS. You did include that resolution?

Mr. SEIDMAN. Yes; we did.

All our recent policy statements in this area have been appended to our testimony.

Senator WILLIAMS. The investment aspects of the resolution go to more than housing, as I see it. Is that right?

Mr. SEIDMAN. It goes to housing in particular, but it also goes to the negative side in that we are asking our affiliates not to invest in firms that are inimical to the interests of workers.

We also adopted, our executive council adopted, a statement with respect to economic enterprise in South Africa, and we are looking into that question, as well.

Senator WILLIAMS. Senator Bentsen.

Senator BENTSEN. Mr. Seidman, my concern is with the concentration of investment in a particular corporation, for example, by a pension fund.

What has happened is some of the things that where they have supposedly a division between their trust department and their commercial department, but that wall has leaked from time to time. We had evidence before our committee when you see its bank and trust department invest 15 or 20 percent of pension assets of a particular trust fund in a particular corporation, they cannot help but have some influence as to the policies of the corporation.

It is giving me a great deal of concern that they are not truly serving the objective of the pension in giving full diversification and safety to that pensioner.

That is what S. 285 points to.

Now, by the same token. I have some concern that if you will start using a pension fund for such objectives, I think the obligation is really to that pensioner to see that he has safety and that those funds are going to be there waiting for him when he retires.

We had a great deal of testimony on the first point. We did not get into the question of social objectives, there was testimony showing there were cases where there appeared to be a conflict of interest between the bank's commercial department and what is happening in the trust department in servicing a pension fund.

I would appreciate your taking a look at this.

Mr. SEIDMAN. We would be glad to comment on S. 285.

[The information referred to follows:]

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

EXECUTIVE COUNCIL
GEORGE MEANY, PRESIDENT
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August 17, 1978

Honorable Harrison A. Williams
Chairman
Subcommittee on Labor of the Senate
Human Resources Committee
Suite 352
Russell Office Building
Washington, D.C. 20510

Dear Senator Williams:

When we testified on August 16, 1978 on pension legislation, Senators Bentsen and Javits raised questions concerning AFL-CIO policies on the investment of pension funds. We were specifically asked to submit at a later date our positions on S. 285, a bill which Senator Bentsen had introduced but which was not specifically under consideration in the hearings.

The bill attempts to prevent excessive concentration of the investment of private pension funds in a relatively small number of corporate stocks by imposing investment limitations on large pension fund managers and by modifying the prudent man rule to encourage investment in small business and higher risk ventures. The bill proposes to accomplish these objectives by:

1. Imposing a tax penalty on any pension fund of $1 billion or more which holds more than 5 percent of the outstanding stock of any security with respect to its aggregate discretionary pension assets. The tax penalty would equal 5 percent of the excess holdings and would increase to 100 percent of the excess if the manager failed to dispose of the excess within 180 days. The 5 percent limit would not apply to investments in companies with a capitalization of less than $150 million.

2. Modify the prudent man rule to allow pension managers to invest 2 percent of a plan's assets in companies with paid-in capital of less than $25 million and relieve a fiduciary from liability with respect to the riskiness of these investments.

We strongly sympathize with the bill's first objective to prevent the concentration of holdings of any one security by large institutional investors. Of the roughly 4000 trust departments in the United States, only 7 of them manage 38 percent of all bank-managed pension assets, and over 17 percent of all pension assets in the United States. Thus, there is a clear need for efforts to avoid too much dominance over securities and control of the economy by certain pension fund managers.

Though the bill's objective is admirable, we feel the specific mathematical limitations might be counterproductive. Instead, we believe greater flexibility should be given to the Department of Labor in carrying out such an objective. Arbitrary formulas are no substitute for independent financial analysis and judgments. For example, if the bill became law, managers holding 5 percent of one company's stock could make only one decision - sell the stock no matter how attractive the outlook of the stock appeared to be.

We have serious reservations about the second proposal. If ERISA has shut off the flow of capital to small or venture capital firms because of a great deal of uncertainty as to what is prudent, we believe there are better ways to deal with the problem than by totally relieving a fiduciary from liability with respect to investment risk for a percentage of the pension fund assets. In large funds, a small percentage can amount to a very large sum of money in absolute terms.

Since the introduction of the bill, the Department of Labor by regulations and advisory opinions has clarified the prudent man rule so that the "relative riskiness of a specific investment or investment course of action does not render such investment or investment course of action either per se prudent or per se imprudent" and "thus, although securities issued by a small or new company may be a riskier investment than securities issued by a 'blue-chip' company, the investment in such a company may be entirely proper under the act's prudent rule."

While we do not want to restrict pension plan investment to "blue-chip" corporations, we think the regulations the Labor Department has announced will encourage diversity of investment without permitting trustees to invest in unacceptably speculative investments which would appear to be possible under S. 285. As I stated at the hearing, we also place a high priority on encouragement to investment in socially desirable projects such as low and moderate income housing, health facilities, etc. provided such investment does not jeopardize the interests of pension plan participants and beneficiaries.

Sincerely,

Bert Seidman

Bert Seidman
Director
Department of Social Security

BS:sra

Mr. SEIDMAN. With respect to the point you just made, Senator, I would just like to make three points:

The first is, that we would be opposed to policies in the investment of pension funds which result in effect in increasing the concentration of control over American industry.

Second, we think that putting a too large portion of particular funds into particular corporations is not in the interest of the participants and beneficiaries of the fund.

Third, while we do favor legitimate social investment, we favor it only when it can be done without injuring the interests of the participants and beneficiaries of the fund, and that would mean that each proposal would have to be looked at very carefully from both points of view.

Senator WILLIAMS. Gentlemen, thank you very much.

Mr. SEIDMAN. Thank you.

Senator WILLIAMS. Next we have Karen Ferguson, director, Pension Rights Center.

Proceed in any way you wish, Ms. Ferguson.

STATEMENT OF KAREN W. FERGUSON, DIRECTOR, PENSION RIGHTS CENTER, ACCOMPANIED BY JAY W. TOWER, STAFF ATTORNEY

Ms. FERGUSON. Chairman Williams, Chairman Bentsen, I am Karen W. Ferguson, director of the Pension Rights Center.

With me is Jay W. Tower, the Center's staff attorney.

The legislation pending before the subcommittees contains extremely important provisions to expand the pension protections of American workers and their families. At the time we wrote our prepared statement we were under the impression that none of these provisions stood any chance of enactment this session and the only provisions that were under active consideration by the subcommittee were those that would have had the effect of overturning the *Daniel* decision; denying workers important information about the operation of their plans; eliminating certain rights of participants in multiemployer plans; doing away with the protection of ERISA's "year of service" rule; and approving the executive reorganization plan to split the administration of ERISA.

We have now been advised that we were misinformed, that it is not your intention merely to report out a "pension industry relief" bill. Accordingly, with your permission, I would like to depart from our prepared statement to discuss those provisions of the bills considered by the subcommittees that would expand pension rights, before turning to the provisions that would dramatically and, we believe, unconscionably, cut back on those rights.

The principal inequities of the private pension system are, as you are aware, that half the private work force is not covered by private pension plans; that of the half covered by private plans one-third to one-half will receive nothing from their plans; that many of those who do receive benefits will get very little and the value of what they will get will too often be eroded by inflation; and, finally, that benefits are too often denied to dependent widows.

The provisions of S. 3017 addressing these problems represent significant efforts to remedy many of these inequities.

We fully support the provisions in S. 3017 for preretirement survivors benefits. Homemakers count on and desperately need this protection. At page 2 of the memorandum attached to our prepared statement we include an excerpt from the most recent of the many letters we have received on this problem.

We fully support the cost-of-living study proposd in S. 3017. The question of how to adapt a fixed benefit system to a time of inflation is of critical importance and deserves careful analysis.

The provision in S. 3017 for employees contributions to qualified pension plans recognizes that the majority of working men and women do not stay on their jobs for the 10 years they typically need in order to get a right to a pension. This, together with the LERA proposals, are important stopgap measures to help some of the people who can afford to save for retirement. These provisions, however, do nothing for the people most in need of retirement income. The only realistic solution for these people, the vast bulk of our workforce, is reduced vesting.

S. 3017 provided for expansion of pension plan coverage through the use of special and master prototype plans. We believe that these plans (which carry with them a slight administrative cost) should be supplemented by the simplified pension plans provided for in S. 3193 (which involve no administrative costs). In this connection we applaud the Treasury's recent decision to introduce a new, simplified retirement income plan for employers purchasing U.S. Retirement Bonds for their employees.

I would like to turn now to the provisions of pending legislation which have been the primary focus of concern at these hearings and which are the subject of our prepared testimony.

S. 3017 contains provisions that would prevent the U.S. Supreme Court from deciding the landmark case, *Daniel* v. *International Brotherhood of Teamsters.* These provisions have been included in the bill at the urging of unions and companies who claim that if the Supreme Court upholds Mr. Daniel's claim that he was defrauded within the meaning of securities law, it will result in tremendous liability, burdensome disclosure, and interference with collective bargaining.

Every argument that the unions and companies are urging before Congress has already been made to the Supreme Court. Lengthy briefs have been filed on these points and oral arguments are scheduled for the fall.

There is no reason to believe that the Supreme Court will not give full consideration to the arguments presented by the unions and companies or that the decision of the Court will not reflect a reasonable and balanced consideration of the issues. In fact, it can be stated categorically that the Supreme Court will not issue a decision that will destroy the private pension system, impose burdensome disclosure, or interfere with the Nation's collective-bargaining processes.

What the unions and companies are asking you to do is almost unprecedented. We have found only one case where Congress took jurisdiction away from the Supreme Court after it had agreed to hear a case. That was *Ex Part McCardle*, a habeas corpus case decided more than 100 years ago immediately after the Civil War.

If Congress wants to act after the Supreme Court has decided the case, that is another question entirely—and one that can be addressed at that time. But surely Mr. Daniel is entitled to his day in court. We urge you not to take this extraordinary action.

All of the pending bills have provisions that would seriously cut back on the reporting and disclosure requirements of ESICA. We oppose enactment of these provisions not only because they would undermine effective enforcement of the ERISA fiduciary standards, but because they are unnecessary. These provisions have already had their intended effect.

In response to the provision in S. 901 that would eliminate the statutory list of information required to be included in annual report forms, the Labor Department undertook a thorough review of complaints about the statutory requirements and proceeded to modify those requirements in accordance with the suggestions received.

In response to the provision in S. 3017 that would eliminate summary annual reports, the Labor Department has undertaken to draft a meaningful form that will provide participants with essential information about the financial operation of their plans without burdening plan administrators. As you are aware, this form will be issued in proposed form in a few weeks.

In response to the provision in S. 3193 for cyclical filing, the Labor Department and IRS have announced that they intend to adopt a cyclical filing arrangement. All interested parties will have an opportunity to comment when the arrangement is proposed.

It is important to remember that the annual reporting forms are the only mechanisms available for enforcement of the ERISA fiduciary standards. As we have noted before, financial reporting is nothing more than a trade off, an extremely modest one at that, for the right of plan sponsors to retain a degree of control over plan assets and to delay full funding of their plans.

Until plans are willing to give up all control of plan assets and to fund their plans completely, there will be a need for annual reporting requirements. Moreover, the Labor Department, as it readily concedes, cannot do the job alone. The Department cannot enforce ERISA without assistance from the public. Without participant initiated leads, some of the most serious abuses now under investigation would never have been uncovered.

In the memorandum attached to our prepared statement we discuss the S. 3017 proposals to suspend the benefits and average the benefit accrual rates of participants covered by multiemployer plans. If these proposals are under serious consideration, they deserve separate hearings with full participation by the retirees and workers who will be affected.

In that memorandum we also discuss our opposition to the proposed legitimization of the elasped time rule.

Finally, we oppose divided jurisdiction. It is doubtful that it will speed up either the exemption or the regulation issuing processes. In fact, the collective bargaining veto arrangement will guarantee delays.

The delays will be no less and could conceivably be worse than those experienced by the agencies in connection with the hour of service and elapsed time rules.

Most important, divided jurisdiction will stop the impetus for a single agency. If the reorganization goes through, our prediction is that there never will be a single agency or a national retirement income policy.

Thank you.

I would like to submit my prepared statement and memorandum for the record because it contains a great many other details that I have not been able to cover.

Senator WILLIAMS. Without objection it will be included in the record.

Would you like to discuss in further detail the single agency approach?

Ms. FERGUSON. We discuss at some length in the memorandum, the specific proposal in S. 3017, which we do have some problems with.

There are a number of reasons for a single agency, very important reasons. Although there is much talk about duplication of effort by Labor and the IRS, we have been observing them for 2½ years, and we notice most of the problems are internal problems.

They are having problems within the Labor Department and they are having problems within IRS, rather than in overlap between the two.

The problems have arisen because the legislative history suggests one interpretation and the agencies are under separate pressures to do something else.

We feel that the proposed agency should be a truly independent agency, for no other reason than the Labor Department has the traditional role to represent the interests of organized labor and that the IRS has the revenue raising function and has taken a legalistic approach to the interpretation of regulations. There is no one with any obligation, any mandate, to truly protect the interests of American workers.

We feel a single agency with such mandate could serve that function and could also get going onto the next step of developing the national retirement income policy that Senator Javits spoke about.

Senator WILLIAMS. You made the point that many workers are not in covered employment long enough to satisfy the present vesting periods, and therefore the answer to this in your judgment would have to be an acceleration of vesting; vesting in a shorter period of time.

You know, of course, the actuarial problem of funding through a shorter period.

Has the Pension Center devoted much of its time and talent to thinking through portability of a pension right to go with the employee through various jobs so that there will be a contribution that will support a pension, without reducing the years for vesting?

Ms. FERGUSON. We have had several thoughts on this.

First, we would like to note, as I think I mentioned in earlier testimony, it has been said that every Western European country has 5-year vesting or better.

We would think it would be appropriate for either subcommittee or both to request a study of vesting in those countries, how do they manage it?

Senator WILLIAMS. Most of them have government support for the funds.

Ms. FERGUSON. That may be one answer.

I think we need to know that. I think it is important to enter the experiences of the countries into the calculus.

In terms of reciprocity or portibility, we have advocated and nobody seems to have picked up on it the suggestion that as a beginning, thought ought to be given to mandating reciprocity at least within international unions.

We have received some tremendously disturbing letters from employees who worked for different locals of international unions and then lost out.

In terms of reciprocity or portibility, we have advocated and nooften the individual has the wrong service with the home plan or the wrong future service, past service or what have you.

It seems to me that the biggest argument against reciprocity arrangements was administrative problems inherent in these arrangements.

Certainly, it might be possible to begin on an international union level because they do talk to each other. That is a possible avenue.

Another important area was suggested by the State of Minnesota. They have a reciprocity law for their construction workers.

Some question as to whether that has been preempted by ERISA, but they maintain it has not. And on a State-by-State basis, some element of reciprocity, whether intra-industry or inter-industry, might be possible, if Congress sanctioned that kind of experimentation.

The other area is the area of portability which means after you get vested, can you carry it with you?

On that we have suggested a number of times the very minimum that people ought to be able, if they want to, if it is economically worth their while, to roll over their vested credits over into an IRA, simply because in the case of a young worker and very mobile worker, he or she will be better off doing that than leaving a benefit frozen in something they were earning when they were 30 years old or 40 years old.

But in terms of the big picture there is a lot of thought to be done, and I think a lot of studies need to be done in this area.

Senator WILLIAMS. Have you ever expressed any of these portability concerns to Mr. Georgine?

Ms. FERGUSON. I assume he is listening now.

Senator WILLIAMS. You ought to meet him. He is right there. Senator Bentsen?

Senator BENTSEN. Ms. Ferguson, and Mr. Tower, I am pleased to see you before us again.

You testified before my committee over on Finance.

Let me state to you what I stated to some of the other witnesses about creation of a new agency. There is a strong feeling in this country that we do not expand this bureaucracy and we do not add more employees. But I do not see anyone that is proposing, unless you are, that we take away some of these functions that the Labor Department now has and that TRS now has, even if you created a new agency.

For example, when you get into the question of evaluating the deductions by business for pension contributions, as to whether or not there is a true deduction, a valid one, everyone I have seen still says that would be an obligation of the IRS, and the checking of certain possible abuses by unions would still be the obligation of the Labor Department.

In addition to this, I do not see all of the IRS people and Labor people that would be needed to staff the new agency transferring, so I think you are talking about a lot of new employees.

I think it would take a long time before we have an effective new agency.

Now, I do not want to preclude a new agency because as I said earlier, I think that the Labor Department and Treasury will be in effect on trial during this interim period.

Neither do I want to condemn this trial. I think we should give it a full good faith effort. If it is not effective, then I am willing to evaluate or reevaluate my position on a new agency.

I am concerned you are going to end up with a triple agency.

Ms. FERGUSON. That is certainly not our conception of it. Our conversations with people in those two agencies, and in other agencies, there is a recognition that if a single agency magically occurred tomorrow, that all of those people who are involved in employee benefit plan functions would transfer to this new agency. It would, particularly at IRS, give considerably increased status, I think, to some of the technical people.

What is happening instead is that there is reorganization going on, at least within the Labor Department. New positions are being created, jobs are being shuffled around, and what is going to happen, we fear, is that there is going to be a very real entrenchment, empire building, what have you, which will be very hard to shake people out of.

You have an extraordinary coalition of groups pushing for a single agency; you have the bankers, us, AFL-CIO.

What happens in another year?

Each of the groups will have established their relations with the staff. This is the way Washington works. There will be a reluctance, a fear of change. That is the basis of our concern. I think I should also mention the need for the single agency surfaces certainly in the *Daniel* case, which we believe is correctly decided——

Senator BENTSEN. Let me say that as far as comments on the *Daniel* case, I do not want SEC in the act, frankly, but I would not argue with you about disclosure.

I think protection of employees to the extent any practical way that we can give disclosure, we want that for employees.

Ms. FERGUSON. My point is the SEC has historically been involved in pensions, the figures of total plan assets, now $279.6 billion in assets, always has been gathered by the SEC, and increasingly the kind of concerns that Senator Javits is expressing, and those you have actually pioneered in, way back in 1973, on questions of concentration of pension fund assets, those are SEC-type matters, and we are going, I am almost positive, to get more and more into investment matters as a part of pension policy, and the SEC is going to be inevitably involved.

Somebody has got to be involved in that area. If the legislation you propose for a 5-percent limit on plan asset holds up, that would have to involve agencies other than the Labor Department. The Labor Department cannot handle that and, in addition, I think you should know that the FTC is heavily involved in the pension area right now.

The FTC has done a study of IRA's and disclosure practices, and they are doing another study on sale of plans to employers. They are heavily involved.

The Civil Rights Commission is involved.

The Justice Department is involved.

The NLRB is involved.

There are many, many agencies involved. Our feeling is that there is a need to centralize all of this into a pension agency.

Senator BENTSEN. Let me take you on another subject for a moment.

We have a number of situations where an employee dies before retirement, and his widow never receives any pension at all. What do you think we ought to do on the right of survivorship?

Ms. FERGUSON. We feel very strongly that the provision in S. 3017 with some minor modifications is absolutely essential.

From the point of view of the American workers and their wives, homemakers in particular, the income they receive during their lifetime is considered to be joint income. The woman stays home on the expectation that she is sharing the husband's income. Merely because a part of his income is deferred to retirement does not change in her view the character of the income.

She expects and he expects that his retirement income will be available to him or them or her when he dies.

The disappointments caused by this forfeiture by reason of death, which is built into every pension plan now, is incredibly tragic.

We, of course, get so many letters, and I am sure you do, too, from these women, and they simply cannot believe what is happening to them.

Inevitably they say, my husband told me that I would be taken care of. He worked for 40 years. What happened to the money?

The refrain is almost identical, letter after letter, and there is nothing you can say to these women, their expectations were reasonable.

Senator BENTSEN. Thank you very much.

Senator WILLIAMS. Excellent statement. Really helpful.

Ms. FERGUSON. Thank you.

[The prepared statement of Ms. Ferguson follows:]

STATEMENT OF KAREN W. FERGUSON AND JAY W. TOWER
PENSION RIGHTS CENTER
BEFORE THE SUBCOMMITTEE ON PRIVATE PENSION
PLANS AND EMPLOYEE FRINGE BENEFITS
AND THE SUBCOMMITTEE ON LABOR
UNITED STATES SENATE
WASHINGTON, D.C.
AUGUST 16, 1978

Chairman Williams, Chairman Bentsen, Senator Javits, members of the Subcommittees. I am Karen W. Ferguson, director of the Pension Rights Center. With me is Jay W. Tower, the Center's staff attorney.

Extremely important provisions are pending before the Subcommittees: Provisions to establish an independent pension agency, to provide pre-retirement survivors benefits and to expand pension coverage to employees of smaller employers unable to afford the costs associated with conventional pension plans.

Unfortunately, none of these provisions is under active consideration by the Subcommittees. Instead, the provisions are being dropped in favor of the Administration's "divided jurisdiction" proposal and what has been aptly termed "the Pension Industry Relief Bill", a bill that would overturn the Daniel case and cut back on the reporting and disclosure requirements of ERISA.

In the ten minutes we have been allotted for oral testimony, we will concentrate on these issues. Other provisions are discussed in the memorandum attached to this statement.

Daniel v. International Brotherhood of Teamsters

Subcommittee staff members expect a bill overturning the Daniel decision to reach the floor of the Senate the week after Labor Day. If all goes as planned there will be no opposition to the bill in the Senate or the House and the Supreme Court will effectively be forestalled from deciding the case this Fall.

Taking jurisdiction away from the Supreme Court after it has agreed to decide a case is almost unprecedented. We have discovered only one case in which this was done and that was more than 100 years ago, in time of war. Why are unions and companies putting so much pressure on Subcommittee members to take such extraordinary action? To understand this, it is necessary to understand what Daniel is all about.

Right now an employer or union can offer workers pensions as inducements to come to work or ratify contracts without putting the workers on notice that there is a chance that they may not get a pension. It happens every day. It can be as simple as a statement, "If you come to work here you will be covered by our pension plan" or "We've just negotiated a contract that provides for $2 a month more in benefits for each year of service".

If the workers accept the offer and come to work or vote to ratify the contract, they will eventually get a booklet describing the terms of the plan or the amendment of the plan. But, not knowing that there's any reason to read the booklet, workers typically do not look at them. They will be put away. It is only when workers begin to approach retirement age that the booklet is pulled out. Then it is read to find out how much of a benefit the worker will receive, not whether he or she will receive a benefit. Should the worker glance at the booklet at an earlier stage, he or she is likely to be impressed by the variety of benefits and options available. Not knowing that there is a need to search the language for plan limitations, none are likely to be noticed.

Workers have no reason to assume that they will not get pensions. They do not know how pension plans work. They assume that if they are "covered" by a pension plan or "eligible to participate" in a pension plan that they will get benefits. In certain plans, this basic misunderstanding is compounded by statements to the effect that employers are contributing a specified amount per employee each week to the pension fund.

Unlike their employees and members, the employers and unions offering the plan as an inducement to workers do know how plans work. They know that the employers' contributions are calculated on certain assumptions about how many people are likely to work long enough and continuously enough to get a right to a pension and how many of those getting a right to a pension are going to die before they or their spouses can collect benefits. It is the failure by the employer or union to disclose the material fact known to them that the worker may not get a pension that the U.S. Court of Appeals for the Seventh Circuit found to be a "fraud" within the meaning of the securities acts.

That is all there is to Daniel. If workers are told that there's a chance they won't get a pension before they make the decision whether or not to participate in a plan, they are not "defrauded"; they cannot claim later that they have been misled.

Given that this is all there is to Daniel, why are unions and employers going to such great lengths to persuade Congress to undercut the decision?

They have already expressed to the Supreme Court their concerns about retroactivity, the alleged burden of "Daniel disclosure", the possible involvement of the Securities and Exchange Commission and their claims that the decision will in some way interfere with collective bargaining. Surely the Court is in a position to weigh these arguments and reach a reasoned decision. Or is this precisely the problem?

Assume for the moment that the Court decides in favor of Mr. Daniel and the members of his class (Local 705 participants who can prove they were defrauded), but makes the rule prospective for everyone else. Assume further that the Court specifies that the required disclosure is nothing more than a statement at the time a pension is offered that

1) there is a chance the person will not get a pension,
2) that the reasons the person will not get a pension are that they may not work long enough or continuously to get a right to a pension or that they might die or the plan may terminate before their benefits are fully insured, and

3) that during the past five years a specified percentage of all persons leaving the plan left without pension rights.

If the Court so decided, none of the arguments advanced by the unions and companies would apply. Their only remaining argument would be that they simply don't want their employees or members to have the information that the Supreme Court might require them to disclose.

If that what they are worried about? If so, that is a material fact which we believe should be disclosed to these Subcommittees.

Forty million American workers and their families depend on the Subcommittees to protect their interests. This means looking beyond the "political realities", the immediate pressures of the moment to the long-range consequences of your actions. It also means being willing to ask some hard questions of the individuals and organizations urging you to prevent the Supreme Court from deciding <u>Daniel</u>.

Why do they oppose <u>Daniel</u> disclosure? <u>If</u> their concern is retroactivity and the impact of another agency and another body of law, why are they not asking you to amend ERISA to provide this kind of disclosure.

Are they worried about the reaction of their employees and members to the discovery that they may not receive pensions?

Are they worried that once their employees and members understand how defined benefit plans work that they won't want those plans?

Are they worried about the possible extension of the <u>Daniel</u> rationale to union organizing campaigns? This last issue certainly merits public discussion. If union organizers have to disclose all facts material to an informed investment decision, they may well have to disclose that certification of the union as collective bargaining agent can mean the loss of benefit accrual credit under another plan.[1/]

As a last point on this subject, Senator Williams has repeatedly stated that Congress was not aware that a pension was a security. In fact, in hearings held on June 21, 1972, Senator Williams was told by former SEC Chairman, Manuel F. Cohen, that a pension was a security. Senator Williams' response to this statement was certainly not one of surprise or protest, you merely thanked Chairman Cohen by stating, "Thank you very much. That is a magnificent statement and profound and helpful, and I am sure it will be with us for the duration of our deliberations on this legislation." The issue at that time was not whether a pension was a security, but whether it was "sold" to employees. Many employers maintaining non-negotiated plans as late as 1973, still held to the concept that regardless of the treatment of pension in collectively bargained plans, their plans were still gratuities. This concept was only finally laid to rest with the enactment of ERISA in 1974.

Certainly these Subcommittees know better than almost anyone outside the pension industry that involuntary, non-contributory defined pension plans are no different from the voluntary, contributory, defined contribution plans that are universally acknowledged to be securities. Some employers maintain both kinds of plans: involuntary, non-contributory, defined benefit plans to provide a basic retirement benefit and supplemental variable annuity plans to provide a second layer of benefits. Typically, the plans are administered by the same trustees and invested in the same stocks and bonds.

The fact that the trend in this country has been toward non-contributory plans is an accident of history and union pressure. It is also a trend that may soon

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1/ If the Subcommittees are interested in pursuing this issue, we can provide them with documentation of a very dramatic instance in which an individual relying on a union organizers' statement that he would get full pension credit for his past service under a company plan, did not seek employment at a non-union branch of his company. The result was that he lost all benefit accrual credit for the earlier years.

be reversed.

The fact that plans are involuntary is the result of public policy favoring forced savings. The relative lack of success of the IRA concept in expanding plan coverage is a good indication of the wisdom of this policy.

The fact that plans define benefits rather than contributions does not mean that they are not heavily dependent on investment return. They are indistinguishable from defined conttibution plans in this regard. The defined benefit part of a plan means only that higher benefit levels and past service credit can be provided -- at a cost, the loss of benefits by others.

The fact that at this moment most participants have no control over their investments in defined benefit plans is likely to be a temporary phenomenon. The resurgence of interest in developing techniques for providing participant input into pension plan investment decisions and the vote of pension stock was signalled by Senator Lee Metcalf on October 26, 1977, shortly before his death, when he stated:

> I believe it is time for beneficiaries of all pension funds -- private and public -- to review arrangements that have been made in their behalf regarding investment and management of those funds, and the voting of stock in their portfolios. They should have a voice in these matters.

Reporting and Disclosure

The bills you have before you would eliminate the summary annual report form and much of the information now required by the detailed annual report form. They would also do away with the requirements that the summary plan description be filed with the Labor Department and that persons leaving plans without vested pension rights and incurring a one-year breakin service be notified of their pension status. There are also provisions for automatic annual benefit statements and consolidation of the EBS-1 Form and the Application for Determination Form.

Proposed Elimination of Summary Annual Reports

S. 3017 and S.1745 would wholly eliminate the summary annual report. The Labor Department is about to propose a summary annual report form that will provide plan participants with meaningful, essential information about the financial operations of their plan. This new summary annual report should provide participants with an understandable overview of their plan's financial condition. It is expected to tell them how much money is in their plan and how much is contributed each year, what gains or losses the plan has experienced, whether the plan has engaged in prohibited transactions or has loans or leases in default and, most important, the kind of information they are likely to find in the detailed annual report on file at the main plan office.

This new summary annual report will encourage participants to take a closer look at what is being done with their plan monies. This is absolutely essential if there is to be realistic enforcement of ERISA's fiduciary standards. We have been told repeatedly by Labor Department administrators and enforcement officials that they cannot enforce ERISA without assistance from the public. Without participant-initiated leads, some of the most serious abuses would never have been uncovered.

Proposed Elimination and/or Diminution of Information Required by Section 103 and the Form 5500 Annual Reports

S 901 proposes to eliminate the statutory list of information required to be included in annual report forms, S3017 authorizes exemption of any plan or class of plans from any or all of the reporting requirements. S3193 proposes to require detailed reporting only once every 5 years with a one-page report for the interim years.

The need for these provisions has simply not been established, Earlier this year, the Labor Department undertook a thorough review of the complaints it had received about the Form 5500 requirements and proceeded to modify those requirements in accordance with the suggestions received. The Department has the authority to make further revisions should further complaints arise.

Similarly, the need for exempting certain plans from the requirements of the law has not been demonstrated. What plans should be exempted and why? Surely the persons urging this exemption have the burden of proving that it is needed, particularly given the fact that ERISA Section 110 already provides for alternative methods of compliance. Indeed, the criteria necessary for granting an alternative method of compliance are more strict than the proposed criteria for the more drastic action of exemption.2/

2/ § 222 of S3017 allows exemption upon a finding by the Secretary that such is
1) "appropriate and necessary in the public interest, and
2) consistent with the purposes of [Title I]."

Requiring that these criteria be met is equivalent to not having any criteria. The terms "public interest" and "purposes of [Title I]" are broad enough for a Teamster plan administrator to drive a truck through. (We are not suggesting that the present Secretary would even consider exempting a Teamster Fund.) The valuelessness of the criteria are highlighted when compared with the present criteria for providing an alternate method of compliance under present ERISA § 110. There the Secretary must find not only a consistency with the purposes of Title I, but must additionally find

1) that participants and beneficiaries will still receive information adequate to apprise them of the financial conditions and operations of their plan.
2) that compliance with the specific design of Title I would either increase the costs to the plan or impose unreasonable administrative burdens on the plan, and
3) that compliance with the specific design of Title I would adversely affect the interests of plan participants.

This standard, while imperfect in its own right, at least requires that the Secretary show the reporting to have an adverse effect on participants and document the cost increases to the plan. This is far superior to a finding that an exemption is in the "public interest".

As for the cyclical reporting proposal, what precisely is the information that is so burdensome to report? What specific items do the proponents of this legislation want to cut out? In considering this proposal it is essential to realize that year by year comparisons of key figures are frequently the only way to determine whether there have been breaches of fiduciary duty.

What all of these proposals fail to recognize is the fact, pointed out in our June 27, 1978 testimony, that financial reporting is nothing more than a trade off, and an extremely modest one at that, for the right of plan sponsors to retain a degree of control over plan assets and to delay full funding of their plans. If plans are willing to give up all control of plan assets and to fund them fully, then there is no need for the protections afforded by Section 103. If they are not willing to do so, then providing the information required by Section 103 on an annual basis is absolutely essential.

In fact, if anything, Section 103, as it is now being interpreted by the Labor Department, is not providing sufficient protection. To mention only one of the more obvious examples, plans are not now being required to report party-in-interest transactions if they claim that those transactions are exempt by statute, class exemption or individual exemption. Since the judgment as to what is exempt is left entirely up to the plan and since non-exempt transactions are unlawful, it would not be surprising if no plans are reporting prohibited transactions.

The area where the Labor Department and Congress should be considering alleviating the reporting burden is in the areas where reporting is not needed to protect plan assets. S3017's proposal for special master and prototype plans is illustrative of one such area. The plan sponsors would give up all control over plan assets and the funding schedule would be prescribed by the financial institution administering the plan. The provision in S3140 for Simplified Pension Plan is another example.

Elimination of the Filing of the Summary Plan Description

To date, no one has come forward with any explanation as to why putting a booklet in the mail and sending it to the Labor Department is burdensome. In fact, it is so little trouble, that under the WPPDA most plans voluntarily filed their booklets, along with their D-1 forms.

The principal purpose of the filing requirement is to provide tangible evidence that the booklet has been written. If a plan has gone to the trouble of writing and filing a booklet, there is a reasonable presumption that it has also been furnished to participants.

The filing requirement also assists the Labor Department in its compliance efforts. The Department has recognized that the only way it will be able to ensure compliance with the requirements that booklets be accurate, comprehensive and comprehensible to participants is through spot audits of booklets on file.

Finally, the filing requirements mean that individuals and organizations, such as ours, that seek to help individuals have a central place to go to learn about the terms of their plans. Although individuals have a legal right to request plan documents and are legally protected if they make information requests, too often they are simply afraid to do so for fear of antagonizing their employer or union. In many instances, the fear is understandable and realistic.

Elimination of the Section 209 Benefit Statement to Non-Vested Individuals

As drafted, Section 209 is arguably ambiguous. Literally read, it requires plan administrators to give benefit status reports to everyone requesting such statements in writing <u>and</u> to everyone who leaves the plan or incurs a one-year break in service, even if the person is not vested. Although an automatic benefit statement to everyone leaving a plan would be desirable, it would impose an administrative burden, particularly on the plans with high turnover.

A more realistic reading that would not impose an undue burden, but would provide important information to the persons most in need of that information is also possible. Section 209 can be read to require plan administrators to furnish benefit status reports to those non-vested individuals who have terminated employment or who have not formally terminated employment, but have incurred a one-year break in service (for example, to raise children or to supplement their education) and who request such reports in writing.

This would provide valuable protection to those persons who need to know how much service they have accrued prior to a break in service so that they can make plans to return to work before losing credit for their prior service.

We believe that the Labor Department has the authority to interpret Section 209 to provide this important information on request and that elimination of Section 209 would not be in the interests of plan participants.

Automatic Benefit Statements

We have no objection to the requirement of automatic annual benefit statements as provided in S1745 as long as such statements are not substituted for the summary annual report. S1745 assumes that participants do not care what is done with their money as long as they receive their benefits. Although this is true of some participants, probably most participants, it is not true of all. As in just about every other area, it is the few concerned individuals whose actions protect the rights of everyone else.

Consolidation of the EBS-1 Form With Other Forms

If all of the information now in the EBS-1 Form is included in the Application for Determination or other form, we would have no objection to consolidation as long as this information is on file at the principal plan office and in the Labor Department's public document room.

Divided Jurisdiction

If the Administration's proposal to divide ERISA jurisdiction between the Labor Department and the IRS is implemented, there will, in all probability, never be a single agency or a national retirement income policy.

The proposed reorganization is the product of the Labor Department's frustration at having to get IRS approval of exemptions to the prohibited transaction provision of ERISA. However frustrating the experience may be for the Department, it should be noted that it has had the effect of providing additional safeguards for participants. It also involves what should be a relatively small and steadily diminishing portion of the Department's responsibilities.

What will happen as a result of the reorganization is that each agency will become more entrenched and less willing to transfer to a single agency, where responsibility will have to be shared. Also, the unlikely alliance of individuals and organizations that now agree that a single agency is the best long-range solution, an alliance that includes both former Labor Department administrators and all organizations involved in the pension area other than ERIC will inevitably dissipate as each of their demands is met by the agencies.

The promise of an evaluation of divided jurisdiction at the end of the two-year period is not the promise of a single agency. If Chairman Williams and Senator Javits genuinely believe, as we do, that there is a need for a single agency in two years or ten, provision for such an agency must be written into legislation now, before the reorganization takes effect.

Specific comments on the single agency proposed in S3017 and other provisions of pending legislation appear in the attached memorandum.

Thank you for giving us the opportunity to testify. We would be happy to answer any questions you may have.

SUPPLEMENTAL COMMENTS
BY THE
PENSION RIGHTS CENTER
ON
ISSUES ADDRESSED BY S. 3017

Employee Benefits Commission

We fully support the concept of the Employee Benefits Commission. As Senator Javits has noted, a single, independent agency is "an essential tool for developing...an administrative mechanism which will aid in formulating a national policy on retirement income and the related matters of capital formation and employee stock ownership. We do, however, have reservations about the composition of the Commission and its resultant lack of independence.

As proposed in S. 3017, the Commission would not have the independence of the SEC-style agency envisioned by Senator Javits in his August 8, 1977 statement. Rather, the two ranking positions on the Commission, are to be occupied by persons with dual obligations - one to participants and beneficiaries, and one to their respective departments. This would mean that the Commission would not be able to escape the conflicting obligations that have impeded the efficient administration of ERISA. The Chairman of the Commission, the special liaison officer for the Secretary of Labor, would have to continue to represent both the interests of organized labor and the interests of plan participants and beneficiaries.

The reason given for tying the Commission to the Departments of Labor and Treasury is to force consideration of pertinent labor and tax law consideration. This suggests a belief that a truly independent pension agency would obstinately choose to operate in a policy vacuum. The experiences of the present independent executive agencies lead to a contrary conclusion. Additionally, it should be noted that while the Chairman and Vice Chairman have terms of six years, their respective Secretaries have lifetimes of only four years.

Preretirement Survivors Benefits

We fully support the concept of preretirement joint and survivor annuities. The following excerpt from one of a great many letters we have received, summarizes the problem and the urgent need for remedial legislation:

> "My husband worked for , Indian Orchard, Mass. for 35 years and died suddenly on 12/27/77 from Emphysyma which was caused from his work. He was 61 yrs. and 3 mo. of age and was to take an early retirement in a few months due to his illness. I went to the Manager and asked about his pension benefits which I am the surviving spouse and feel the right to his benefits. They told me he had to be 62. I asked what happens to the 35 years which the pension fund was attributed in his name but had no response.
>
> "He had worked hard and put in long hours and had a continuous service of 35 years without being absent from work.
>
> "I am in my 50's and also lost my job the very same day and have no income coming in from any source. I have a son who is 18 yrs. of age and wants to continue his education this fall, pending on some financial aid. I cannot get any aid as I am not 60 and also have no dependents under 18 yrs. of age.
>
> "I live in a small town and employment is hard to find. I do not want to go on Welfare, I would rather work."

The only modifications we suggest are as follows:

In the case of preretirement death -

1. The surviving spouse be permitted to receive 100% of the reduced benefit the participant would have received. There is no need for the 50% reduction since the payment is being made for the duration of one life rather than two.
2. The amount not be paid before what would have been the participant's early retirement age. The reason for this is to preserve the status of the annuity as retirement income.
3. To clarify that the preretirement joint and survivor annuity is also available to the survivors of persons with vested pension rights who were not active participants under the plan at the time of their death.

Special Master and Prototype Plans

The reason most frequently advanced by small employers for their failure to set up pension plans appears to be cost, the cost of setting up and administering a plan. Whether costs are a significant deterrent to the expansion of pension plan coverage is unimportant in this discussion. What is important is the perception and the resulting lack of increasing coverage. The master plan approach of S. 3017, if properly executed, could eliminate the fears of burdensome costs - dollar and time - while providing an avenue for greater pension coverage. Although we welcome the concept, there are at least three points we feel need clarification.

As proposed, the master sponsor has no obligation with respect to ensuring the payment of employer contributions. Rather, upon delinquency, the master sponsor ceases its status of fiduciary and the only available recourse is a participant suit against the employer sponsor. While we can understand a hesitancy in involving the financial institutions, who will be the master sponsors, in potential litigation with the numerous employer sponsors under their wing, nevertheless, an employee covered by a master plan would, unlike most other employees, be without a protecting trustee. The obvious remedy is to retain the master sponsors' status as fiduciary. The minimum solution would be the imposing of a statutory obligation, both upon the master sponsor to promptly notify the EBC (or Labor and Treasury) of delinquencies, and upon the agency (or agencies) to sue to collect the delinquencies. In no event should participants lose credit as a result of delinquencies.

We also have questions about the interaction of the master plan with the proposed change in the definition of employer as party-in-interest.

If the master plans receive the hoped for enrollment, there will be few, if any, sponsor employers who employ five percent or more of the covered employees. As such, present restrictions on investment in employee operations would be lifted, availing leasebacks and other forms of commission to employers for joining a particular institution's master plan.

Finally, and most important, we submit that master plans should not be permitted to integrate pension and social security benefits. These will be new plans, so that the argument that elimination of integration requires costly plan amendments does not apply. Also those plans should be required to have participation and vesting schedules that realistically reflect the mobility of the American work force. Employers should have the option of joining special master and prototype plans at minimal cost, or setting up the Simplified Pension Plans provided by S. 3140 at no cost.

Elapsed Time

We oppose the proposed legitimization of the elapsed time rule. The rule would permit the elapsed time method of measuring years of service if "in the aggregate", employees are not disadvantaged. What this means is that as long as some employees do better under an elapsed time approach than they would under the 1000 hour rule, it does not matter if other employees lose the pensions they would have received under the 1000 rule. This is unconscionable. If the savings from use of the elapsed time rule are as great as ERIC and the United Steelworkers of America claim, employers can afford to adopt versions of the elapsed time rule that guarantee that all employees receive one year of pension credit for each year in which they work 1000 or more hours. All that is required is that the "service spanning requirement" now applied when an individual returns to work within a 12-month period also apply when an employee does not return within a 12-month period, regardless of the reason the employee leaves the plan.

The 1000 hour rule is one of the most fundamental protections of ERISA. Under no circumstances should these Subcommittees permit it to be eroded.

Summation of Different Benefit Accrual Rates

Section 204 of ERISA established standards of benefit accrual for defined benefit plans, Under two of these standards, the "3%" rule and the "fractional" rule, the accrued benefits of a participant upon separation is based on the normal retirement benefit as it exists at the time of separation.

Section 231 of S. 3017 would allow multi-employer plans to base accrued benefits not upon the benefit as defined at the time of separation, but rather upon the benefit as defined in each year of the participant's service. The result will inevitably lead to a paid benefit that is less than the defined benefit promised in the plan. For instance, if a plan provides a maximum benefit in 1979 of $200, and increases the maximum to $300, in 1980, a person who qualifies for the maximum benefit and retires in 1981 will not receive a benefit of $300, but rather something less. Furthermore, the language of S. 3017 suggests the possibility of retroactive application to benefits already accrued. This would cut back the anticipated benefits of millions of employees,

Even applied prospectively, the proposal would be open to question. It is inconsistent with one of the principal justifications for defined benefit plans, their ability to set benefits at levels in effect when the employee leaves work covered by the plan.

Far simpler, and more equitable methods of cutting multi-employer costs would be to convert to a defined contribution approach or limit increases in future defined benefits. This very serious departure from current law and practice should not be considered without extensive input from the multi-employer participants whose benefits will be affected.

Suspension of Benefits

S. 3017 would allow multi-employer plans to suspend a pensioners benefit if he or she performed any work in the industry, or trade or craft covered by the plan. This is a drastic reduction in the rights of nonforfeitability created by ERISA.

It is, in many respects, similar to the IRS rule that permits forfeitures resulting from non-compete clauses if plans have vesting schedules better than ERISA. Both represent efforts to restore the old concept of a pension as a tool to be used by unions and management to further their purposes.

The unions are anxious to broaden the suspension of benefits provisions because it is an effective way of preventing older workers from taking the jobs of younger workers. What it fails to take account of is that retirees often go back to work because they cannot afford to live on their retirement incomes. They need to supplement their pensions with whatever jobs they are able to find. To put them to the choice of a pension or what is likely to be an occasional part-time job is simply unfair.

The proposed monetary penalty and lengthened period of suspension add to the injustice. The legislation would lengthen the suspension period beyond the employment period and impose a monetary penalty for failure to report re-employment. This allows the employer and the plan, the two parties most interested in not paying a pension, to be judge and jury on the question of whether there was re-employment and whether any failures to notify were intentional. The non-forfeitable rights to a pension should not be allowed the subject of such cavalier treatment. In those few cases of intentional non-reporting, the plan has the resources to sue the retiree for the return of the benefit. If necessary, a court can determine an equitable method of repayment out of future benefits.

Employee Contributions

The S. 3017 provision for employee contributions is patterned on the Canadian system where employee contributions are the rule. The provision affords a tax deduction to certain persons able to supplement the benefits, if any, that they will receive from their plans.

The problem with the proposal is, first, that it does not differentiate between those persons who will get very substantial pensions and so will collect twice and those who will only get a return of their own contributions. Second, it does nothing for people who are most in need of pension protection, those who cannot afford to make contributions, ~~or~~ most of the persons who have been most anxious to be able to save on their own behalf, engineers and scientists and other highly paid mobile professionals. Finally, it may, as the unions have long feared, relieve some employers of their sense of obligation to provide adequate pensions for their employees.

Despite our reservations, this concept, along with the LERA concept, deserves careful consideration and we generally support both.

Tax Credits for New and Improved Plan

Conceptually, the granting of a tax credit to sponsors who set up new plans and make significant improvements in existing plans is probably sound. However, unless specific standards for new or improved plans are set, there is a likelihood that the new plans and the "improved" plans would not be worth the tax revenue lost. We propose that the Subcommittees consider including in any final legislation specific standards that must be met in order to qualify for a tax credit. For example, in an existing plan elimination of integration would be a sufficient improvement, whereas a change from a ratio of 2.2 to 2.0 would not be sufficient. Similarly, full vesting at four years would be significant, full vesting at nine years would not be.

Changes in the Party-in-Interest Definition

In discussing the Master Plan proposal, we touched upon the effects of exempting from "party-in-interest" status those employers with less than five percent of the employees in a plan. We have been unable to find any legitimate reason for the proposed exclusion of five percent employers. This would permit significant numbers of employers covered by multi-employer plans to engage in prohibited transactions. How many employers employ more than five percent of the people covered by the Central States Teamster Fund?

We are also unable to find any justification for excluding unions with under five percent of the employees under a plan, employees who earn less than 10% of a corporate payroll, or 10 percent partners of joint ventures with service providers from the party-in-interest definition.

Elimination of the Civil Penalty for Prohibited Transactions

S. 3017 would eliminate the ERISA §502(i) civil penalty on prohibited transactions in favor of the tax penalty of Internal Revenue Code section 4975. We do not oppose the consolidating of the provision. However, given that it in the domain of the Secretary of Labor or the Employee Benefit Commission that includes fiduciary duty, efficiency dictates that 502(i) remain and 4975 exits. The proposed revision would require first the discovery by the Secretary of Labor or the EBC of the transaction, to be followed by reporting to the Internal Revenue Service, followed by its acting. This is a needlessly burdensome procedure, resulting in increased paper and costs of government.

Denial of IPA Benefits to Owner-Employees, Corporate Officers and Shareholders

We support this provision.

Study of Impact of Inflation on Retirement Benefits

We support this provision.

Small Business Representation on the Advisory Council

We support this provision.

Solvency Standards for Multiple Employer Trusts

We support this provision if it is found that state regulation is not adequate.

Exemption of Reciprocal Agreements From Party-in-Interest Prohibitions

We support this provision.

Prohibition of Reductions in Retirement of Disability Benefits Due to Workmen's Compensation or Increased Social Security

We support these provisions,

Senator WILLIAMS. Our next witness is the National Coordinating Committee for Multiemployer Plans, Robert Georgine, chairman.

I am looking forward to your testimony, Bob. Why don't you just proceed as you wish, and we will see that your full statement goes into the record.

STATEMENT OF ROBERT GEORGINE, CHAIRMAN, NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

Mr. GEORGINE. Thank you very much, Mr. Chairman.

I appreciate very much this opportunity to testify at these hearings on a number of amendments to ERISA.

I will focus principally on S. 3017. I would first like to commend Chairman Williams and Senator Javits for introducing this bill which contains many provisions which are responsive to the special needs of multiemployer plans and their participants.

I am testifying before you today as chairman of the National Coordinating Committee for Multiemployer Plans. The Coordinating Committee is a nonprofit organization whose sole purpose is to represent the interests of the 8 million people who are participants in negotiated multiemployer pension and welfare plans. These plans provide benefits for workers in such industries as building and construction, maritime, the needle trades, and retail and service trades.

Our affiliates include over 80 national unions and funds, and local Taft-Hartley trusts. Together they represent the great majority of participants in multiemployer plans. Because of the frequent job changes in these industries, a multiemployer plan—that is, one which provides an employee with credit for service with a number of participating employers—is often the only way to insure that these employees will get a pension. Indeed, such multiemployer plans provide a measure of portability on a voluntary basis which does not exist in other plans.

Multiemployer plans have special characteristics not fully recognized under the present law.

Frankly, we believe that participants in multiemployer plans and those who sponsor them through collective bargaining are at a crossroads. The challenges to their continued existence come from many directions.

In some instances, the industries in which they exist are dying, on a national or regional basis. In addition, in industries such as construction, the level of employment resulting in contributions to the plans has still not recovered from the depression of the mid-1970's. Furthermore, more and more employers are going nonunion and taking with them the work which would otherwise produce income to these funds.

Finally, ERISA has the potential for inflicting the stroke which breaks the backs of our plans instead of helping them to flourish. The impact of these trends and their potential result will be far reaching and adverse to the aging members of our population who will be deprived of any pension coverage.

This Congress has already recognized that the termination insurance program as set forth in title IV simply will not function for multiemployer plans. We appreciate the opportunity to work with the

PRGC and ultimately with you in developing a new program which will provide for the needs of participants in plans which are financially troubled while not overburdening remaining plans to the point where they in turn must terminate.

We also appreciate the opportunity that we have had to testify before you previously about our needs and are pleased to see that S. 3017 includes many of the provisions which we feel are necesary if our plans are to flourish, such as provisions to facilitate our reciprocity agreements, a more flexible definition of multiemployer plans, provisions to impose a statutory duty on employers to make contributions to collectively bargained plans, and several other provisions, some of which I will discuss in greater detail at this time.

One of the most important features of S. 3017 is section 274 which would clarify, once and for all, the fact that a participant in a typical pension plan is not purchasing a security when he or she goes to work.

My lawyers tell me that there is a legal proverb that "hard cases make bad law." That clearly is the situation in the *Daniel* case.

This case is a grave threat to the existence of multiemployer plans. I have not only negotiated multiemployer plans, but I am a participant in such a plan, and I certainly favor adequate and effective disclosure to plan participants. However, the *Daniel* case, in reversing 40 years of history, threatens to undermine the fiscal integrity of plans by imposing liability for retroactive compliance with vaguely defined standards of disclosure including disclosure about the statistical probability that an individual will receive a pension. The requirement does not make sense for the future; but if applied retroactively it might result in payments which will totally undermine the actuarial soundness of our plans. Furthermore, it fragments even further the bureaucratic maze of administration of the Nation's pension laws.

I am not a lawyer, but I understand that the *Daniel* case does more than subject pension plans to the antifraud provisions of the securities laws, which, in itself, makes no sense at all.

I understand that in a properly filed class action, the holding in *Daniel* would require plans today to grant benefits retroactively if disclosure 20 years ago was inadequate by standards that ever go beyond what is required prospectively by ERISA.

When I last testified before the Human Resources Committee last fall, the Chairman of the Securities and Exchange Commission claimed that I was wrong. But he never disclosed either to this committee or to me why my fears are unfounded.

You also had witnesses then as well as now who try to assuage our fears by noting that the Supreme Court might restrict the *Daniel* rule to future application. Frankly, those who take the position that the securities laws should apply to our plans but that such applicability should only be prospective demonstrate either the most arrogant bureaucratic instinct for empire building or the height of irresponsibility. Either the disclosure rules under ERISA are adequate or they are not. If they are not, they should be amended to make them more adequate, but not by imposing the relative uncertainy of the securities laws standards.

A recent Labor Department study estimates that the liability to pension plans as a result of the *Daniel* decision could approch $40 billion, exclusive of legal fees or other costs of litigation. Our own consultants' estimates are as high as $100 billion.

That is just ridiculous. I cannot even believe what that means, $100 billion. But even if that is not accurate, even if it is only a fraction of that, because of the nature of multiemployer plans their share of this liability would ultimately be borne by the participants, not by the employers, and would cause a reduction in accruals of future benefits and could possibly bankrupt some multiemployer plans.

Multiemployer plans exist in industries where the length of employment and the economic conditions of the industry make the establishment of pension plans on a single employer basis unlikely and in many cases impossible. These plans are the result of hard-fought collective bargaining and their continued existence should not be taken for granted by this Congress. Many are experiencing significant financial hardship. The additional burden of compliance with the complex securities laws could well be the last straw for some of these multiemployer plans.

When you enacted ERISA you were painfully aware of the plight of persons whose pension expectations were defeated by strict eligibility requirements. But you were also aware that retroactive applicability of ERISA's standards could create substantial unanticipated costs for existing plans and by severely disrupting their actuarial calculations, could bankrupt these plans to the detriment of a great many more workers. The balancing of these equities led to a congressional judgment that ERISA's break rules, generally, should not apply retroactively. This was the only responsible decision at the time and it should be reaffirmed, in light of *Daniel*, by the passage of an amendment specifically recognizing that the participation of employees in pension plans does not constitute the purchase of a security under the Federal securities laws.

Another significant feature of S. 3017 is the provision which would create a single agency to administer ERISA. The coordinating committee has long supported the principal of one agency. As long ago as April 1975, in my testimony at the oversight hearings held by the House Subcommittee on Labor Standards, I expressed concern about the problems of dual administration and called for a single agency to be given jurisdiction over this important and complex area.

ERISA has been the law for almost 4 years now and the need for eliminating dual administration is even more apparent. Despite the best efforts of officials in both agencies, dual jurisdiction of the Department of Labor and the Internal Revenue Service has proved extremely frustrating, time consuming, and cumbersome to plan administrators and other persons interested in the important job of insuring that the objectives of ERISA are carried out in practice.

From the day ERISA was signed into law, we have been following the developing administration of the act with interest and concern. We have tried to insure that the administrative interpretations of ERISA would be consistent with the intent of Congress and based on a practical understanding of the requirements of multiemployer funds. In connection with this effort, we have filed numerous memorandums and letters with both Labor and Treasury. In many cases, though certainly not always, the responsible administrative personnel at these

Departments have been cooperative and receptive to our suggestions. In general, however, even when they have agreed with us, they have not been in a position to take action with respect to our recommendations because of the necessity of coordinating with another agency with a possibly differing viewpoint. This is one serious problem resulting from the division of responsibility under ERISA.

In nearly all of our efforts, we have had two agencies and two sets of administrators to deal with. Each agency is necessarily concerned with the resolution of issues falling under the jurisdiction of the other. Coordinating has proven to be cumbersome and time consuming and has made it virtually impossible to get an answer—much less a quick answer—to many of the problems arising under ERISA.

The coordinating committee has been particularly concerned about those aspects of dual administration which interfere with the ability of our plans to service their participants properly and which threaten the economic soundness of our plans.

One such aspect has been the implementation of the prohibited transactions exemption provision. When you enacted the prohibited transactions section of ERISA 3½ years ago, you recognized that the prohibited transactions sections could only achieve your goals if they were supported by an effective exemption process. Unfortunately, in the case of pension plans, the process involves dual administration of the worst order, that is, a plan must actually obtain an exemption from both agencies, each one having veto power.

Even where the agencies do not disagree, the delay involved in seeking two separate administrative rulings has caused great hardship to our plans. For example, it has been over 2 years since we sought an exemption from the prohibited transactions rules to clarify the ability of our plans to provide for portability of benefits. This exemption is essential to multiemployer plans because many industries covered by these plans have mobile work patterns. Yet, no action has been taken, in part because of dual administration.

Even in those areas where jurisdiction does not overlap and cooperation is not mandated by statute, the agencies have been slow in promulgating regulations, in part due to the understandable desire not to undercut the other agency's authority or create regulations which would be inconsistent with another section of the act. For example, it took 3 years for the Treasury Department to finalize the basic definition of a multiemployer plan and proposed regulation on suspension of benefits and seasonal industries, areas of great concern to our plans, have still not been published, after 3½ years.

The recent agreement between the Department of Labor and the IRS to divide their responsibilities is a positive step. We view the President's plan to reorganize and streamline the administration of the Employee Retirement Security Act as an important step toward elimination of many of the problems inherent in the law. Therefore, we support his effort.

Elimination of the overlapping jurisdiction problems between Federal agencies, and a reduction of administrative burdens facing many plans is necessary in order to make ERISA more effective. We hope that this reorganization will strengthen the very heart of the law—the protection of the millions of American workers who participate in private pension and welfare plans.

However, the coordinating committee supports the principle in S. 3017 that effective enforcement can best be achieved by the consolidation of all aspects of private benefit plan administration in one agency which can then devote its full energies to enforcement of this important statute. Such a single agency will be better able to provide a uniform and consistent administration of a national pension and welfare plan policy in the interests of the Nation's workers and retirees.

As I have previously stated, we appreciate your inclusion of a number of helpful provisions in S. 3017. Specifically, we endorse the following:

MULTIPLE EMPLOYER TRUSTS

We support your efforts and those of the executive branch to insure that the so-called multiple-employer trusts are regulated. Some of the stories we have heard about workers finding themselves without health benefits certainly cry out for the kind of protection envised in your bill. By the same token, we agree with the method you have selected to distinguish between these multiple-employer trusts and selfinsured collectively bargained multiemployer plans where participation is based on a commonality of interest with respect to the member's employment relationship.

PROHIBITED TRANSACTIONS

We endorse your effort to relieve the technical burdens created for many plans in their daily transactions by defining the term party in interest to exclude those persons who are highly unlikely to be in a position to influence the actions of a plan or of plan officials. We note that even those persons will still be subject to the fiduciary responsibility rules of ERISA.

RECIPROCAL AGREEMENTS

One of the greatest benefits now being provided by multiemployer plans on a voluntary basis is the portability of benefits from one plan to another. One of these arrangements, called money follows the man, involves the transfer of contributions from wherever an employee may be working in his trade to his home pension plan, where all of his pension credits are accumulated. We are concerned that the minimum standards provisions of ERISA and the Internal Revenue Code as well as the prohibited transactions provisions may be read to bar such arrangements. We appreciate, therefore, your inclusion of sections 231 and 265 to clarify this situation.

SUSPENSION OF BENEFITS BECAUSE OF REEMPLOYMENT

The vesting provision of ERISA may require that payment of benefits by a multiemployer plan to a person, who although he or she has reached retirement age, continues to be employed with the same employer, but in a different craft, or in the same craft and area, but in a different industry.

The current provision may also be read to deprive a multiemployer plan of any practical means of enforcing a legitimate definition of retirement. Furthermore, the law may bar a plan from suspending benefits on account of self-employment in the same trade, craft, or industry in the broadly defined geographic area covered by the plan.

We endorse the provisions of S. 3017 providing for suspension on account of either employment or self-employment in the same trade, craft, or industry in the broadly defined geographic area covered by the plan. We also are heartened by your inclusion of provisions permitting suspension for a reasonable period of time so as to preclude use of the pension as a form of unemployment insurance and to allow for reasonable penalties for misrepresentation or withholding of material fact.

AMENDMENTS TO CONFORM PLANS TO FINAL REGULATIONS

One would have thought that simple fairness dictates that a plan amendment designed to comply with final regulations will not be considered in violation of ERISA simply because it alters amendments adopted after ERISA was signed into law but prior to the issuance of the final regulations. Yet, the agencies have not been willing to issue such a ruling. We applaud you for including such a provision in the bill.

OBLIGATION OF EMPLOYER TO CONTRIBUTE

In an inexplicable rule, the Labor Department and IRS held 2 years ago that the failure of a multiemployer plan to collect delinquent contributions on a timely and reasonable basis was prohibited transaction in that it amounted to an extension of credit to the delinquent employer. However, in the same ruling, the agencies held that the employer's failure to contribute was not a prohibited transaction, even though, in effect, the employer was unilaterally extending credit to himself.

Employer contributions are the lifeblood of multiemployer plans. It is in the interests of the participants, the sponsoring unions, and those employers who meet their obligations to make it unlawful for an employer to fail to make his agreed-upon contributions.

While we agree with section 262 of S. 3017 in this respect, we disagree with section 271(b) which singles out this new right and bars the Secretary of Labor from enforcing it. While we would not make it mandatory for the Secretary to bring these collection actions, we would at least urge that the Secretary be permitted to do so. Furthermore, like the Fair Labor Standards Act, we would urge that a violation of section 262 should result not only in an order enforcing payments, but in an order providing for an equal amount as liquidated damages payable to the fund.

ADDITIONAL AMENDMENTS

We also applaud your inclusion of provisions (a) providing for the determination of participation on a plan year basis, (b) remedying the technical imperfections of the provisions dealing with the maritime industry's 125-day standard, (c) approving the Labor Department's elapsed time regulations, (d) authorizing multiemployer plans to refund mistaken contributions within a year after the plan administrator knows that the contribution was made by mistake of fact, (e) providing special lump sum distribution rules for multiemployer plans, (f) permitting funding to take account of future amendments, and (g) permitting the summation of different benefit accrual rates for different periods of employment in determining the accrued benefit to which a participant is entitled upon his separation from service.

JOINT AND SURVIVOR ANNUITY

We could support legislation which would make the joint and survivor protection available just as soon as an employee has become vested. Furthermore, we support making it available to someone who retires on a disability pension before the qualified early retirement date.

However, two difficulties remain for multiemployer plans which must operate within negotiated contribution limits.

Under present law, an employee may be charged with the spouse protection, as, for example, by an adjustment of his or her ultimate pension for the value of the earlier years of spouse protection. What is of particular concern to us is that the amendment forbids that charge. This will mean significant added cost for a typical multiemployer plan that found that it has to charge for election of preretirement coverage. The amendment in its present form would add to cost on the order of 10 percent. This is not the time when such a cost can be obsorbed by these participating multiemployer plans.

A second difficulty is that the provision as it now reads would direct payment to the spouse and therefore nullify any choice by the participant designating another beneficiary for a joint and survivor annuity or some other form of death benefits under the plan.

Similarly, the amendment would require a defined contribution plan, upon the death of a vested employee, to add the balance of his vested account to his spouse. Such plans, at least in the multiemployer area, do in fact vest and in the event of death, add the balance of the account to the designated beneficiary. The bill as now worded would perhaps inadvertently void any choice by the employee and direct payment to the spouse, whatever the circumstances may be.

EXCLUSION OF NONCOVERED SERVICE

Collectively bargained multiemployer plans are generally funded on a basis of fixed amounts of contributions based on the work of employees covered under the collective bargaining agreement. So, for example, if a carpenter works 1,500 hours during the year on work subject to the collective bargaining agreement, his employer will make the required cents-per-hour contributions, he will receive vesting credit for the year and will accrue a benefit based on the 1,500 hours' worth of contributory service.

Unfortunately, what is happening with more and more frequency is that the employee is performing work under a bargaining agreement and will, at the same time, be performing nonunion work for which he is making no contributions to the plan.

Under the vesting regulations issued by the Labor Department, a carpenter can work under the contract for 1 year and then work on the nonunion jobs of the same contractors for 9 years, and receive 10 years of vesting credit. This is simply unfair to the employees who continue to work under the contract and to the employers who make contributions to the plan.

We urge an amendment which would permit multiemployer plans to disregard an employee's service for participation and vesting purposes if it is the same type of work for the same employer but not within the bargaining unit.

This is a very important issue to us, one that I probably should have highlighted in the beginning instead of the end.

Mr. Chairman, I now turn my attention to a number of other provisions in the bill which we believe are not in the interests of participants in collectively bargained pension plans.

CREDIT FOR IMPROVEMENT OF QUALIFED PLANS

The bill provides a 5-percent tax credit for employers who substantially improve their plans so that the rights of their employees significantly exceed the minimum standards under ERISA.

While we certainly would like to see substantial improvements, the tax credit proposal in this bill would provide a reward to employers who have delayed improving their plans and would provide no recognition to those plans which improved standards substantially years ago, even before ERISA.

Indeed, it would grant a competitive advantage to the employers who first improve their plans after enactment of the bill over those who have already improved their plans. This is an arbitrary and inequitable form of discrimination which we oppose.

CREDIT FOR ESTABLISHMENT OF SMALL PLANS

Section 304 would provide a tax credit for small employers who establish or maintain qualified employer retirement plans. In the first place, it is not clear whether this provision is designed to apply to employers who contribute to multiemployer plans. If not, it will provide an incentive to the withdrawal of such employers from multiemployer plans to the disadvantage of the plan. If the provision does apply to contributions to multiemployer plans, it unfairly discriminates amongst signatories to the collective bargaining agreement and contributors to the plan solely on a basis of their size. For these reasons, we cannot support section 304.

EMPLOYEE CONTRIBUTIONS

Multiemployer plans are noncontributory and we prefer that they remain that way. True, the negotiated contributions are part of a settlement package and that affects the wage rate itself. Nevertheless, it would introduce troublesome diversions if employee contributions were now to become deductible.

Particularly disturbing in this connection is the provision that would require every pension plan to take an employee's contribution if offered. This would introduce into multiemployer plans complexities of administration that would far outweigh the benefits that might result for particular employees.

It may be relatively simple for a single employer pension plan to accommodate the receipt, crediting and accounting of contributions by individual employees; it would be infinitely more difficult for multiemployer plans which are one or two steps removed from each of the participating employer. A contribution by an individual employee would have to be deducted for the employer and forwarded to the pension fund.

The employee would have to be advised by this employer and later by the plan as to his account. Many of the participating employers in multiemployer plans are small establishments, with poor recordkeeping, faulty reporting and high business turnover. Consequently, the entire process would give rise to a high degree of error and misunderstanding, expensive to the plan. It would also be expensive to the individual who would inevitably have to be charged with the administrative costs.

The complications would be further compounded in the case of a regional or national plan encompassing employers in different localities who deal with different local unions. This sort of plan is at least two steps removed from each participating employer. Contributions are generally policed by the local unions but forwarded to the plan. These extra steps would obviously multiply the opportunity for error and misunderstanding.

If Congress were to make employee contributions deductible we would not oppose provisions which would eliminate any obstacles to such contributions to a qualified plan but we strongly recommend that the bill should be revised to remove the requirement, at least as far as multiemployer plans are concerned, that would compel a plan to receive the contributions of individual employees when they are offered.

NONDISCRIMINATORY IRA'S

Section 306 would forbid establishment of an individual retirement account for the owner, officer, or substantial stockholder of a company. This ban should be broadened to forbid an employer to establish or finance an IRA for any arbitrarily selected employees or groups of employees. IRA's represent a great threat that they may in time develop into selective substitutes for nondiscriminatory pension plans protective of the rank and file. That possibility should be foreclosed.

FIXING VESTED RIGHTS

We favor the addition of an amendment that would eliminate a dangerous ambiguity under the present statute with respect to an employee who terminates covered employment with vested rights long before his or her pension is to begin.

An individual may leave a plan at age 40 with fully vested rights to a deferred pension. Twenty-five years later, when this employee is ready to draw down his pension, he may find that the plan has doubled or tripled its benefit plan for those who remained in covered employment but without any intention of applying the increase to those who terminated long before. Yet, under the terms of the present statute, it may be possible for such an employee, just before he's ready to receive benefits, to secure temporary employment under the coverage of the plan and then have an arguable case that he or she is automatically entitled to a doubling or tripling of the benefit that had been vested 25 years earlier. This opens the door to the worst form of adverse selection.

It must be recognized that multiemployer plans, different from single employer plans, have no control over the employment or reemployment of participants. The short period of employment that a person may need in order deliberately to arrange a doubling or tripling of his benefits may, as a matter of fact, be given to him as a favor by participating employer to whom it does not represent a significant individual cost. It is easy to imagine widespread development of collusive practices representing wholesale abuse of these pension funds, not consistent with their actuarial soundness. We do not believe that Congress intended such a result.

We suggest an amendment that would clarify the law to the effect that a separation from service for the purpose of establishing vested benefit accruals be defined by a plan as a 1-year break in service or some comparable cutoff period that will serve to avoid what may otherwise become a widespread abuse of multiemployer plans by those who learn to manipulate technicalities.

CONCLUSION

Mr. Chairman, we believe there are many important provisions in S. 3017 which are necessary to help multiemployer plans to continue to provide retirement security to their participants. We appreciate your efforts and those of your colleagues in this area.

We, of the National Coordinating Committee for Multiemployer Plans, will do our best to provide whatever assistance and data you need in our mutual efforts to improve ERISA.

Thank you.

Senator WILLIAMS. Excellent statement, Mr. Georgine.

Thank you very much.

We are pleased to be joined by the Chairman of the Finance Committee, and we hope you will feel at home here, Senator Long.

Senator LONG. With this company, I do feel at home, Mr. Chairman.

Senator WILLIAMS. I wanted to just briefly understand the situation you described where an employee has a year under the bargained contract for pensions, and then 9 years of employment where there is not a contract.

That time is all accounted for. Where there is the same contractor who has both union contracts and jobs that are nonunion. I can see the entire period of employment is accounted for under the plan for the individual; is that the situation you are addressing yourself to?

Mr. GEORGINE. That is specifically the situation.

Senator WILLIAMS. So, the employee works under the union contract and then he works in nonunion but for the same contractor, and it is the contractor who goes both ways, union and nonunion, is that it?

Mr. GEORGINE. It is the unique system of double-breasted, as we call them, contractors in the construction industry.

Senator WILLIAMS. And, under ERISA, the plan has to credit for all 10 years because they were all with the same employer, but that 10-year credit is only supported with 1 year's contributions because under the plan, contributions are made only for the union work.

Mr. GEORGINE. It could conceivably happen.

Senator WILLIAMS. In the hypothesis which you stated, yes.

In any of these bills, do we approach any of the answers on this?

Mr. GEORGINE. No, there is not, Mr. Chairman.

We have suggested some language that could assist us in that particular problem.

Senator WILLIAMS. Senator Bentsen?

Senator BENTSEN. I am delighted to see Mr. Georgine before us. I do not know anyone who has more knowledge and experience in multiemployer plans.

You have made some very valuable contributions to us in our consideration of ERISA.

I certainly agree with you on the results of the *Daniel* case and what it could do to pension plans in this country.

I would like you to amplify for me another point. That is the one about the man who has worked and qualified for his pension at the age of 40 and then reaches the point of approaching 65, and in the last year decides he would take a job someplace and is able to double or triple his benefits.

I can see some real problems there, too.

Mr. GEORGINE. That could conceivably happen.

A participant in the plan would work long enough in the plan to get complete and total vesting. Then he could leave the industry to work on another plan that is not related, and when it comes time for his eligibility for retirement benefits, he may find that there has been a tremendous increase in benefits with those who have stayed in after he had left, and work out some kind of deal with a friendly employer to put him to work for 6 or 7 months, 8 months, long enough for him to qualify for present benefits, and by so doing double what we would have been entitled to had he not been able to do that.

It just seems unfair that those that remain in the plan, and the employers that have given tenure to contribute to the plan, then be penalized or paid this much more money to someone who has left the plan much earlier with the intention of getting only what he was vested to get at that particular time.

Senator BENTSEN. I would like to get your thoughts on another point, too. That is the amount of contribution in multiemployer plans.

I can recall the testimony we had when we were considering ERISA, and the testimony at that time was multiemployer plans were really safer; we did not have as many problems there; and that the premium that would be charged should be less than under single employer plans.

It did not work out that way. We find the reverse to be true now because in certain industries, as you cited in your testimony, they are just declining and you are seeing the compounded impact on crafts in that area.

Yet if we raise the premium enough to really cover the actuarial assumptions as we now see them, and see the economic problems, we get to the point of diminishing returns.

We get to the point where people drop out of the field.

Would you comment on that?

Mr. GEORGINE. That is a problem. You are perfectly right in saying that in the beginning when we testified on ERISA, our studies showed that less than one-tenth of 1 percent of multiemployer funds ever went under, and that we really felt there was really no need for reinsurance, so to speak, for multiemployer funds.

However, we have found because of the flat economy and the fact that there has been for a long period of time, especially, for instance, in the construction industry, we have had 10 or 11 years of double digit unemployment. The money has just not come into the funds.

Right now we find there are many funds that have not gone under, but are at that point where they could or could not go.

We feel now the insurance is an important factor for multiemployer funds.

However, if you were to pay the premium that is necessary to really insure those funds, we find we might be talking about $50 premium or as high as that much.

That would destroy the whole system. We have suggested in detailed recommendations to PBGC just what some of the remedies would be to that particular problem, and we would be glad to give them to the Senator.

Senator BENTSEN. I think you should.

I think we ought to have them before the subcommittee, and we share this concern equally with the Human Resources Committee, and we are deeply concerned about the solvency of the multiemployer plans, and yet we do not want to run into this problem of running them out of the system.

Thank you very much.

Senator WILLIAMS. Senator Long?

Senator LONG. Mr. Georgine, you know that this bureaucracy has very human frailties, jealousies and pride, just like the rest of us.

Naturally, each department likes to think that it is the lead department, the lead agency in doing this, and the committees like to think of themselves the same way.

Those of us from the Finance Committee tend to prefer to have Treasury people handle the program, because they report to us, and that tends to make us a little more influential.

What is wrecking this ERISA program is the complexity of it. I think we can agree on that. That is the biggest problem.

Senator WILLIAMS. Did you say wrecking?

Senator LONG. What is hurting the pension program. What is hurting the employees stock ownership program more than anything else in the complexity which has been created by the agencies.

Senator WILLIAMS. How can we simplify it?

Senator LONG. Here is my proposition.

Let us let both Departments bring in their plans to simplify. Let us appoint an impartial group to see which plan is simplest. Whichever plan is simplest, that Department will run it. The other Department will advise only and will not have any say so at all, but just give the benefits of their thoughtful comments.

I think we fellows up here might be able to find some impartial person that we might be willing to trust, provided that you fellows could find some impartial person.

As far as I am concerned, that would provide an incentive for someone to do a job, to really come in with something that is simple.

As far as I am concerned, I would be perfectly willing to let the Labor Department handle it, provided they have the simplest plan.

The Secretary of Labor is a fine man. I have no complaint about him. I think the same thing with respect to the Secretary of the Treasury, and their assistants. They have good people.

But too many cooks in the kitchen—what is the phrase—spoil the broth.

It seems to me somebody ought to be in charge of this thing and somebody else ought to take a back seat.

Let me repeat my proposition. Let the people who can bring in the simplest plan, whoever can do that, let his department run it.

Mr. GEORGINE. I think that is a good proposition, Senator.

You have a knack for undressing a problem and really exposing it, and you also not only talk about the complexities of ERISA in the whole pension system, but the complexities of our Government as we know it, and the complexities of the Congress.

So we would be glad to accept a delegation of authority to give you a simple way of working this out, and then you could accept our plan, and that would probably be good for everyone.

Senator LONG. As far as I am concerned, I am very dismayed, having participated in the pension reform bill, that by the time we got a bill employers were forming less pension plans rather than more. That was a joint effort by the Labor Committee and the Finance Committee.

I thought we did a good job of cooperating with one another.

We were accommodating each other and very considerate of one another. I thought we had good people working on it. The complexity in it now, it is counterproductive.

I would like to mention one other matter. Have your people found in the construction trades, that your workers could get the benefit of the employee stock ownership proposals?

Mr. GEORGINE. Pass that by me again.

Senator LONG. The proposal that employees would own some stock in the company.

Mr. GEORGINE. We have not considered that.

Senator LONG. There is an article on the front page of the Wall Street Journal yesterday, and it said that if employees own some stock in the company, particularly if it was a substantial amount of stock, they were far more productive.

I notice in my hometown, if you go around on Sunday and you see somebody working, there will be some guys who are working for themselves, and you probably have seen that in some areas.

Mr. GEORGINE. We try to discourage that.

Senator LONG. They make a lot of money.

I would think some of those fellows probably carry union cards, perhaps not all, but I think a lot of them do.

Do they or not? You would probably know.

Mr. GEORGINE. There may be cases like that. We try to discourage that.

We feel that there is a line of demarcation between employee and the employer, and that for the best interest of all, that that line should be held.

Of course, there are some European systems where the employees do hold stock in the company and are union members. We do not think that is a good system.

Senator LONG. We have more than 10 million workers in this Nation right now who do own some stock in companies, and we passed a tax provision in the Finance Committee to say it the employer claims the 10-percent investment tax credit, he can get an extra one and one-half percent provided that stock in the company goes to the workers. A lot of companies have taken advantage of it, especially capital-intensive companies.

American Telephone & Telegraph, General Motors, and Dow Chemical have such plans, as do almost all the major oil companies.

I would like to urge you to look at the hearings we have had before the Finance Committee; our witnesses stressed that it is good for the workers, and it is also good for management, because workers take more interest if they are working for themselves and if they own a piece of the action.

Labor has never been, in some areas, enthusiastic about it. But in some areas this program has worked extremely well. Testimony, for example, from the South Bend Lathe people pointed out that there was a company going broke, going out of business, and the workers just took it over to save their own jobs, you might say.

I called down to Wilmer Mizell and asked him to have the EDA make a loan to help them get going, and the community helped raise some money.

Within 1 year, that stock was selling for at least 10 times what they paid for it.

They saved their jobs. They managed to raise their pay so they are making a lot more money, and the company is making a profit and a good profit, a decent profit, where prior to that time it was going broke.

This all happened because, when these fellows owned it themselves, they really had an incentive to make the company succeed.

I was just wondering if your people had looked into it because it would seem in an area such as yours a worker who owns his own tools ought to be able to command a higher wage than one who just goes to work with his hands and has to use the other man's tools.

I would think in your area that it ought to be possible, and if you worked at it, and I would help you put it over, for these fellows insofar as they wanted to put some of their money into their own effort, that they ought to make a good return out of it.

That might sound like a lot of money. If you look at how it works out in the capitalist world today for investors, tax-exempt bonds are more attractive nowadays than corporate stock.

Now all I am saying is, if you want to make it competitive for a worker to own the tools with which he is working, it would be fair to think he ought to make a good return on his investment.

Your industry has not done much about this, even though I would think in your area of labor you have probably got more private fellows working for themselves than almost any; have you not?

Mr. GEORGINE. We have a great deal of small contractors that are one, two, three, four men shops. Certainly, some of them are interrelated, there is no question about that.

We do see some problems. Now, when you take away that division between management and labor, and make labor in fact management. There are some contradictions there that create some problems.

However, Senator Long, of course none of our people that I am aware of are in the 70-percent bracket.

Senator LONG. I would like to put them there.

Hope springs eternal.

Mr. GEORGINE. I would like to have them there, too.

Let me say this with regard to ERISA. We, in the construction industry, for years have taken funds from pension funds, and have invested them back into industry, into construction. We cannot do that now. That is a prohibited transaction. That is one which we have asked for exemptions on for over 2½ or 3 years now, and have not been able to get full relief.

Senator LONG. You are at the right place.

You are talking to Pete Williams, chairman of this committee, and I am sure he will do what he can to help.

Senator WILLIAMS. I think we are on track. We know the problem. While we do not have the final answer in this bill, we are at least searching for some of the answers.

Senator LONG. Now, I have this study on the motivational effects of the stock ownership, it is by the Department of Labor, by the way, and I would like to ask it appear in the record.

Senator WILLIAMS. Without objection.

Senator LONG. I will provide you copies of it and xerox it for you.

[The study referred to follows:]

MONTHLY LABOR REVIEW
U S Department of Labor
Bureau of Labor Statistics
July 1978

In this issue

Articles on the average workweek, the World Auto Councils, the 1970 postal strike, and employee-owned firms

Employee-owned companies: is the difference measurable?

Employee ownership may be associated with better attitudes toward the job and higher productivity and profits, according to a recent 98-firm survey

MICHAEL CONTE AND ARNOLD S. TANNENBAUM

Employee ownership can be found throughout the history of the United States, although companies that are wholly owned by employees (including workers) have always been rare. One survey reported that 389 companies, in which a large proportion of the stock was directly owned by employees, were established in the United States between 1791 and 1940.[1] The number of companies with at least some degree of employee ownership was probably much larger, and there is evidence that this number has grown in recent years.[2]

Several aspects of performance in a variety of employee-owned companies are analyzed in this article.[3] The data employed include: the size and sales volume of employee-owned companies; the percent of employees who participate in the ownership plan; the percent of equity owned by nonmanagerial as well as managerial persons; and aspects of control of the company by employees. Also analyzed are the attitudes of managers toward the ownership plan and their judgment about the effect of the plan on productivity and profit. Actual profit data were available for a subset of companies, and the relationship between profit and other characteristics of these companies was studied.

Employee ownership can take two forms: direct, where employees own shares in the company as would ordinary shareholders in a joint-stock company; or "beneficial," where employees own shares through a trust, as illustrated by the Employee Stock Ownership Trust (ESOT).[4] The Employee Retirement and Income Security Act of 1975 stipulates that the holdings of an Ownership Trust must be invested "primarily" in the stock of its company—unlike the holdings of the usual profit-sharing trust, which may be diversified, or of a pension trust, which must be diversified.

Contributions to the Trust are governed by an Employee Stock Ownership Plan (ESOP). Depending on the plan, contributions may be made on the basis of a profit-sharing principle (whereby some fixed percentage of company profits is annually transferred to the Trust), a cost principle (whereby a fixed percentage of labor costs is annually transferred to the Trust), a fixed contribution principle (whereby a fixed dollar amount is transferred to the Trust), or by other methods determined entirely at the discretion of a single party or parties. The central requirements, however, are that the Ownership Trust invest "primarily" in employer securities and that disbursements from the Trust be made in employer securities. Dividends that may be declared are not usually distributed immediately to employees but, rather, are held in trust. Nonetheless, the financial well-being of the "beneficiaries" of stock in the Trust is tied to the success of the company.

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Finding who owns what

A list of 148 companies in the United States and Canada, thought to have some degree of employee ownership, was compiled.[5] After conducting telephone interviews, usually with the financial officer, 98 of these companies actually were found to have some component of worker ownership; 68 firms had Stock Ownership Plans, and 30 had direct ownership. Their median size was approximately 350 employees; 17 percent had fewer than 100 employees and 25 percent had 1,000 or more. During the previous year, almost half of the companies had sales of at least $75 million.

As shown in table 1, employees in about three-quarters of the companies owned at least half of the equity; ownership of the entire equity by employees was more likely to occur in stock-plan than directly owned companies. This table refers to the percent of equity held by all employees, including managers. Table 2, on the other hand, refers to the percent of equity owned by the workers alone, which, of course, is less than that owned by all employees.

The measure of equity owned by workers in stock-plan companies was obtained by multiplying the percent of the company's equity owned by the Trust times the percent of the Trust's equity owned by the workers. Because of the way records are kept in most of the stock-plan companies, we found it necessary to rely on the distinction between salaried and other personnel as the basis for distinguishing rank-and-file workers from managers in these companies. Furthermore, although most of the directly owned companies could report the allocation of ownership between managerial and other personnel, only about half of the stock-plan companies could report the precise allocation of stock within the Ownership Trust. In these companies, 54 percent of the Ownership Trust stock, on average, is owned by nonsalaried employees. This average, then, was used to define the amount of worker-owned stock within the Trust in each of the remaining cases.[6] As estimated, therefore, worker-owned equity in the remaining cases is directly proportional to (that is, 54 percent times) the percent of the company's equity in the Trust itself.

Table 2. Percent of total equity owned by workers only, in 83 companies

Equity owned by workers	Percent of companies		
	Stock ownership plan (N = 58)	Direct ownership (N = 25)	All companies (N = 83)
Less than 3 percent	34	8	27
Between 3 and 9.9 percent	16	8	13
Between 10 and 49.9 percent	43	20	36
Between 50 and 100 percent	7	64	24

NOTE: Fifteen companies did not provide data relevant to the percent of equity owned by workers.

Employee owners in the Trust are entitled to dispose of their stock at market value once it has been distributed to them. Unlike employees in directly owned companies, however, owners in a Trust generally do not vote their stock. The following tabulation shows the percent of companies where voting rights and other employee control mechanisms are reported to be available:

	Percent of stock-plan companies	*Percent of directly owned companies*	*Percent of all companies*
Employee-owners have:			
Stock-voting rights ..	27	97	50
Representatives on Board of Directors .	36	77	49
Union representation	32	33	32
Influence on important decisions other than through a union. ...	51	77	56

In general, the data indicate substantial differences between stock-plan and directly owned companies in these measures of employee influence over company decisions. For example, only 36 percent of the respondents in companies with Stock Ownership Plans report that worker representatives sit on the board of directors; 77 percent of the companies with direct ownership report the presence of workers on the board. Similarly, 51 percent of the respondents in companies with ownership plans, compared to 77 percent in companies with direct ownership, indicate that employees influence "important" decisions in the company. In some of the companies, this influence reportedly extends to such decisions as whether or

Table 1. Percent of total equity owned by employees, including managers, in 87 companies

Equity owned by employees	Percent of companies		
	Stock ownership plan (N = 60)	Direct ownership (N = 27)	All companies (N = 87)
Less than 10 percent	4	4	4
Between 10 and 49.9 percent	18	18	18
Between 50 and 99.9 percent	28	59	38
100 percent	50	19	40

NOTE: Eleven companies did not provide sufficient percent of equity owned internally data to determine the percent of equity owned internally.

not to make major capital acquisitions. The two types of companies do not, however, appear to differ with respect to whether or not employees are unionized. Although not specifically measured, indications are that directly owned companies have significantly fewer unionized employees than do comparable ownership-plan companies.

Employee ownership and profitability

Profit data were supplied by 30 companies. The ratio of pretax profits to sales was used as a basis for gauging profitability. Each company's ratio was then divided by its industry's 1976 ratio.[7] This weighted ratio was the primary measure of a company's pretax profitability. For five companies, however, an additional adjustment was necessary. Because these companies are directly and wholly owned by employees, they distributed a part of their "profit" to employees in the form of wages. This allocation of funds has the effect of depressing the conventional profit statement, although it has the corresponding advantage of reducing taxes. These moneys, however, should be considered as part of the company's profit for purposes of comparison with other companies in our set. To calculate the amount of money diverted from profits to wages in the five companies, the average wage differential between the worker owners and nonowner workers was used.[8] This differential in each company was added to its formally stated profit figure, and this final value was used for computing the profitability of these five companies. Although this adjustment seems appropriate as a way of maintaining comparability among companies that employ different accounting procedures, the unadjusted profit statements also were compared. This unadjusted value is, most likely, overly conservative; but there may be some utility in examining both measures of profitability.

The average adjusted profit ratio for the 30 companies was 1.7; the unadjusted ratio was 1.5. In both cases, these values, which are greater than 1, indicate greater profitability among employee-owned companies than comparable sized companies in their respective industries. However, because the variance in profitability among the 30 companies is relatively large and the number of cases is small, statistical significance is not achieved. It is also possible that the "sample" of companies may be select with respect to profitability. The results are suggestive, however, that employee ownership, in one form or another, may be associated with the profitability of a company.[9]

Table 3. Regression coefficients for the predictors of "adjusted" and "unadjusted" profitability

Predictor	Adjusted	Unadjusted
ESOT (= 0) vs. direct ownership (= 1)	22	-34
Percent employees participating in plan	30	31
Percent equity owned internally	31	19
Percent equity owned by workers	[1]1 02	76
Worker representativeness on board of directors	18	-18
Employee stockholders vote	05	-24
Multiple r	72	47

[1]p < 02

NOTE: The data necessary to calculate the adjusted profitability ratio are unavailable in five companies of the subset and five companies did not provide information concerning all of the predictors in the regression. The number of cases in the adjusted and unadjusted cells are therefore 20 and 25 respectively.

In table 3, the two indexes of profitability (adjusted and unadjusted) are predicted using several aspects of employee ownership in a regression analysis. The predictors include: (1) the form of employee ownership, whether direct or through a Trust (Ownership Trust is scored "0"; direct ownership is scored "1"); (2) the percent of employees who participate in the plan; (3) the percent of company equity owned by employees (by managers and workers); (4) the percent of company equity owned by the workers themselves; (5) whether employees have representatives on the board of directors; and (6) whether employee stockholders have voting rights.

These predictors jointly explain a substantial amount of the variance in "adjusted" profitability, but only one of the predictors, the amount of equity owned by the workers themselves, proves statistically significant (p less than .02); the more equity the workers own, the more profitable the company, other things being equal (beta = 1.02).[10]

The second variable of importance in this analysis, the amount of equity owned internally, has, if anything, a negative relationship with profitability (beta = -.31); but the statistical significance of this variable is marginal, at best—a coefficient of this size occurring about one out of four times by chance. Variation in "internal ownership" in this context is really variation in ownership by managerial personnel, because ownership by the workers themselves is controlled in the analysis. The possible implication, therefore, is that increases in the amount of equity owned by managers may have a negative effect if this increase is not accompanied by an increase in the equity owned by the workers. This result is not strong statistically, but it may be worth considering as a hypothesis.

The impact of the remaining variables can easily be attributed to chance, but it is interesting to see that they, too, imply, if anything, negative relationships in the regression. Direct ownership (rather than through a Trust), the percent of employees who participate in the plan, the existence of worker representatives on the board, and the existence of voting rights show a negative relationship (if anything) to profitability when the percent of equity owned by the workers themselves is controlled.

Prediction of the unadjusted profitability index is not as good as the prediction of the adjusted index, the multiple correlation being only 0.47, and none of the predictors meets the usual criterion of significance. The pattern of results, however, is similar to that for the analysis of the adjusted profitability index; the one predictor that approaches a marginal level of statistical significance is the precent of equity owned by the workers.

The negative signs associated with several of the variables in table 3 do not imply (or they would not imply, even if they were statistically significant) that these characteristics are associated with low profitability; they imply (or would imply) such a negative association only under the conditions of the regression analysis where, for example, the amount of equity owned by the workers is controlled statistically. In fact, because companies where workers hold a high percent of the equity are likely also to be directly owned, direct ownership, like the amount of worker ownership itself, is positively associated with profitability.

Table 4 helps to illustrate these associations. This table shows the simple, zero-order correlations among the variables presented in the regression analysis. Correlations that are significant at the .05 level or better are indicated. We see in this table not only how the predictors may be associated with profitability, but also how the predictors relate to one another. For example, companies in which workers hold a high proportion of the equity tend to be directly owned (r = .68), to have worker representatives on the board (r = .36), and to provide voting rights to employee owners (r = .68). On the other hand, the correlation between the percent of equity owned by the workers and that owned internally (by workers and managers) is not as high as one might expect, in view of the fact that internal ownership includes ownership by workers (r = .34). The proportion of equity owned by managers in many of these companies is relatively large and "internal ownership," therefore, reflects managerial ownership more than worker ownership.

Direct ownership in this table is significantly and positively related to adjusted profitability (r = .48)—unlike the relationship indicated in the regression analysis—because direct ownership is associated with the percent of equity owned by workers, which appears from the regression analysis to be more closely associated with profitability. Voting rights is also associated with the percent of equity owned by workers and it, too, shows a positive relationship with adjusted profitability (unlike the relationship in the regression analysis), although the magnitude of the correlation does not meet the criterion of statistical significance, given the small number of cases.

The percent of employees who participate in the ownership plan, however, does not show the relationship to profitability that one might expect from the hypothesis that employee ownership has a positive effect on profitability (r = .33). The explanation may hinge on the association, or rather lack of association, between the percent of employees who participate and the percent of equity owned by workers (r = .14). Apparently, many companies that have relatively widespread employee ownership, in fact, involve only a small proportion of the companies' equity in such ownership. Many members, in other words, own very little.

Subjectively supported by managers

In a previous study, substantial sentiment in favor of employee ownership was found among

Table 4. Correlations among aspects of employee ownership and profitability

Characteristics	Profit (adjusted) (N = 20)	Profit (unadjusted) (N = 25)	Stock plan vs direct ownership (N = 75)	Percent employees participating (N = 75)	Percent of equity owned internally (N = 75)	Percent of equity owned by workers (N = 75)	Workers on board (N = 75)
ESOT (= 0) vs. Direct ownership (= 1)	*.48	.27					
Percent employees participating	-.33	.29	*.23				
Percent of equity owned internally	-.02	.06	.10	*.25			
Percent of equity owned by workers	*.80	.31	*.68	.14	*.34		
Workers on board	.24	.08	*.36	.08	.04	*.43	
Employee stockholders vote	.30	.18	*.68	.11	.11	*.47	*.22

*p < .05

both managers and workers in a company that had recently adopted an ownership plan.[11] Employee ownership, they felt, contributed substantially to the satisfaction of all employees, to the motivation of workers, and, ultimately, to the productivity and profitability of the company. Records of the company also indicated that grievances and waste (in the form of expendable tools) declined and that productivity and profitability increased during the period immediately following the introduction of the plan (although profitability was higher during one period a number of years earlier).

In the present analysis, a management representative in each company was asked questions about the effect of employee ownership on productivity and profit. "Do you think that employee ownership affects profits? Does it increase profits, decrease them, or have no effect?" Similar questions were asked concerning productivity. On average, the responses to these questions indicated substantial support for employee ownership. The analyses presented in the previous section, suggesting that employee-owned companies are associated with above average profitability within their respective industries, lend some credence to the claims of these managers. However, the managers who credited employee ownership for high levels of profit did not necessarily work for the more profitable companies.

Managers in companies that were substantially worker-owned were no more likely to ascribe positive effects to employee ownership than managers in less intensively worker-owned companies even though the proportion of equity owned by workers appears to be related to profitability. On the other hand, employee ownership is more likely to be reported to have positive effects on profit where such ownership is direct, rather than through a Trust; managers also respond more favorably where workers are not represented on the board.

Each manager respondent was asked whether employee ownership affected the attitudes of workers toward their job. The average response was 0.84 on a scale from 0 to 1, where "1" means that work attitudes are better and "0" that they are worse as a result of the ownership plan. Their response, therefore, implies that these managers, on average, perceive employee-ownership plans as having a substantially positive effect on the attitudes of employees. But, according to a regression analysis, this judgment by managers may be less positive where workers have representatives on the board of directors. In general, managers were more satisfied with the plan where ownership is direct rather than through a Trust and where the percent of employees who participate in the plan is relatively large. It seems reasonable that managers should think well of the plan where participation is widespread. On the other hand, we have seen that widespread ownership, *per se*, is not associated with profitability; such ownership may very well mean that many employees own only a very small fraction of the equity—and it is the amount of equity owned by workers that appears to be most often associated with profitability.

Taking stock

Employee ownership in the United States has taken a number of forms, although examples where workers own a substantial part of a company's equity are rare. These data, although only preliminary, offer a glimpse of the possible impact of employee ownership on the economic performance of companies and employee attitudes. On the basis of this brief analysis, some tentative conclusions may be suggested: The industrial relations climate in employee-owned companies appears to be good, in the judgment of managerial respondents; managerial respondents in these companies see employee ownership as having a positive effect on productivity and profit; the employee-owned companies that have been studied appear to be profitable—perhaps more profitable than comparable, conventionally owned companies; the ownership variable most closely associated with profitability is the percent of equity owned by the workers themselves; although workers' influence in the company, as judged by managers, is a function of worker-owned equity, managers' evaluation of the ownership plan is not affected in a positive way by either the amount of equity held by the workers or the amount of influence exercised by the workers; managers appear more favorably disposed toward plans with widespread participation among employees, even though this may involve only a small fraction of the company's equity.

These conclusions are tentative. The companies that provided profit data may be select, and the analyses are based on correlations that illustrate association among variables—they do not prove causation. The results, however, are sufficiently encouraging to justify a detailed, longitudinal study of a number of companies over a period of years. Such a study should include measures of the attitudes and motivations of all employees within the companies as well as measures of company performance. If employee ownership does have an effect on the economic performance of a company, as the data of this study tentatively suggest, the explanation may be found, at least partly, in the effect of ownership on the employees themselves. □

FOOTNOTES

[1] Derek Jones, "The economics and industrial relations of producer cooperatives in the United States, 1790–1940," mimeo.

[2] "Employee Ownership," Survey Research Center, Institute for Social Research, University of Michigan, Sept. 23, 1977. Matthew J. Bonaccorso and others, "Survey of Employee Stock Ownership Plans," unpublished masters thesis, University of California, Los Angeles, Graduate School of Management, December 1977.

[3] The study reported here was done under a grant from the Economic Development Administration, U.S. Department of Commerce. The views expressed are those of the authors.

[4] Louis Kelso and Patricia Hetter, *Two Factor Theory: The Economics of Reality* (New York, Random House, 1968).

[5] The list was culled from articles in newspapers, magazines and professional journals, conversations with colleagues, and references given by persons in employee-owned companies whom we contacted.

[6] The definition of "worker" implicit in the stated procedure differs somewhat in the two types of companies. "Workers" may include foremen and salaried clerical workers in some directly owned companies, but not in stock-plan companies. Table 2, therefore, may overstate the difference in worker ownership between stock-plan and directly owned companies, although we do not believe that the definitional inconsistency accounts for the entire difference shown in the table.

[7] Robert Morris Associates, Annual Statement Studies (Philadelphia, Credit Division, 1976).

[8] These nonowner-workers performed essentially the same jobs as the worker owners and received the union wage rate

[9] For studies in which performance of worker-owned plywood firms is compared to that of conventional firms, see Carl J. Bellas, *Industrial Democracy and the Worker-Owned Firm* (New York, Praeger Publishers, 1972); Katrina Berman, *Worker-Owned Plywood Companies. An Economic Analysis.* (Pullman, Wash., Washington State University Press, 1967); "Comparative productivity in worker-managed cooperative plywood plants and conventionally run plants," unpublished, 1976; Paul Bernstein, "Democratization or organization: theory, practice and further possibilities," Ph. D dissertation, Stanford University, 1972. See also Seymour Melman, "Managerial versus cooperative decision making in Israel," *Studies in Comparative International Development*, 1970–71, who compares the performance of kibbutz firms with conventional firms in Israel. For an analysis of companies that have substantial profit-sharing programs, some of which entail a degree of employee ownership, see Bert L. Metzger, *Profit Sharing in 38 Large Companies* (Evanston, Ill., Profit Sharing Foundation, 1975).

[10] "Beta" refers to a standardized regression coefficient.

[11] *An employee owned firm*, Survey Research Center, Institute for Social Research, The University of Michigan, Jan. 17, 1977. For a study of the reaction of both managers and workers in Israeli kibbutz, Yugoslav, American, Austrian, and Italian factories that differ in their system of ownership, see Arnold S. Tannenbaum and others, *Hierarchy in Organizations* (San Francisco, Jossey-Bass, Inc., 1974). See also Ana Gutierrez Johnson and William Foote Whyte, "The Mon Dragon System of Worker Production Cooperatives," *Industrial and Labor Relations Review*, October 1977, pp. 18–30, and Richard J. Long, "The Effects of Employee Ownership on Organization, Employee Job Attitudes, and Organization Performance: A Tentative Framework and Empirical Findings," *Human Relations*, January 1978, pp. 29–48.

Senator LONG. I would hope very much, Mr. Georgine, in keeping with all the other fine leadership you have provided the labor movement, that you would move to help your fellows to earn more and more and acquire a larger and larger stock equity position in their companies.

I wish you would just look at this thing. We want to help you do what you are trying to do.

I really think that we share the same desire. We want these fellows to have a good retirement. We want them to have a good pension. We want them to own their own homes. I just do not see anything wrong with their owning a piece of the action, too.

It seems to me it does no harm to have at some point where just a good worker or good business agent can become president of the company, chairman of the board. This has happened before.

There are some companies where one of the fellows has risen up from the ranks and became the top man, in charge of the whole thing.

Mr. GEORGINE. We will certainly take a look at it.

Of course, to have a business agent as part of the company, there is some other laws that deal with that particular problem. There have been some that got in trouble over that.

Senator LONG. There have been some good ones who did not get into trouble.

For example, the fellow running the Chicago Northwest Railroad, who is the chief executive officer, got together with other employees to buy the railroad.

He borrowed every nickel he could borrow. In addition, about 10 percent of the guys went along with him, when they bought that railroad. Where that railroad was not making money, they have made it make real money. It is a well run railroad, one of the most efficient railroads there is. They are doing a good job. He did not plan to be the chief executive officer, but the people said, if you think you can run it any better, buy it.

He took them up on it.

I do not see anything wrong with the fact that a guy can go to work at the bottom of the totem pole and wind up being chief executive officer.

That is in keeping with the American dream, is it not?

Mr. GEORGINE. That is part of our system.

Senator LONG. Thank you very much.

Senator WILLIAMS. Thank you Senator Long.

Mr. Georgine, thank you.

Do you have anything further Senator Bentsen?

Senator BENTSEN. No.

Mr. GEORGINE. Thank you.

Senator WILLIAMS. There will be a rollcall vote in the Senate at 11:45, so we are going to call the next two groups of witnesses up here together, the Business Roundtable and the National Federation of Independent Business.

STATEMENT OF BORIS AUERBACH, SECRETARY, FEDERATED DEPARTMENT STORES, ON BEHALF OF THE BUSINESS ROUNDTABLE, ACCOMPANIED BY VIRGIL B. DAY OF VEDDER, PRICE, KAUFMAN, KAMMHOLZ & DAY; AND JERRY L. OPPENHEIMER OF MAYER, BROWN & PLATT, WASHINGTON, D.C.

Mr. AUERBACH. My name is Boris Auerbach, secretary, Federated Department Stores, Cincinnati, Ohio.

I appear today on behalf of the Business Roundtable. I am accompanied by Virgil B. Day of Vedder, Price, Kaufman, Kammholz & Day, Washington, D.C., and Jerry L. Oppenheimer of Mayer, Brown & Platt, Washington, D.C.

The Business Roundtable's members are the chief executive officers of 190 of the country's major companies. They are vitally concerned with public issues that affect the social and economic well-being of the Nation.

The roundtable welcomes this opportunity to present its views on the proposals to amend ERISA and the Internal Revenue Code which are pending before you.

At the outset, let me commend the members of these subcommittees, particularly Chairmen Williams and Bentsen and Senator Javits, for introducing important legislation and for scheduling these hearings. We recognize and appreciate your leadership and concern for the well-being of private pension and welfare plans. They provide benefits to participants and beneficiaries and also contribute importantly to capital formation.

A major congressional objective in enacting ERISA was to encourage the establishment and continuation of private benefit plans. We believe it is timely and appropriate to review whether the objectives of Congress have been achieved and whether private pension and welfare plans have been strengthened for the benefit of all concerned.

Today, I will briefly summarize the general views of the Business Roundtable on the proposals which are before your subcommittees. We understand that a more specific statement will be filed for the record on behalf of major plan sponsors by the ERISA Industry Committee (ERIC), which has been concerned with ERISA since its passage. The Roundtable was instrumental in fostering the establishment of ERIC and works closely with ERIC on ERISA matters. That statement will amplify how we believe ERISA can be strengthened.

GENERAL OBSERVATIONS

The Business Roundtable supports the general purposes of the pending bills (1) to foster and encourage the establishment and maintenance of private employee benefit plans; and (2) to simplify compliance with ERISA's provisions and plan administration. Excessive costs have been incurred in administering plans. In addition, unnecessary and burdensome paperwork and redtape and lengthy delays in issuing regulations have hindered achievement of ERISA objectives.

Simplified, rather than duplicative and costly compliance requirements, and clear, timely and understandable, rather than delay, confusing and inconsistent regulations, will significantly assist in reaching objectives which are in the best interests of both plan sponsors and plan participants.

We are pleased that certain problems which have arisen since ERISA's enactment, particularly in the area of simplified reporting and disclosure, have been resolved by actions of the executive branch.

The Business Roundtable supports the adoption of amendments that will clarify conflicting ERISA provisions, eliminate burdensome and unnecessary compliance costs, and codify important regulatory decisions. We oppose substantive amendments which would greatly expand ERISA standards and requirements at this time. Many of these amendments would not be in the best interests of either plans or participants. In a period of escalating costs, many of these amendments would subvert the objectives of fostering and encouraging the establishment and maintenance of private plans and would inhibit the continued existence, improvement and growth of private pension plans when plan sponsors are seriously concerned with higher compliance costs.

We note in this regard that on July 12, President Carter signed an Executive order establishing an 11-member Presidential Commission on Pension Policy which will conduct a 2-year study to develop and recommend national policies for retirement programs. We strongly urge that major substantive amendment of ERISA would be premature until an overall, comprehensive assessment of retirement policy issues is completed by that Commission.

The following general comments are offered in the hope that they will be helpful to the committee in its continuing analysis of employee benefit matters.

S. 3017 proposes to consolidate in a new Federal agency the Employee Benefits Commission, the principal responsibilities for administering ERISA. S. 901 would allocate responsibility for various aspects of ERISA to either the Treasury or Labor, but not to both.

The principal multiple jurisdiction problems arose immediately after passage. These problems initially plagued many plan sponsors, but we believe they are no longer pressing issues. We believe there are more significant and potentially rewarding issues pending before you and the Internal Revenue Service, Treasury Department, Department of Labor, and Pension Benefit Guaranty Corporation, and we strongly urge that you take no action in this regard at least until the recently announced reorganization proposal of the administration has been implemented and there has been a reasonable opportunity to assess our collective experience with it.

Generally, we support the suggested amendments which deal with simplification of ERISA reporting and disclosure requirements. We view these as revisions to ERISA which will reduce costly and unnecessary reporting requirements and which will facilitate more efficient and orderly administration of employee benefit plans without reducing the protections afforded to participants under ERISA.

In addition, we believe these changes may make qualified retirement plans more attractive to a broader segment of employers and may slow the recent high rate of plan terminations.

Specifically, we support (1) simplified and cyclical annual reporting; (2) consolidation of form EBS-1 with the IRS form 5300 series; (3) elimination of the summary annual report; and (4) simplification of reports of participant's benefit rights.

We do believe, however, that the requirements for notice to interested parties could be eliminated without eroding ERISA protections.

Moreover, the proposal to combine the Department of Labor's EBS form 1—the plan description form required pursuant to ERISA—with the Internal Revenue Service form 5300—which is the determination letter application—should be carefully tailored so as not to require a plan to obtain a determination letter from the IRS before its tax qualification is recognized. Under present law, there is of course no requirement that a plan obtain an advance determination letter that it is a tax qualified plan. We do foresee serious practical problems if a plan is not qualified until the determination letter is issued.

We strongly support the proposal to revise section 514 of ERISA to clarify the applicability of Federal and State securities laws to employee benefit plans.

This clarification of ERISA will be imperative if the case of *Daniel* v. *International Brotherhood of Teamsters*, now before the Supreme Court, is not overturned. We believe it is clear that the antifraud provisions of both the 1933 and 1934 acts were never intended to apply to noncontributory, mandatory pension plans.

A finding in *Daniel* that such provisions do apply is contrary to 40 years of interpretation of congressional intent regarding the securities laws; raises the prospect of massive liability for both unions and employers; seriously interferes with labor-management relations and collective bargaining; and unwisely applies yet another body of law to be interpreted by yet another Government agency to an already overburdened governmental regulatory structure.

Hence, we strongly support this amendment, but we do suggest that it be clarified to cover profit-sharing plans and thrift plans, except where voluntary investment of employees' contributions in securities of the employer is present.

Although it is clear in both the statutory language and the legislative history that ERISA preempts State laws relating to employee benefit plans, recent court decisions have made serious and questionable inroads into the preemption provisions of ERISA.

Notwithstanding the broad ERISA preemption provisions, recent court decisions would allow States to regulate insured group employee welfare benefit plans.

Federal preemption is essential to multistate employers who provide uniform private pension and welfare benefits on a nationwide basis.

State-by-State requirements governing the content of welfare plans would result in unwieldly plan administration and could result in plan terminations or the curtailment of certain welfare plans.

ERISA clearly and appropriately provided such preemption, and we believe an appropriate reaffirmation of the congressional intent is needed.

Accordingly, we recommend that S. 1393, which would exempt health plans from the ERISA preemption provisions, should be rejected.

We have serious reservations about some of the substantive provisions which are before you, particularly the proposals (1) to prohibit retirement income offsets for workmen's compensation payments; (2) to amend the joint and survivor annuity provisions and to mandate additional vesting requirements in the event of death by adding insurance features is defined benefit plans; (3) to establish uniform accounting or actuarial standards regarding plan assets and liabilities; (4) to require immediate funding of benefit increases scheduled for future years; (5) to require a Department of Labor study of cost of living adjustments which we believe would duplicate other studies; (6) to require that qualified plans accept employee contributions; (7) to give tax credits for new or improved plans; and (8) to amend ERISA to authorize or direct investment of plan assets in specific types of businesses or categories of assets, for example, in new, small, regional, or medium size businesses. Detailed comments on these and other provisions will be submitted in the ERIC statement.

We thank you for your attention, and we would welcome an opportunity to answer your questions.

Senator WILLIAMS. Thank you very much, Mr. Auerbach. We will insert the ERIC statement in the record at this point, right after the Business Roundtable's statement. Now, if you will stay on as part of for future years; (5) to require a Department of Labor study of cost the panel, we will turn to Senator Bentsen

[The prepared statements of the Business Roundtable and ERIC follow:]

STATEMENT OF THE BUSINESS ROUNDTABLE BEFORE
JOINT HEARING OF THE LABOR SUBCOMMITTEE,
SENATE HUMAN RESOURCES COMMITTEE AND THE SUBCOMMITTEE
ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS,
SENATE FINANCE COMMITTEE

AUGUST 16, 1978

My name is Boris Auerbach, Secretary, Federated Department Stores, Cincinnati, Ohio. I appear today on behalf of the Business Roundtable. I am accompanied by Virgil B. Day of Vedder, Price, Kaufman, Kammholz & Day, Washington, D.C., and Jerry L. Oppenheimer of Mayer, Brown & Platt, Washington, D.C.

The Business Roundtable's members are the chief executive officers of 190 of the country's major companies. They are vitally concerned with public issues that affect the social and economic well-being of the nation.

The Roundtable welcomes this opportunity to present its views on the proposals to amend ERISA and the Internal Revenue Code which are pending before you.

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At the outset, let me commend the members of these Subcommittees, particularly Chairmen Williams and Bentsen and Senator Javits, for introducing important legislation and for scheduling these hearings. We recognize and appreciate your leadership and concern for the well-being of private pension and welfare plans. They provide benefits to participants and beneficiaries and also contribute importantly to capital formation.

A major Congressional objective in enacting ERISA was to encourage the establishment and continuation of private benefit plans. We believe it is timely and appropriate to review whether the objectives of Congress have been achieved and whether private pension and welfare plans have been strengthened for the benefit of all concerned.

Today, I will briefly summarize the general views of the Business Roundtable on the proposals which are before your Subcommittees. We understand that a more specific statement will be filed for the record on behalf of major plan sponsors by the ERISA Industry Committee (ERIC), which has been concerned with ERISA since its passage. The Roundtable was instrumental in fostering the establishment of ERIC and works closely with ERIC on ERISA matters. That statement will amplify how we believe ERISA can be strengthened.

General Observations

The Business Roundtable supports the general purposes of the pending bills (1) to foster and encourage the establishment and maintenance of private employee benefit plans; and (2) to simplify compliance with ERISA's provisions and plan administration. Excessive costs have been incurred in administering plans. In addition, unnecessary and burdensome paperwork and red tape, and lengthy delays in issuing regulations have hindered achievement of ERISA objectives. Simplified, rather than duplicative and costly compliance requirements, and clear, timely and understandable, rather than delayed, confusing and inconsistent regulations, will significantly assist in reaching objectives which are in the best interests of both plan sponsors and plan participants.

We are pleased that certain problems which have arisen since ERISA's enactment, particularly in the area of simplified reporting and disclosure, have been resolved by actions of the Executive branch.

The Business Roundtable supports the adoption of amendments that will clarify conflicting ERISA provisions, eliminate burdensome and unnecessary compliance costs, and codify important regulatory decisions. We oppose substantive amendments which would greatly expand ERISA standards and requirements at this time. Many of these amendments would not be in the best interests of either plans or participants. In a period of escalating costs, many of these amendments would subvert the objectives of fostering and encouraging the establishment and maintenance of private plans and would inhibit the continued existence, improvement and growth of private pension plans when plan sponsors are seriously concerned with higher compliance costs.

We note in this regard that on July 12, President Carter signed an Executive Order establishing an eleven-member Presidential Commission on Pension Policy which will conduct a two-year study to develop and recommend national policies for retirement programs. We strongly urge that major substantive amendment of ERISA would be premature until an overall, comprehensive assessment of retirement policy issues is completed by that Commission.

The following general comments are offered in the hope that they will be helpful to the Committee in its continuing analysis of employee benefit matters.

Multiple Jurisdiction

S. 3017 proposes to consolidate in a new federal agency, the Employee Benefits Commission, all responsibility for administering Titles I and IV of ERISA and sections 401, 415 - 419, 6057 and 6058 of the Internal Revenue Code, insofar as these sections relate to employee benefit plans covered by ERISA. S. 901 would allocate responsibility for various aspects of ERISA to either the Treasury or Labor Department, but not to both.

The principal multiple jurisdiction problems arose immediately after passage of ERISA. These problems initially plagued many plan sponsors, but we believe they have now largely dissipated or been resolved. The multiple jurisdiction matter is not now of major concern to most plan sponsors. We believe there are more pressing and potentially rewarding issues pending before you and the Internal Revenue Service, Treasury Department, Department of Labor, and Pension Benefit Guaranty Corporation, and we strongly urge that you take no action in this regard at least until the recently announced reorganization proposal of the Administration has been implemented and there has been a reasonable opportunity to assess our collective experience with it.

Paperwork Elimination

Generally, we support the suggested amendments which deal with simplification of ERISA reporting and disclosure requirements. We view these as revisions to ERISA which will reduce costly and unnecessary reporting requirements and which will facilitate more efficient and orderly administration of employee benefit plans without reducing the protections afforded to participants under ERISA. In addition, we believe these changes may make qualified retirement plans more attractive to a broader segment of employers and may slow the recent alarming high rate of plan terminations.

Specifically, we support (1) simplified and cyclical annual reporting; (2) consolidation of Form EBS-1 with the IRS Form 5300 series; (3) elimination of the Summary Annual Report; and (4) simplification of reports of participant's benefit rights. However, the proposal to combine the Department of Labor's EBS-1 form (the plan description form required pursuant to ERISA section 102(a)(2)) with the Internal Revenue Service Form 5300 Series (determination letter applications) should be carefully tailored so as not to require a plan to obtain a determination letter from the IRS before its tax qualification is recognized. Under present law, there is, of course, no requirement that a plan obtain an advance determination letter that it is a tax qualified plan. If a plan is not qualified until a determination letter is issued, given the normal delay in obtaining a determination, there would often be no basis for claiming a deduction for contributions made during the taxable year of adoption of or amendment to a plan unless the contributions were included in the employees' taxable income. Thus, plan adoptions or amendments could be delayed to the detriment of plan participants and beneficiaries. In addition, if plans were required to obtain contributions, the Service would be required to rule with regard to all plans and plan provisions. It has not been willing or able to do this in the past.

Securities Laws and Retirement Plans

We strongly support the proposal to revise section 514 of ERISA to clarify the applicability of federal and state securities laws to employee benefit plans. This clarification of ERISA will be imperative if the case of Daniel v. International Brotherhood of Teamsters, now before the U.S. Supreme Court, is not overturned. We believe it is clear that the antifraud provisions of both the 1933 and 1934 Securities Acts were never intended to apply to noncontributory, mandatory pension plans. A finding in Daniel that such antifraud provisions do apply (1) is contrary to 40 years of interpretation of Congressional intent regarding the securities laws; (2) raises the prospect of massive liability for both unions and employers; (3) seriously interferes with labor-management relations and collective bargaining; and (4) unwisely applies yet another body of law to be interpreted by yet another governmental agency to an already overburdened governmental regulatory structure. Hence, we strongly support this amendment but suggest that it be clarified to cover profit sharing plans and thrift plans, except where voluntary investment in securities is present.

Preemption

Although it is clear in both the statutory language and the legislative history that ERISA preempts state laws relating to employee benefit plans, recent court decisions[1/] have made serious and questionable inroads into the preemption provisions of ERISA. Notwithstanding the broad ERISA preemption provisions, recent court decisions would allow states to regulate insured group employee welfare benefit plans. Federal preemption is essential to multistate employers who provide uniform private pension and welfare benefits on a nationwide basis. State-by-

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1/ See, for example, Dawson v. Whaland, 522 F.2d 70 (1st Cir. 1977), cert. denied, 46 U.S.L.W. 3645 (April 18, 1978).

state requirements governing the content of welfare plans would result in unwieldy plan administration and could result in plan terminations or the curtailment of certain welfare plans. ERISA clearly and appropriately provided such preemption, and we believe an appropriate reaffirmation of the Congressional intent is needed. Accordingly, we recommend that S. 1393, which would exempt health plans from the ERISA preemption provisions, should be rejected.

<u>Other Provisions</u>

We have serious reservations about some of the substantive provisions which are before you, particularly the proposals (1) to prohibit retirement income offsets for workmen's compensation payments; (2) to amend the joint and survivor annuity provisions; (3) to establish uniform accounting or actuarial standards regarding plan assets and liabilities; (4) to require immediate funding of benefit increases scheduled for future years; (5) to require a Department of Labor study of cost of living adjustments which would duplicate other studies; (6) to require that qualified plans accept employee contributions; (7) to give tax credits for new or improved plans; and (8) to amend ERISA to authorize or direct investment of plan assets in specific types of businesses or categories of assets, for example, in new, small, regional, or medium size businesses. Detailed comments on these and other provisions will be submitted in the ERIC statement.

We thank you for your attention and would welcome an opportunity to answer your questions.

THE ERISA INDUSTRY COMMITTEE (ERIC)

Comments For

THE SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS
SENATE COMMITTEE ON FINANCE

And

THE SUBCOMMITTEE ON LABOR
SENATE COMMITTEE ON HUMAN RESOURCES

On

S. 250 - To Prohibit the Reduction of Disability Payments

S. 901 - The Pension Simplification Act

S. 1383 - To Clarify the Status of the Hawaii Prepaid Health Care Law

S. 1745 - The ERISA Small Business Paperwork Reduction and Investment Act

S. 2992 - To Provide Uniform Accounting of Pension Liabilities

S. 3017 - The ERISA Improvements Act of 1978

S. 3193 - The ERISA Paperwork Reduction Act

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INTRODUCTION

These comments are submitted on behalf of The ERISA Industry Committee (ERIC). Its ninety members include half of the nation's fifty largest industrial companies and represent a cross-section of the nation's largest retailers, utilities, banks and insurers.

ERIC members are genuinely concerned about the well-being of their employees. The approximately 8.5 million participants in pension plans sponsored by ERIC members represent about twenty percent of all participants in private pension plans. Welfare plans sponsored by ERIC members cover about 22 million individuals, over ten percent of the nation's population.

For convenience, these comments generally follow the order of S. 3017 and are not necessarily in the order of importance to ERIC. For the sake of brevity, they are summary and do not deal with every provision of each of the pending bills. We anticipate that the comments will raise questions. Accordingly, we would welcome the opportunity to amplify them through supplemental submissions, to confer with members of the Subcommittees and their staffs, and generally to make the experience of ERIC's members and counsel available to the Subcommittees. We also hope to comment subsequently on proposals not considered herein.

I. Multiple Jurisdiction (S. 901 and S. 3017)

S. 3017 would consolidate in a new agency all responsibility for administering Titles I and IV of ERISA and certain sections of the Internal Revenue Code. S. 901 would allocate responsibility for various aspects of ERISA to either the Treasury Department or the Department of Labor.

The principal multiple jurisdiction problems arose immediately after passage of ERISA. Those problems have been largely resolved, and the multiple jurisdiction matter is not now of major concern. There are now more pressing matters pending before these Subcommittees and the Internal Revenue Service, Treasury Department, Department of Labor, and Pension Benefit Guaranty Corporation. Accordingly, we urge that this matter be deferred at least until the Administration's recent reorganization plan has been implemented and there has been a reasonable opportunity to assess its operation.

II. Reporting and Disclosure (§ 4 of S. 901, §§ 2-4 of S. 1745, §§ 221-29 of S. 3017 and S. 3193)

ERIC generally supports the various proposals to simplify reporting and disclosure requirements. More specifically, ERIC supports the proposed (1) simplified and cyclical annual reporting, (2) consolidation of Form EBS-1 and the Form 5300 series, (3) elimination of the summary annual report, and (4) simplification of reporting of participants' benefit rights. These revisions should reduce costly and unnecessary requirements, facilitate more efficient administration of plans without reducing ERISA protections, and may encourage plan adoptions and retard plan terminations.

Section 2 of S. 901 should eliminate problems resulting from the undue specificity in ERISA section 103. If, however, the present specificity is retained, the proposed delineation of accountants' and actuaries' responsibilities envisioned by sections 226 and 228 of S. 3017 should also reduce unnecessary duplication and expense. Nevertheless, we would prefer to see these professions reach a satisfactory accord without further government intervention.

We make three additional suggestions.

A. Consolidation of Forms (§ 224 of S. 3017 and § 2 of S. 3193). There is no present requirement that a plan obtain an advance determination letter that it is a tax qualified plan. The proposal to combine Labor's Form EBS-1 (the plan description form) with the Service's Form 5300 series (determination letter applications) should be carefully tailored so as not to require a plan to obtain a determination letter from the Service before its tax qualification is recognized or effective.

If a plan were not qualified until a determination letter was issued, given the normal delay in obtaining a determination, there would often be no basis for claiming a deduction for contributions made during the taxable year of adoption of or amendment to a plan unless the contributions were recognized by the employees as income when made. Thus, for example, plan adoptions and amendments, particularly at year-end, could be hindered or precluded. In addition, if plans were required to obtain determinations, the Service would have to be required to rule with respect to all plans and all plan provisions. It has not always been willing or able to do this in the past.

B. Notice to Interested Parties. ERIC strongly urges the repeal of Code section 7476(b)(2) which, in effect, requires the notification of interested parties prior to the filing of any request for a determination letter. ERIC supports the proposition that participants and beneficiaries be informed of amendments which affect them, but, as suggested by Senator Bartlett in his testimony, this notification requirement is unduly burdensome and expensive, serves no useful purpose, is generally ignored or misunderstood by participants, and duplicates other reporting requirements.

Under the regulations, the request for a determination letter must be filed within a certain period of time after notification is given. This significantly reduces flexibility in adopting plan amendments, particularly, for example, when the amendments must be approved by a board of directors. If timely notice cannot be given, amendments may be delayed from one plan year to the next. Moreover, giving notice is often expensive where many work sites or retirees are involved.

Participants and beneficiaries may object to a request for a determination letter only on grounds that the plan is not qualified. This is a matter the Service can well decide without assistance from participants and beneficiaries. A provision cannot be rejected merely because a participant or beneficiary "doesn't like" it.

Participants and beneficiaries receive notice of amendments through the annual report, the summary of the annual report (which would be eliminated by the current proposals), and updates to the summary plan description. If the Service were ever erroneously to approve a plan or plan amendment, a participant or beneficiary could obtain corrective action by civil enforcement under ERISA section 502.

In short, little, if any, benefit is derived from these notices. Accordingly, and in furtherance of simplifying ERISA compliance and reducing unnecessary costs, the requirement of notice to interested parties prior to filing a request for a determination letter should be eliminated.

C. Reporting and Master Trusts. ERISA section 103 should be amended to reverse the Labor Department regulations requiring plans of related employers which invest through a single master trust to allocate on Forms 5500 assets of the master trust to the individual plans. The required allocation is contrary to generally accepted accounting principles, misleading to plan participants, expensive, and unnecessary. Each participating plan should be able to report its undivided interest in the master trust, accompanied by the trust's full financial statement, as is permitted for common or collective trusts which commingle the assets of plans of unrelated employers.

III. Reciprocal Agreements (§ 231 of S. 3017)

ERIC understands that the purpose of the proposal is to permit mobile, short-term employees, such as construction workers, to rely on a single plan for retirement benefits. Generally, employer contributions for a specific employee are readily ascertainable under multiemployer plans, and the proposal contemplates the immediate transfer of such contributions to the "home plan" prior to the employee's accruing any service related rights in the "away plan".

As drafted, however, the proposal might apply to a long-term participant in any collectively bargained plan, including a single employer plan, even though his share of employer contributions may not be readily ascertainable and his entitlement to benefits may depend on complex actuarial assumptions and formulae. Most employees, especially participants in single employer plans, do not frequently change employment, and pension plans are appropriately designed to benefit primarily long-term employees. ERIC is concerned that the proposal might foster more rapid employee turnover. Accordingly, it should be restricted to its original purpose and to multiemployer plans.

IV. <u>Reductions in Retirement Disability Benefits (S. 250 and § 237 of S. 3017)</u>

ERIC strongly opposes the proposal to prohibit the reduction of pension benefits by the amount of worker's compensation awards. Plans have been designed with the knowledge that such offsets are permitted (see Rev. Rul. 68-234, 1968-1 C.B. 157), and there is no reason now to prohibit elimination of potentially very costly duplication of benefits.

The policy against double benefits has long been extant in Social Security (see 42 U.S.C.A. §§ 402(k)(2)(B), (k)(3), and 424(a)) and was recently reaffirmed by Congress by requiring reduction of Social Security survivors' benefits for persons receiving Civil Service annuities (see section 334(b)(2) of the Social Security Amendments of 1977, P.L. 95-216).

Worker's compensation eligibility is determined solely by State panels, but the cost is borne entirely by employers. Many employees take normal retirement and subsequently receive worker's compensation. If disability benefits cannot be offset, they may well be eliminated from retirement plans to the detriment of employees, particularly those who are disabled in other than work related injuries.

V. Joint and Survivor Annuities (§ 238 of S. 3017)

ERIC strongly objects to the proposal, in effect, to amend significantly ERISA's vesting rules and require retirement plans which provide annuity options to provide life insurance for all who are more than fifty percent vested. This proposal would increase plan costs, might lead to reduced benefits, and would conflict with existing life insurance programs.

Most participants who would be affected are relatively young. Their accrued benefits are generally based on compensation and length of service. A 30 to 40 year old with 10 or 20 years of service will generally not be in the higher compensation ranges. Thus, the "insurance" benefit the surviving spouse would receive (one half of the accrued vested benefit) would be relatively small. Furthermore, no amount would be paid the surviving spouse until the employee would have reached his earliest retirement age which often would be 20 or 30 years after his death. Typical employees would not consider such "insurance" very valuable. Nonetheless, forgoing forfeitures on the death of participants would, in the aggregate, increase funding costs. Furthermore, costs associated with administering elections, maintaining accounts, and paying annuities could be significant.

The proposal to eliminate the option of reducing benefits if a preretirement survivors' annuity is provided would force all participants, even those who are not married or otherwise do not receive this death protection, to share the costs. We note that current law extends the "insurance" benefit only to those who could have retired with joint and survivor benefits before death.

Furthermore, participants are commonly covered by group life insurance programs, without any waiting period for vesting, which provide death benefits of two or three times compensation, regardless of age or length of service. The proposal's increased cost could force many employers either to reduce benefits under the plan or to terminate group insurance arrangements. In any event, the proposed death benefit does not justify the increased costs.

ERIC also opposes the proposal to require lump sum payments to surviving spouses of participants who are more than fifty percent vested from plans which do not provide annuity payments. In addition to the "insurance" objections raised above, we are troubled that the proposal apparently would not permit participants in such plans to decline lump sum payments. Employees should have flexibility in their estate plans. Indeed, due to divorces, subsequent remarriages, tax and other factors, the surviving spouse may be the least appropriate beneficiary.

Moreover, many participants may wish to avoid the operation of Code section 2039(c) which includes in a decedent's gross estate benefits payable in a lump sum on death from a qualified plan. The required payment within sixty days after the end of the year in which the participant dies also seems superfluous in view of ERISA section 206(a) and Code section 401(a)(14).

ERIC proposes that all profit sharing, thrift and similar plans which currently provide that a participant's entire account will be vested on death be made exempt from any joint and survivor annuity requirements. Many such plans provide for annuity payments and, therefore, must now provide joint and survivor annuities, unless the employee elects otherwise. However, because the survivor is assured of the total accrued benefit, even if not vested before death, the supposed ERISA protections are unnecessary and unnecessarily increase the costs of maintaining such plans.

VI. Elapsed Time (§ 239 of S. 3017)

The proposal would remove any remaining doubt that ERISA permits (as affirmed by Automated Packaging Systems, Inc., 70 T.C. No. 20 (May 15, 1978)) use of the elapsed time system of crediting service. It is used by many plans to measure employee service by reference to the time elapsed between the date of hire and the date of termination.

We urge, however, the deletion of that part of the proposal which would require regulations to assure "that employees whose service is measured in terms of elapsed time are, in the aggregate, not disadvantaged by the use of such system" (emphasis added). An "aggregate" test would raise troublesome issues such as (1) who are "disadvantaged employees"; (2) whether the measurement would be made location by location, plan by plan, or for all participants with a common employer; and (3) whether actual service records would be required to justify the use of the elapsed time method.

VII. Funding of Future Benefits (§ 251 of S. 3017)

ERIC strongly opposes the proposal to require that after 1980 a plan's funding method take into account provisions of a plan which are not yet effective. It could significantly alter customary collective bargaining practices, would accelerate the cost of funding plans (and thus contribute to inflation), would result in significant and unnecessary additional complexity, and could, therefore, result in additional plan terminations.

The explanation of this proposal indicates that employers would be able to reduce contributions immediately in the event that an amendment were adopted to reduce benefits in the future. The explanation, however, ignores the fact that plans would be required to fund immediately future benefit increases.

Collectively bargained benefits typically are phased in over several years. The commencement date of increased benefits is frequently as important as (or more important than) the amount of the increase. The proposal would negate any advantage of deferring increased benefits to future years and would therefore make bargaining more difficult.

Furthermore, the proposal would engender controversy and further complexity. The proponents recognized that an amendment might never become effective. Thus, the explanation suggests that regulations would be issued for "appropriately" adjusting the funding standard account in the event any provision is not actually implemented. This would add further complexity to funding standard accounts.

Finally, we note that the proposal would deem any provision "adopted but contingent on a future event" as not effective prior to the occurence of the event. This provision, although necessary, would be difficult to apply. More specifically, it would exempt contingent provisions from immediate funding requirements, but what contingencies are contemplated? Would increased benefits subject to confirmation by a board of trustees or by an employer qualify? In any event, future benefit increases customarily might be made contingent on some event, even though it was virtually certain that the event would occur. Thus, administering the proposal could be difficult.

VIII. Fiduciary Responsibility (§§ 9-11 of S. 1745 and Part 4 of S. 3017)

ERIC generally supports the proposal in section 264 of S. 3017 to revise the cofiduciary responsibility provisions.

Plans are established to provide important coverage for participants and beneficiaries, and only incidentally to support other objectives, regardless of how laudable. Accordingly, ERIC strongly opposes legislation to authorize or require investment of plan assets in specific types of businesses or categories of assets, for example, in new, small, regional or medium sized businesses or in low or moderate income housing. Such legislation would inevitably lead to weakening the financial resources relied upon for retirement security.

IX. Impact of Inflation on Retirement Benefits (§ 273 of S. 3017)

ERIC strongly opposes any authorization of a Labor Department study regarding requirements for cost of living adjustments to private plan benefits. The effect of inflation cannot be isolated from a consideration of related issues, such as the definition of an "adequate" retirement income, the role of Social Security and other government programs, their relationship to private pension plans, the mechanisms for funding future benefits, and the effect of indexed benefits on inflation, capital formation, and economic growth.

Congress last year created a National Commission on Social Security to report within two years on the adequacy of retirement income provided by public and private plans, including the need for, and financial impact of, an inflation index for the elderly.

Similarly, after a Labor Department study was proposed, the President established a Commission on Pension Policy to develop within a year national retirement policy. It is to focus on financing and benefit structures and effects on private capital formation and economic growth.

In addition, the Advisory Council on Social Security is focusing on the retirement income goals for Social Security and private plans, the impact of inflation, and alternatives to the present system. The Council's reports are due on October 1, 1979.

Accordingly, any additional Labor Department study would duplicate the work of these three bodies, would be completed significantly after their reports have been made, and would unnecessarily dissipate resources.

X. The Daniel Case (§ 274 of S. 3017)

ERIC strongly supports the proposal to clarify that Federal and State securities laws do not apply generally to the interest of an employee in an employee benefit plan. However, the proposal also must clearly cover profit-sharing and thrift plans except for voluntary employee investments in employer securities. As emphasized in its testimony before the Labor Subcommittee on October 14, 1977, ERIC believes that legislation is imperative if the Daniel*/ case is not reversed by the Supreme Court.

Daniel raises the prospect of massive liability for unions and employers alike, is at variance with ERISA, promises interference with labor-management relations and collective bargaining, applies yet another body of law to the regulation of employee benefit plans, and needlessly involves another agency in a most comprehensive regulatory scheme.

XI. ERISA Preemption (S. 1383)

ERISA clearly and appropriately preempts State laws relating to employee benefit plans. Nonetheless, recent

*/ Daniel v. International Brotherhood of Teamsters, 561 F.2d 1223 (7th Cir. 1977), cert. granted, 98 S.Ct. 1232 (Feb. 21, 1978).

court decisions have seriously eroded ERISA preemption with regard to State mandated benefits and assignment or alienation of benefits. Accordingly, ERIC urges (1) an appropriate reaffirmation of Congressional intent and (2) the rejection of S. 1383 which would exempt health plans from the ERISA preemption provision.

A. State Mandated Welfare Benefits. Wadsworth v. Whaland*/ held that a New Hampshire law mandating the inclusion of mental health coverage in all group insurance policies issued in that State was not preempted because ERISA section 514(b)(2)(A) permits state regulation of "insurance". Pennsylvania recently adopted a law that would require medical plans to cover physical therapists services. Other States require coverage for the services of psychiatric social workers and chiropractors. Disparate State laws are particularly troublesome for multistate employers who frequently transfer employees (whose benefits and coverage may thus change) and may have employees who live in one State but work in another which imposes different requirements.

The States rarely reflect on the inflationary consequences of their laws or recognize that resources available for employee benefits are limited. Mandating one type of

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*/ Wadsworth v. Whaland, 562 F.2d 70 (1st Cir. 1977), cert. denied, 46 U.S.L.W. 3645 (Apr. 18, 1978).

coverage often requires discontinuing another. For example, the trustees of the plan in a companion case to Wadsworth now provide mandated New Hampshire mental health coverage, but they were forced to discontinue previously provided dental and vision protection. In effect, these State laws preclude employers and employees from determining which benefits should be provided. Thus, they conflict with free collective bargaining.

Employees and their dependents suffer from these State laws regardless of how well intended. Faced with mounting costs, unwieldy administration and vexatious litigation, some employers will terminate or curtail plans; others will not adopt or expand them. ERISA's purpose to encourage the growth of plans is thus frustrated. Moreover, Wadsworth has encouraged employers to self-insure in order to avoid the reach of State laws. Such action, particularly in the case of smaller or marginal employers, could be most unfortunate for participants who could look only to the resources of their employers for protection.

Significant confusion over the role of the States has been fueled by pending litigation regarding, for example, the health insurance laws of California, Hawaii, and Minnesota. ERIC strongly recommends that this confusion (and litigation) be terminated by an appropriate reaffirmation of the ERISA preemption provisions.

B. Assignment and Alienation of Benefits. ERISA provides that benefits payable to a participant may not be assigned or alienated and would seem to preempt any State law to the contrary. Nevertheless, the anti-assignment and preemption provisions have not been properly applied in many family support and divorce proceedings.

For example, in Cartledge v. Miller, pending before the U.S. District Court for the Southern District of New York, the plan administrator contested the attempted garnishment of a participant's plan benefits. In an amicus curiae brief, the Department of Justice argued that Congress intended to prohibit certain involuntary transfers but also intended an implied exception for family support orders. ERIC submits that no such exception was intended.

As a second example, we note that California courts now permit an employee's spouse to join a plan in which the employee has an interest, whether or not vested, as a party to a divorce action. The plan may challenge the joinder only upon a showing that the employee has no interest in the plan or that the order grants different rights than those to which the employee is entitled, requires present payment of future benefits or payments after the spouse's death, or awards the spouse more than his community property interest in the plan.

Retirement plans are now being routinely joined in California divorce actions. One ERIC member has been joined more than 40 times. Unless a plan is prepared to accept whatever may transpire in these proceedings, it must appear and protect its interests through an attorney. The costs involved are high, but so are the risks of not appearing. Indeed, acquiescence in a court ordered assignment may jeopardize a plan's tax status. In short, the burdens and risks presented by these proceedings are borne by other plan participants.

ERIC appreciates the financial problems of a dependent family or divorced spouse, but it believes that Congress intended plans to make unencumbered payments to participants and to have all creditors enforce their rights against the participant. We submit that an appropriate Congressional reaffirmation of this policy is urgently needed.

XII. Lump Sum Distributions (§ 301 of S. 3017)

ERIC supports the principle that "defined benefit plans shall be considered separately from defined contribution plans for purposes of determining the balance tó the credit of an employee under the lump sum distribution rules". The proposal should not be limited to multiemployer plans.

Generally, defined contribution and defined benefit pension plans of a particular employer cover different groups of employees or serve different purposes. For example, one plan may be the "primary" pension plan and the other may be a savings plan in which participation might be voluntary. An employee should not be required, for example, to withdraw in a lump sum (with adverse impact on savings) his interest in the "primary" defined benefit pension plan merely to assure that a withdrawal of his interest in the savings plan is treated as a lump sum distribution. ERIC strongly urges that all defined benefit plans of a single employer be treated as a single plan, separately from defined contribution plans of that employer, as would be the rule for multiemployer plans.

We also suggest that the proposal be clarified by inserting the word "multiemployer" before the word "plan" in each place it appears in proposed Code section 402(e)(4)(C)(ii). Otherwise, the proposal might be read to require that an employee who has rights under both a defined benefit multiemployer plan and a defined benefit single employer plan of the same employer might have to receive distributions from both plans to qualify for lump sum treatment.

Finally, we note that no employer "maintains" a multiemployer plan. By definition, such plans are maintained pursuant to collective bargaining agreements with more than one unrelated employer. Thus, the words "contributed to" should be inserted for "maintained" in proposed Code section 402(e)(4)(C)(ii).

XIII. Deductible Employee Contributions, Special Master and Prototype Plans, and Simplified Pension Plans (§ 303 and Title IV of S. 3017, S. 3140 and S. 3288)

ERIC supports proposals which foster the growth of private plans, increase employee savings, and encourage capital formation. Thus, ERIC generally supports the goals of the special master and prototype plan and simplified pension plan concepts embodied in S. 3017 and S. 3140, respectively, but objects strongly to the proposal to apply the limits and other constraints applicable to H.R. 10 plans to simplified pension plans. All plans, large or small, should, at most, be limited by Code section 415 and the other constraints applicable to corporate plans.

More specifically, ERIC supports the concept of deductible employee contributions to qualified plans, such as those contemplated in S. 3288 and S. 3017, but urges that arbitrary and unnecessary limitations on gross income for eligible employees, such as those in section 303 of S. 3017, be rejected.

In addition, ERIC strongly urges that plans be given the option, and not be required as contemplated by section 303 of S. 3017, to accept employee contributions. The substantial associated administrative costs could dictate the choice of a defined contribution rather than a defined benefit plan. For smaller employers, it might even lead to the termination of existing plans. Even with defined contribution plans, employee contributions require separate accounts for employer and employee contributions and, thus, entail additional costs. Accordingly, many employers do not permit employee contributions even for individual account plans.

Indeed, the additional costs may exceed many employees' voluntary contributions. Lower compensated employees generally do not ake maximum advantage of such programs. An election to contribute could be made annually. Once made, however, the individual account would be maintained until the employee's interest terminated. Thus, costs would be incurred indefinitely, even though a particular employee might make a single contribution of less than $1,000.

The cost inefficiencies would be exacerbated if an employer maintained more than one qualified plan for the same group of employees. For example, many larger employers maintain a defined benefit plan as the primary pension plan, a savings plan, and a stock bonus plan. If each such plan were required to accept contributions and employees were allowed to elect to which plan contributions were made, the amount contributed to any particular plan could be relatively minor, and employees might elect to disperse their contributions among such plans.

The voluntary contribution proposal presents other problems. For example, it does not state whether employee contributions can be withdrawn or the effects of such a withdrawal. Nor does it indicate that a terminated employee may be "cashed out" if he has no nonforfeitable rights to employer contributions. Administering small sums in such situations would be costly.

XIV. Credit for Small Employers for Establishing Plans (§ 304 of S. 3017)

The proposal to grant credits to small businesses which establish plans is technically deficient and unfairly discriminates against larger employers and against small employers who have responsibly established plans. Employers who have not established plans would be "rewarded" at the expense of others (including competitors) who have been more responsible. Moreover, no employer should be denied a credit merely because it employs more persons who benefit from the plan, has greater annual receipts, or is affiliated with another employer and, thus, is a "large" employer.

The definition of "small business" under section 112 of the Small Business Administration Act varies for different purposes (e.g., government procurement, lease guarantees, loans, etc.) and for different industries. Thus, there would be no certainty which employers might benefit from the proposal. Finally, although proposed Code section 44C(e) would attempt to deny the credit to employers who terminate plans, adjustments to the years for which a credit was claimed may be barred by the statute of limitations. For example, if an employer who claimed the credit terminated his plan in the ninth year following its establishment, all of the years in which the credit was taken generally would be "closed", and we understand that the Service does not normally retain returns of individuals or partnerships once the statute of limitations expires.

XV. Credit for Improved Plans (§§ 124 and 305 of S. 3017)

ERIC also opposes the proposal to grant income tax credits for "improved plans" which permit "significantly earlier participation" and "significantly more rapid" vesting than required by ERISA or if there is some other similar "significant improvement" in benefits and rights.

This proposal would discriminate perversely against those "enlightened" employers who have in the past maintained plans which exceed the requirements of ERISA by rewarding employers (including competitors) who have previously maintained minimally qualified plans.

In addition, the proposal would be difficult, if not impossible, to administer. How would the "significance" of an improvement be measured? A change in the vesting schedule for one plan may have a far greater effect on the number or percentage of vested participants than the same change by another plan. For example, even a change from ten to five year "cliff" vesting may have very little effect in some cases. Similarly, what would be a "significant improvement" in benefits? Would a "normal" increase pursuant to collective bargaining qualify?

XVI. Retroactive Disqualification of Plans (§ 307 of S. 3017)

ERIC strongly supports the proposal to prohibit the Service from retroactively disqualifying a plan unless it is determined that the failure to meet the qualification requirements in preceeding years was the result of an intentional failure or willful neglect on the part of the person maintaining the plan.

Prior to ERISA, a plan could be disqualified under the Code if, even inadvertently, it entered into a prohibited transaction or otherwise failed to meet the strict qualification standards. ERISA eased this draconian rule somewhat by substituting excise taxes for disqualification as the penalty for certain prohibited transactions. The proposal would further ease the burdens on persons who make good faith efforts to comply with ERISA and would further reduce the cases where innocent beneficiaries and participants are hurt by disqualification. In Aero Rental, 64 T.C. 331 (1975), to a limited extent, the Tax Court applied a similar rule, and its statutory adoption would be welcomed.

XVII. Actuarial/Accounting Standards (S. 2992)

ERIC generally supports efforts to provide meaningful data to all interested parties. Nonetheless, we are troubled by the proposal to require the promulgation of "uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing actuarial assumptions used in such calculations".

We are particularly concerned and confused that the proposal would amend Code section 412 which deals with minimum funding. Although generally accepted reporting standards might be useful for some purposes, we question the need for further government intervention (with all the ensuing regulations and cost) in this area and submit that flexibility in selecting actuarial methods and assumptions is imperative, especially for funding purposes.

The Labor Department intends to propose within a month new reporting standards and the American Academy of Actuaries, at the invitation of the Financial Accounting Standards Board, is studying these and related issues. S. 2992 should be deferred while these activities are ongoing and until the purposes of, need for, and implications of the proposal are better understood.

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Senator BENTSEN. If I may say, Mr. Chairman, I am very pleased to have Mr. McKevitt before us. He has testified extensively before our Subcommittee on Finance and has made some very major contributions, and as a result has brought me to initiate some efforts in the way of amendments to the act, to try to bring about a simplification in the way of jurisdiction, and I have been very grateful for that.

STATEMENT OF JAMES D. "MIKE" McKEVITT, WASHINGTON COUNSEL, NFIB, ACCOMPANIED BY EDWARD H. PENDERGAST AND ROBERT SEMENZA, CERTIFIED PUBLIC ACCOUNTANTS FROM BOSTON, REPRESENTING SMALL BUSINESS OF NEW ENGLAND

Mr. MCKEVITT. Thank you, Senator.

Mr. Chairman, my name is Mike McKevitt, and I am the Washington Counsel for the National Federation of Independent Business. Joining me today is Mr. Edward Pendergast and Mr. Robert Semenza, who are practicing CPA's from Boston and who are representing the Smaller Business Association of New England. Mr. Pendergast will have a statement, as well.

Proceeding under the 1-minute rule, I would like to just touch on a summary of our testimony. I want to say, first of all, hats off to you, Senator Bentsen, for all the great work you have done on this. We are deeply appreciative of it.

We can cite case histories as evidence of the paperwork dilemma; we have done so in the past. We believe, as in the case of administrative complexity, that the committees are well-versed in this area. So, rather than dwell on these problems, it is time to devote our energies to solutions and some very good solutions are now under consideration by these committees.

NFIB finds much in both Senator Bentsen's bill, S. 3193, and Senators Javits and Williams' bill, S. 3017, which will be of immense benefit to employers and administrators of pension plans.

We are particularly pleased to see included in S. 3017 a provision to authorize the exemption or modification of existing paperwork requirements for any employee benefit plan when such measures are consistent with the public interest.

NFIB has testified on several occasions in support of such measures for small business, for we believe that they not only relieve small business from unnecessary regulatory burdens, but provide an equitable solution to the ever-present problem of the unequal burden small business experiences in attempting to comply with Government regulations.

Similarly, the Senators' provisions to require the agencies to develop reporting forms and requirements which are tailored as much as possible to different types and sizes of plans will be a real boon to small plans which are generally less complex than the larger plans, and therefore should not have to submit forms, obviously intended for those larger plans.

Those two provisions, as well as many others in S. 3017, reflect a reasonable approach to the elimination of superfluous requirements without endangering the flow of necessary information between the Government and pension plan administrators.

The same kind of approach is found in Senator Bentsen's bill, S. 3193, although in general the bill deals with different reporting requirements.

Perhaps the most important change that S. 3193 would make is in the filing of annual reports every 5 years instead of every year. In the other years, plans would be required to file a simplified annual report.

The positive impact of this proposal, particularly on small plans, would be tremendous. Time and costs expended by the employer/administrator in preparing and submitting these forms would be reduced significantly, as would the burdens on administrative personnel within the agencies.

In addition, the consolidation of EDS–1 with other forms, provisions for which are found in both bills, would simplify immeasurably the task of complying with the ERISA paperwork requirements.

In conclusion, it is our hope that the committees will work together to resolve what differences they have concerning the most effective way of reducing the onerous burdens caused by the dual administration of ERISA.

We suggest, however, since there seems to be no philosophical difference regarding the paperwork burden, and that the bills introduced by Senators Bentsen, Javits, and Williams are complementary in their provisions to reduce this problem, that these committees give immediate attention to reporting out a bill which combines the paperwork provisions of S. 3017 and S. 3193.

Speaking for the small business community, I can assure you that your efforts will be deeply appreciated.

Senator WILLIAMS. Thank you very much, Mr. McKevitt.

As you can see, we are the two committees that were the developers of our ERISA program. We are the ones that have followed it and have, of course, spent a great deal of time understanding the problems. And we are here together today, in this joint hearing, and we will stay together in working toward a solution to them. You are right in making the observation that this is necessary.

Mr. MCKEVITT. We certainly appreciate it. Thank you.

Mr. Pendergast has a statement, Mr. Chairman.

Mr. PENDERGAST. Thank you, Mike.

My name is Edward Pendergast. I am a practicing CPA and past president of the Smaller Business Association of New England.

I am appearing here with Mr. McKevitt to complement his testimony. I would like to have my statement placed in the record, and I would just like to make some comments that I think specifically apply to the main points of the testimony.

Senator WILLIAMS. We will include it in the record right after the NFIB statement.

Mr. PENDERGAST. Mr. McKevitt has already talked about the matter of jurisdiction, and I think that S. 901 addresses that issue quite well. I have some concern about the establishment of an employee benefit corporation. I do not think we need another governmental agency. I think that we can eliminate the duplication and we will be satisfied.

The efforts to combine forms and redudce paperwork should be designed as Mr. McKevitt has suggested.

We are a little concerned about S. 2992, which suggests that uniform accounting for assets and liabilities be established by Treasury. We prefer that to be done by the private sector as is being done now by the Financial Accounting Standards Board.

S. 1745 addresses the issue of the prudent man rule, which we think has been one of the biggest problems in continuing to reduce the availability of capital for small businesses. We think it is nice that we allow the opportunity for assets to be invested in small business; we do not know why it is restricted, and we would suggest that public policy be that the prudent man rule state that the pension plans and the profit-sharing plans across the country are encouraged to invest in small business, and in fact, specify that some specific percentage, such as 5 percent, absent any self-dealing, would specifically avoid the prudent man law.

S. 3017 suggests that plan permit employee contributions in order to qualify to become qualified plans. We think it is good to encourage plans to permit employee contributions, but we do not think the extra paperwork warrants requiring even the smallest plans to have this provision to be eligible for exemption.

S. 3017 has two tax credit provisions. One is a credit to establish small plans, which we think is welcome, but we suggest that the size standard be a stipulated amount, such as 200 employees, rather than to use the more nebulous SBA size standard, as in the present bill.

There is also a credit allowed to expand plans, which we think is a good idea. However, we think the terms of the credit should be statutory rather than subject to regulation, and we do not see any reason why H.R. 10 plans should be specifically excluded from this.

If there is concern that these plans would become too discriminatory, provisions could be enacted to control this. Elimination of H.R. 10's from this credit is unfair.

The provision to refuse IRA privileges to owner-employees is too drastic and again unfair. It would deny IRA privileges to employees in companies that have only shareholder-employees.

It would deny IRA to a 10-percent employee that has no control over establishment of employee benefit plans.

The proposal to establish a master and prototype plan is a very helpful approach. We are only concerned that the ensuing regulations will actually result in good, simple plans that pass the test that Senator Long has talked about, which is simplicity.

There is a requirement now to report on 3 percent transactions. This seems to be repealed by Senator Bentsen's bill, S. 901, in section 403. There also is a repeal of the ability to have a retroactive disqualification of plans for acts that were carried on in a prior period, and we approve of this under S. 3017, section 307.

We are very concerned about S. 3017, section 273, that establishes an investigation to see the impact of inflation on employee pension plans. Any requirement to include that, the impact of inflation on these plans, would be a very drastic change that would cost tremendous amounts of money, given the example of what we have had to do in social security.

I guess in conclusion, I would have to tell you if you really want to have the simplest plans, as Senator Long has suggested, from my experiences, having been a member of the IRS Small Business Advisory Committee under Commissioner Alexander, that if you hire him to do the job, you will have a lot fewer problems.

Thank you.

Senator WILLIAMS. Thank you very much.

Let me say that this is, of course, a formal hearing. Your contribution is greatly appreciated. You can see that before us is a period of hard, hard work on the legislation, and I hope we can stay in continuing relationship that would be less formal and through written communications and personally, if we could, as we come to grips with the specifics of legislative response to the needs in this area.

I am going to excuse myself and go to the floor to vote, so if you will take over, I will hurry back and we can continue our hearings without a break.

Senator BENTSEN. Let me say, Mr. Pendergast and Mr. Auerbach and Mr. McKevitt, there seems to be a general consensus, obviously, on the paperwork and the administration has responded to, I think, some of the legislative pressures that have been put on them by some of the legislation that we have passed through the Finance Committee. And I see some real progress now being made in that regard through the simplification of the reporting procedures and a single report being sent, and that being then distributed by one agency to the rest of the agencies.

I think we will accomplish those, and it is about time, but I think it is going to come to fruition rather quickly now.

The one point you made, Mr. Pendergast, on the prudent man rule, has been a great concern to me, that small business, because it does normally have a higher degree of risk, would not be eliminated from investment portfolios. But if you talk about that there be an encouragement put in, say, of 5 percent, that would concern me, and it would concern me for this reason, that we had a discussion earlier about social objectives for pension funds, be it small business or be it low income housing—whatever it might be, I think you begin to forget the real purpose of the pension, and that is for the pensioners and for total safety for them and a guarantee that those funds are going to be available.

I would rather see us move—and I think the Departments have moved on this question—by saying that the fact that they have invested in small businesses would not be a violation of the prudent man rule; they would have to look to the entire portfolio.

And I started out with the idea of a percentage, but the more I probed it, the more I began to hear investment bankers and people in fiduciary positions say, "Well, that can be looked on as a cap; that is as far as we go."

Well, I have moved in my opinion to more along the lines of what I think the Departments are proposing now. We are trying to accomplish the same objective, and I believe the new language that has been developed helps a great deal in the interpretation of the prudent man rule.

Mr. PENDERGAST. I agree that it helps.

Senator BENTSEN. OK.

Mr. Chairman.

Senator LONG. Have all you gentlemen made your statements?

Mr. PENDERGAST. Yes.

Senator LONG. Well, let me just ask this question, and whoever feels like answering it can respond to it. The thought occurred to me that rather than have an endless amount of bookkeeping, why not just let an employer fill out a form that would not take more than about two or four pages at most, providing certain information that comes to mind, and then just send whoever is handling it—be it the Treasury or be it the Labor Department or whoever it might be—just send you a copy of the tax return with the backup information that supports that tax return, and if everything looks all right, that would be it; and if it does not look all right, then audit, just like you would a tax return. Why not do that? It seems to me that that would enormously reduce the paperwork and the complexity of all this.

Mr. PENDERGAST. Senator, I think that that is an excellent idea particularly for small business. I am not qualified to tell you what you should do for the large and multiemployer plans that may have more complexities than the small, independent businesses, and the small, independent businesses can think of ways to simplify that. There are certain codes, questions, that if they have all positive answers, that you would know that there would be no additional plan requirements. And we hope that something like that will be developed.

Senator LONG. Well, under the SEC regulations, isn't most of the information about how a company made its money available, even to the public?

Mr. PENDERGAST. Well, if it is a publicly held company, it may be, if it is fully registered. But for private companies, it is not available.

Mr. SEMENZA. But even for large companies that fall under the SEC, there is very little information about their pension plans, not to mention information on their liabilities in their public reports.

You are talking about the largest private sources of capital in the world. I think you have to save some form of reporting and accounting, at least for the large plans.

I think there should be simplification in reporting for small plans, and I think there should be further exclusions in the financial reporting required of small plans.

Senator LONG. But if I am a shareholder, even in a closely held corporation, I have a right to see the books, haven't I?

Mr. PENDERGAST. Very frequently, profit sharing and pension plan does not appear on the books. There is no detail of how money is being invested. The people that you want to be concerned about are the employees having the feeling that those moneys are being invested prudently, and there is no way to access that information through a company source; it is a separate source for the pension plan and profit sharing plan.

Senator BENTSEN. Well, let me say to Senator Long, Mr. Chairman, my bill, S. 3193, talks about a simplified report being attached to the tax return.

Senator LONG. Yes, because it seems to me that there ought to be somebody—whoever is managing the plan, or a banker who might be involved in it, or a lawyer to the employer, or somebody—ought to be around who would be asking questions on behalf of those employees to protect their interests. There ought to be somebody in the Government, either the Treasury, or Labor, or somewhere, that has the right to—if they have reason to think that something might be amiss, just like a bank inspector would do—to go take a look into it, and if it looks to them like something is not the way it ought to be, they ought to do like you do with an Internal Revenue Service audit; just go in there and ask every question the mind of man can think of, and you want to see all the receipts and everything else.

But unless there appears to be something wrong about the thing, why make them fill out all that? In other words, it seems to me that I could fix out a form bigger than all this for you to fill out, even for a small business, to provide all that information and drive you out of your mind and cost a great deal of money, when it is not necessary. What is necessary, if you have some indication that you are doing something wrong, then you ought to take a good look at it. That is how the IRS does the tax return, isn't it?

Mr. PENDERGAST. I am inclined to agree with everything you are saying, particularly as it applies to small business. I just think there would have to be some cautions that on a two- to four-page form you could incorporate all those cautions that we are talking about. So I would agree.

Mr. AUERBACH. Well, I think, Senator, we would agree with you that first of all, a great deal is being done. I think we are seeing the administration doing things because of the interest that you gentlemen are expressing. And we agree with Senator Long that there is more that can be done.

Senator LONG. Well, you people who have to fill out all of those forms I think ought to be privileged to grade them. In other words, just say "How much of this junk do you think is really necessary?"

For example, out there in the State of California, they have to fill out, just for a person applying to go on welfare—some poor soul comes in, and unless you can find they have some income you do not know about, they are eligible to be on the roles. To put that person on the roles, the forms they had to fill out laid end to end were 70 feet. So that works out to roughly 65 pages, let us say, of information you have to fill out in order to draw $100 a month on welfare.

Now, the people in California sat down and figured out what they thought you ought to do, and I think it was about a two-page folder—or no more than four pages—and they had a blank on the back sheet where they requested or put in any particular evidence that might be relevant or might help support your claim.

And I would think that you people in the business world ought to be able to give us some of that, or what you think would be necessary for it to work.

Mr. PENDERGAST. Senator, I think we have been talking to Senator Bentsen. In his S. 901 and S. 3193, he has gone a long direction toward proposing at least six steps that would simplify, and I think it is a good starting point. I think it incorporates a lot of your ideas.

Senator BENTSEN. Mr. Chairman, the things that we have talked about in some of this legislation is to do away with the SAR, which is really the summary report, which has really not been too beneficial to the employee and not utilized, and that the EBS-1 be abolished;

that the employer be given an option to participate in a special master plan, an approved pension arrangement; and obviously, that SEC involvement be severely limited. Those are some of the things we are trying to accomplish here.

Senator LONG. We are voting on final passage over there, Senator, so you might want to start right now, and I will be right along behind you.

Mr. Auerbach, I just cannot let this chance pass. Your group—haven't you put in a major employee stockownership plan recently?

Mr. AUERBACH. Yes, sir, we have, and we are delighted to support your current proposal which will enable industries that are not capital intensive to use it in a much more meaningful way.

Senator LONG. I wish we had had you as a witness recently. We held some hearings on that subject.

How are you raising money for that employee stockownership plan in your company?

Mr. AUERBACH. It is not being used as a source of raising money. The company is simply making a contribution equal to the credit.

Senator LONG. Taking the credit for it?

Mr. AUERBACH. Taking the credit and having the money go to the plan which we established in accordance with your concepts.

Senator LONG. Well, thank you very much, gentlemen, for your testimony here.

[The prepared statements of Mr. McKevitt and Mr. Pendergast follow:]

NFIB National Federation of Independent Business

STATEMENT OF

JAMES D. "MIKE" McKEVITT
WASHINGTON COUNSEL

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Senate Human Resources Subcommittee on Labor and Senate Finance Subcommittee on Private Pension Plans and Employee Fringe Benefits

Subject: Employee Retirement Income Security Act of 1974 (ERISA)

Date: August 16, 1978

Mr. Chairman, I am here this morning on behalf of the National Federation of Independent Business (NFIB), a non-profit association comprised of more than 540,000 small and independent businesses from every state in the nation. NFIB members include proprietorships, partnerships and corporations; we represent nearly every type of business from retail and professional to manufacturing.

Our interest in testifying before your Committees this morning on the subject of ERISA derives from the position in which so many of our members have been placed since the enactment of ERISA in 1974. Small businesses are most often labor intensive. They generally do not utilize expensive equipment and real estate as much as larger businesses, but depend largely upon the skill and productivity of their workers. And we have observed that many small employers are highly concerned with the welfare of their employees, not only on but off

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the job as well. Working side-by-side in a smaller organization provides an opportunity for employer-employee contact and understanding that is rarely present in larger organizations. Consequently, small employers are anxious to provide pension and welfare benefits for their employees. A reasonable resolution of the ERISA problems is, therefore, seen as essential by most small employers.

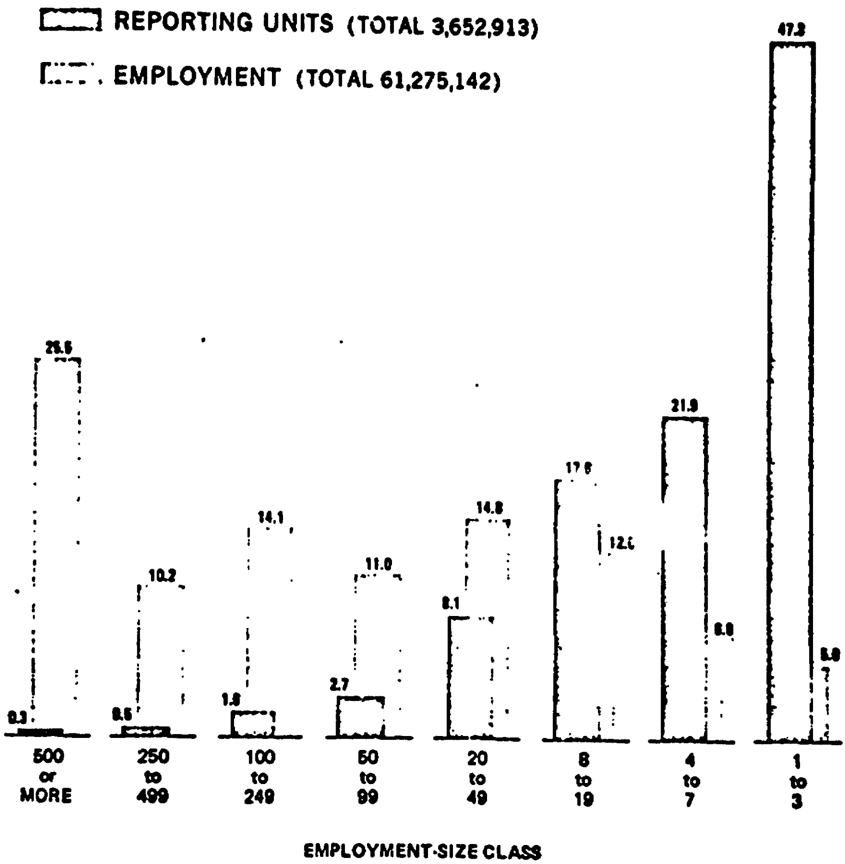
The very distribution of businesses and pension plans by size demonstrates the necessity of keeping smaller employers and plans very much in mind when making adjustment to the Federal system for regulating pensions. The following table on page three consists of U.S. Department of Commerce figures which show that in terms of numbers of reporting units, the vast majority employ less than 100 employees.

If the number of sole proprietorship and partnership employers are also considered, it comes as no surprise that just as the vast majority of American businesses are small, the overwhelming majority of pension and welfare plans are filed for groups of less than 100 employees.

We appear this morning not as technical experts on the various arcane provisions that have grown up in this area, but in an attempt to make some general observations and suggestions which we hope will inform this Committee's consideration of ERISA legislation in this and future Congresses.

Table 1

PERCENT DISTRIBUTION OF EMPLOYMENT AND REPORTING UNITS BY EMPLOYMENT-SIZE CLASS: 1973



U.S. Bureau of the Census, County Business Patterns, 1973, United States CBP-73-1, U.S. Government Printing Office, Washington, D.C. 1974

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The Employees Retirement Income Security Act has, in the short time since its enactment, become a major burden for small firms with pension plans and a serious obstacle for those small employers who wish to establish one. The law is extremely complex and vague, and its implementation has been both confusing and costly to small business, resulting in thousands of small employers terminating their pension plans.1/

NFIB's greatest concern is that ERISA will make it increasingly difficult for smaller employers to provide this type of fringe benefit and thus to attract quality employees. In the end, this simply translates into another competitive advantage for big business. Because of this, NFIB has been involved in seeking solutions to ERISA-caused problems since the Act was signed into law on September 2, 1974.

These hearings are being held to determine viable solutions to ERISA-caused problems. For this reason, NFIB sees no reason to recite the full litany of difficulties experienced by employers in attempting to comply with the Act's provisions. The Committees are already well versed in these matters. Suffice it to say that we agree with the Commission on Federal Paperwork's assessment that the reporting requirements and the dual administration of ERISA by the Department

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1/ "Foundation for a National Policy to Preserve Private Enterprise in the 1980's", Joint Economic Committee, Washington, D.C., April, 1977, p. 24.

of Labor and the Internal Revenue Service are the two elements of ERISA which cause the most severe problems and which demand immediate attention.

Certainly, many of the difficulties experienced by small business arise from the Congressionally-mandated dual administrative provisions of ERISA. While it is true that Congress delineated some areas of separate jurisdiction between the Department of Labor and the Internal Revenue Service, many other provisions of the Act either dictate or imply overlapping jurisdiction. As a result, the administration of these overlapping areas has led to conflicts between the two agencies in their interpretations of specific provisions, lengthy delays in promulgating basic rules and regulations, and a duplicative, burdensome array of reporting, recordkeeping, and disclosure requirements. Above all, there has rarely been any consensus--either inside or outside of the government--as to which agency has the final authority for administering each statutory provision of ERISA.

The elimination of problems caused by the dual administration of ERISA is long overdue. For this reason, we are encouraged by the recent efforts of President Carter and his reorganization team to devise a plan to resolve these problems by establishing clear and separate authority for IRS and DOL in distinct areas of jurisdiction. In our opinion, the President's proposed reorganization plan for ERISA is a vital first step in ameliorating the bureaucratic and paperwork burdens imposed by ERISA.

We would urge the Congress, however, not to overlook its responsibility to contribute to the endeavor to simplify the administration of ERISA. The President's reorganization proposal is commendable, but should be regarded only as an interim step in the final resolution of ERISA-caused burdens. Ultimately, it must be Congress' responsibility to correct by legislation the administrative and paperwork burdens imposed by legislation in the first place. It now seems apparent that a majority in Congress agree with this assessment, and that the time is ripe for enactment of substantive reforms to ERISA. NFIB would like to commend Senators Bentsen, Javits and Williams for taking the lead early in the Congressional effort to unravel the administrative complexities mandated by ERISA.

The problems arising from dual administration of ERISA have been so severe that the concept, as embodied in S. 3017, of a single agency to administer and enforce the law as a solution to these problems seems both logical and practical. NFIB at this time, however, is reserving final judgment on this legislation. It is not the logic behind the proposal which disturbs us; it is the practical effect of implementation. Had ERISA originally been administered by one agency, many of the problems which now plague employers with pension plans might have been avoided. This was not the case. But I find myself wondering if changing horses in midstream won't create more problems than it solves. Specifically, while administration of the Act has been haphazard up to now, there is at least a certain amount of momentum already present and likely to increase as a result of President Carter's commitment to improve ERISA administration. The administrative apparatus is in place in DOL and IRS. The only thing that remains is to make the machinery work at a faster, smoother pace. The effect of creating a new agency might well be the loss of this momentum. At the very least, it would take time to completely staff the new agency and put it in operational readiness. In addition, it seems plausible that some amount of consultation between the new agency and the two former administrators would be necessary, especially in the case of IRS. It then seems conceivable that instead of consolidating and coordinating the functions now performed by IRS and DOL, we would simply be creating another alphabet agency and increasing the bureaucratic maze surrounding ERISA.

Given this scenario, there are certain distinct advantages to the proposal offered by Senator Bentsen in S. 2352, because it would reform the existing structure rather than start from scratch. Establishing a clear division of authority between IRS and DOL could be accomplished within a short period of time because it would necessitate neither physical nor personnel re-locations, and the lines of authority would be drawn in such a way that each agency would administer provisions of the law which directly relate to its expertise and primary interests. NFIB favors this approach, because we believe it to be in the best interests of both administrators of pension plans and the beneficiaries of such plans. Relief from the unwieldy, complex administration of ERISA is needed soon if we are ever to rejuvenate the market for pension plans. S. 2352 offers the best hope for quick remedial action.

Given the different approaches of S. 3017 and S. 2352, NFIB recognizes that some time may elapse before a consensus can be reached as to the most viable long-term solution to ERISA's administrative problems. There is one problem area, however, which we believe could be substantially resolved in a short period of time and with minimal difficulties. I refer to the paperwork burden. While it is reasonable to consider much of this burden as a direct by-product of the administrative confusion, much can be done to simplify the paperwork independently of reforms to the administrative apparatus.

The paperwork burden imposed by ERISA is particularly acute for small business. In fact, the Commission on Federal Paperwork, in its study of ERISA published in December of 1976, clearly states that small business bears the biggest burden in trying to comply with ERISA, since there is little or no consideration given by the agencies as to the differences in resources and abilities to comply. In addition to multiple dates and places for filing various forms, elaborate and detailed reporting and recordkeeping requirements are so complex that employers/administrators must often ask the agencies exactly what is expected for compliance. Such questions often generate conflicting instructions. The small business employer or his administrator then faces the difficult task of determining the best and wisest course of action: 1) fill out the form in accordance with one agency's instructions and risk a penalty from the other agency; or 2) double his time and money spent on filling out the form and submit two separate versions of the same form.

NFIB could cite case histories as evidence of the paperwork problem, but we believe, as in the case of administrative complexities, that the Committees are well versed in this area. Rather than dwell on problems, it is time to devote our energies to solutions. And some very good solutions are now under consideration by these Committees.

NFIB finds much in both Senator Bentsen's bill, S. 3193, and Senators Javits' and Williams' bill, S. 3017, which will be of immense benefit to employers and administrators of pension plans. We are particularly pleased to see included in S. 3017 a provision to authorize the exemption or modification of existing paperwork requirements for any employee benefit plan when such measures are consistent with the public interest. NFIB has testified on several occasions in support of such measures for small business, for we believe they not only relieve small business from unnecessary regulatory burdens, but provide an equitable solution to the ever-present problem of the unequal burden small business experiences in attempting to comply with government regulations.

Similarly, the Senators' provision to require the agencies to develop reporting forms and requirements which are tailored as much as possible to the different types and sizes of plans will be a real boon to small plans, which are generally less complex than the larger plans and therefore should not have to submit forms obviously intended for those larger plans.

These two provisions, as well as many others in S. 3017, reflect a reasonable approach to the elimination of superfluous requirements without endangering the flow of necessary information between the government and pension plan administrators. The same kind of approach is found in Senator Bentsen's bill, S. 3193, although in general the bill deals with different reporting requirements. Perhaps the most important change S. 3193 would make is in the filing of annual reports every 5 years instead of every year. In other years plans would file a simplified annual report. The positive impact of this proposal, particularly on small plans, would be tremendous. Time and costs expended by the employer/administrator in preparing and submitting these forms would be reduced significantly, as would the burdens on administrative personnel within the agencies. In addition, the consolidation of EBS-1 with other forms, provisions for which are found in both bills, will simplify immeasurably the task of complying with ERISA paperwork requirements.

It is our hope that the Committees will work together to resolve what differences they have concerning the most effective way of reducing the onerous burdens caused by the dual administration of ERISA. We suggest, however, since there seem to be no philosophical differences regarding the paperwork burden, and that the bills introduced by Senators Bentsen, Javits and Williams are complementary in their provisions to reduce this problem, that these Committees give immediate attention to reporting out a bill which combines the paperwork provisions of S. 3017 and S. 3193. Speaking for the small business community, I can assure you your efforts will be most warmly appreciated.

Thank you.

TESTIMONY OF

EDWARD H. PENDERGAST
HURDMAN AND CRANSTOUN, C.P.A.S

representing

THE SMALLER BUSINESS ASSOCIATION OF NEW ENGLAND

before

THE SENATE HUMAN RESOURCES SUBCOMMITTEE ON LABOR
and
THE SENATE FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS

JOINT HEARINGS ON BILLS RELATING TO THE

Employee Retirement Income Security Act of 1974 (ERISA)

August 16, 1978

Mr. Chairman, thank you for the opportunity to express the feelings of small business that have resulted from the enactment and subsequent regulations of the Employee Retirement Income Security Act of 1974 (ERISA). Your concern in this matter is appreciated by the entire small business community.

When ERISA came into being in 1974 it was hailed as a great protector of the employee from plans that were arbitrary and discriminatory, and from a loss of benefits due to insolvency of the plans or provisions that reallocated benefits to other employees.

What has happened is of almost as much concern as the original problem. Introduction of dual responsibility of Treasury and Labor has created a maze of paperwork, contradictory regulations and confusion that is unparalleled. The small businesses that do not have plans are certainly reluctant to start them.

Social security tax increases have acted further to reduce the interests of business. While I can not cite examples of plans terminated solely because of increases in Social Security, I can testify that firms have not adopted plans because of the increases in Social Security taxes.

The purpose of these hearings is to consider seven bills proposed to help reduce "excessive paper work, red tape and other unnecessary complications". There are eight major issues covered in these bills.

> First, is the matter of jurisdiction. We are in favor of those bills that eliminate joint jurisdiction between Treasury and Labor (S.901). We would be in favor of having one agency collect data for Treasury, Labor and the Pension Benefit Guaranty Corporation, only if it was combined with the elimination of joint jurisdiction. Otherwise this does not address the duplication and regulation. We are not in favor of the establishment of separate Employee Benefits Corporation because it establishes one more governmental agency, and although it eliminates some duplication of responsibility it perpetuates some of the Treasury - Labor duplication.
>
> Second, is an effort to combine forms and reduce paper work. We applaud each of these and urge that all of the efforts be joined. We are

concerned that the provision in S.3193 to have Form 5500 filed once each five years might not be appropriate for large plans or multi-employer plans.

Third, the suggestion that uniform accounting for assets and liabilities (S.2992) be established by Treasury is inappropriate. The Financial Accounting Standards Board is about to issue uniform accounting standards. The problem is correctly identified. We suggest the solution lies in the private sector.

Fourth, the prudent man rule has added one more impediment to small business' ability to attract capital. S.1745 addresses this issue. We would like it expanded to specifically allow, even encourage some specific minimum of assets such as 5%, to be invested in small business.

Fifth, plans must permit employee contributions under a section of S.3017. While we would encourage plans to permit employee contributions, the extra paperwork does not warrant requiring even the smallest plans to have this provision to be eligible for exemption.

Sixth, deals with tax credits in S.3017. The credit to establish small plans is welcome but we suggest that the size be 200 or fewer eligible employees at date of inception rather than a more nebulous SBA size standard. The credit allowed to expand plans is a commendable idea. We feel that the terms of the credit should be statutory rather than subject to regulation and that it should be extended to HR 10's. If there is concern that these plans would become too discriminatory, provisions could be enacted to control this. Elimination of HR 10's from this credit is unfair.

Seventh, the provision to refuse IRA privileges to owner-employees is too drastic. It would deny IRAs to employees in companies that have only shareholder-employees. It would deny IRA to a 10% employee that has no control over establishment of employee benefit plans. If there is a need, a less onerous test can be established.

Last, the proposal to establish a special master and prototype plan is a very helpful approach. We are only concerned that the ensuing regulations will actually result in good, simple plans.

In summary, the proposed bills are generally very positive approaches to ameliorating the problems of establishing and maintaining plans for the small businesses. A detailed analysis and comment is attached.

DETAILED ANALYSIS AND COMMENT ON EACH BILL

S.901

- A. Jurisdiction over participation, vesting and funding strictly to Treasury; prohibitions from self-dealing strictly to Labor. We urge passage of this. It creates no new agency and eliminates dual responsibilities. If one agency collected data as suggested by S.1745, together with this provision it would simplify the whole process.
- B. A single form and a single annual filing date for employee benefit plans (See S.1745). The single form is a very good idea but a single filing date would be a burden on government agencies and advisors to plans.

S.3017

- A. Establish an Employee Benefits Commission to assume jurisdiction over ERISA plans. This sets up an additional governmental agency. We prefer S.901 for simplicity and efficiency.
- B. Section 224 Combines EBS-1 and determination letters, 5300 series (See S.3193). This is a salutory step and should encourage new plans.
- C. Section 226 Enrolled actuaries and "qualified" public accountants must rely on each others representations. No objection, but the term "qualified" public accountants should be clarified.
- D. Section 273 Adds small business representations to advisory council. We support this.
- E. Section 303 Employee contributions must be allowed by a plan in order to qualify. This is a desirable goal but the extra paperwork does not warrant requiring it to make even the smallest plans eligible.
- F. Section 340 Establishes a credit to establish small plans. This is

worthwhile to determine if it stimulates creation of new plans. The small plan is defined as one established by an employer who meets SBA size standards under Section 112 of the Small Business Act (15USC632). The definition should be legislative rather than regulatory. We suggest 200 or fewer employees be the standard.

- G. Section 305 Establishes a credit for the improvement of qualified plans. The eligibility to be determined by the Employee Benefit Commission. HR 10 plans are excluded. It should be made clear whether this credit can be granted more than once. The eligibility should be legislated rather than regulated. HR 10 plans should be included. We do not see why any entity should have to incorporate to receive employee benefits equal to that of the businesses that are incorporated.

- H. Section 306 Denial of IRA benefits to owner-employees. Why Congress has this prejudice toward the entrepreneur is difficult for us to understand. A 10% test is certainly too discriminatory even granted the prejudice. Failing omission of this section which omission we recommend, we recommend increasing this to at least a 30% test.

- I. Establish special master and prototype plans. This is very desirable, but we recommend close monitoring by Congress to ensure that the bureaucracy make this attractive and simple for the small business.

S.3193

- A. Obtain determination letters at time plan is created and absorb EBS-1 into the requirements for filing for determination (See S.3017). This is a very desirable approach toward simplification.

- B. File 5500 once every five years on a staggered basis. File simple forms annually. While this is a good idea for small business, we are not able to determine if this is prudent for large and multi-employer plans.

- C. Require a booklet for simple explanation for small business. This is helpful and should have been done without legislative instruction.

S.2992

Requires the Secretary of the Treasury to establish uniform accounting for calculating and reporting assets and liabilities of pension plans and for disclosing actuarial assumptions. The Financial Accounting Standards Board is studying this and will rule on it shortly. This is a function that belongs in the private sector, not in the governmental sector.

S.1745

- A. Establishes a single form and annual filing date (See S.901). The single form is laudable. If annual filing date means all plans file at once, this is impractical. If it means that plans have one date to file all forms but that the date can be selected by the plan we approve it.

- B. Requires Treasury, Labor and Pension Benefit Guaranty Corporations to choose one agency to collect data. This is some improvement over the present system but does not solve the duplication of regulation. If we could combine this suggestion with that proposed in S.901 eliminating dual responsibility for regulation we would have taken giant steps in simplification.

- C. Small business representation on the advisory council. We applaud this.

- D. Relief from delay in receiving a determination letter. This is good because it eliminates a penalty for events beyond the control of the plan.

- E. Prudent man "is not violated because an investment may be in a venture capital organization or in a smaller business." This is an improvement. The prudent man rule has reduced access to capital by small business. We would urge that the statement make it public policy to encourage investment in small business and allow that up to a 5% investment in a small business would not violate the prudent man rule absent any self-dealing.

S.250

Prohibits reduction of certain disability payments whenever certain social security payments are increased. As long as the reduction does not increase benefits of some other employees, this appears to be an unnecessary provision.

S.1383

Clarifies status of the Hawaiian Prepaid Health Care Law. No comment.

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Senator LONG. Now, the Senate is voting, and Senator Williams will be back in just a few minutes. I believe that, if I might be excused, I will go over and vote, and I will call this meeting in recess for 5 minutes. I think that is long enough for me to get back here, and Senator Williams is coming back.

[Short recess.]

Senator WILLIAMS. We had to recess in order to go vote on a measure that came out of this committee, as a matter of fact, dealing with higher education and the opportunity grants that we have legislated for students who need some support in going to college.

We return now to our ERISA hearings, and we are very pleased that our next witness, Mr. John Finnell, knows about the benefits of ERISA. As a matter of fact, one of its provisions, the pension plan termination insurance program, was created right here in this committee, and was there to help Mr. Finnell when he needed it. Mr. Finnell is now retired and has been the beneficiary of insurance payments made by the Pension Benefit Guaranty Corporation.

Mr. Finnell, I know you were employed at the Washington Medical Center.

STATEMENT OF JOHN FINNELL, RETIREE

Mr. FINNELL. Yes, sir.

Senator WILLIAMS. And how long were you employed there?

Mr. FINNELL. I was employed there 22 years on a full-time basis, and I retired when I was 65, and worked 5 years after that as a consultant to the administrator, and particularly, I worked with our attorneys and with our insurance adjusters with respect to legal matters, legal cases against the hospital because I had been charged with the safety program there, and I had investigated these cases, and so I worked for 5 years on a consulting basis. I am completely retired now.

Senator WILLIAMS. And while you were employed there, you were covered under a pension plan that would be available to you upon retirement, is that right?

Mr. FINNELL. I was not covered—they did not have a pension plan for a number of years. And 5 or 6 years, I believe it was, before I retired, the corporation did establish its own pension plan.

Now, I did not pay into it. It was just purely voluntary on the part of the corporation. But it was something we were counting on when we retired. It was to be a part of income when I retired.

Senator WILLIAMS. When you retired, did you receive the pension?

Mr. FINNELL. Yes, sir. I received a pension from the hospital, from the Washington Medical Center, for I believe about 5 years. Then they ran into financial difficulties, and they were unable to continue the plan.

Consequently, I would have had nothing in the way of a pension plan now.

Senator WILLIAMS. Because of the plan's financial difficulties, the plan was terminated?

Mr. FINNELL. Yes, sir. It was taken over by the insurance corporation.

Senator WILLIAMS. All right. Now, would you explain, as you understand it, how the insurance corporation—that is, the Pension Benefit Guaranty Corporation——

Mr. FINNELL. Yes, sir.

Senator WILLIAMS [continuing]. That was created by ERISA, and was intended as an insurance program paid for by the pension plans themselves to pay retirees' pensions if there is a failure of a plan—now, what happened? Did it work for you?

Mr. FINNELL. Well, I received my last check from the hospital on time, and I received my first check from the pension plan the next month, right on time. There was never any break in the payments.

Senator WILLIAMS. In other words, even though the medical center's plan had to terminate for financial reasons, because they were covered under the Pension Benefit Guaranty Corporation, the pension plan termination insurance program, there was no break in payments to you at all?

Mr. FINNELL. That is correct.

Senator WILLIAMS. Could I ask you, how does this help you with your retirement income? How much is it and how does it relate to social security?

Mr. FINNELL. Well, it is a very nominal—it is not related to social security. I do have social security.

Senator WILLIAMS. Well, I mean, in terms of your total income—you are also covered under social security.

Mr. FINNELL. Well, this plan pays me $159.69 a month, and that is approximately what it takes to pay my real estate taxes in Montgomery County. So if I did not have this, I probably would have to sell out or try to get a part-time job to pay this $1,800 in taxes.

Incidentally, they have gone up. We bought our home in 1953. The real estate taxes have gone up between 500 and 600 percent since that time. Consequently, that takes quite a slice out of my income. I am totally retired, so that without this pension all I would have then would be social security.

Senator WILLIAMS. So this makes it possible for you to remain in your own home.

Mr. FINNELL. Yes, sir—unless they raise the taxes again.

Senator WILLIAMS. Well, thank you very much.

Let me ask my colleagues here, Senator Bentsen and Senator Javits, whether they have questions of you.

Senator BENTSEN. Mr. Finnell, is your pension income and your social security your total income?

Mr. FINNELL. Oh, no, it is not my total income. I worked for a number of years, and I saved some money and invested some, so I have some other income. But with respect to any pension, this is the only pension that I have, and I do get social security.

Incidentally, I have been paying on it ever since it first started, too.

Senator BENTSEN. Well, if you did not have this, would you find that your ownership of your home would be jeopardized because of the increase in taxes?

Mr. FINNELL. Well, it makes it a pretty close thing now. If they do much more taxing, I am going to have to do like a lot of other people in Montgomery County have done, just move out and go someplace else.

There is no point to selling your home. I can get more money for my home than I paid for it, of course, but if I had to buy another one, and stay here in this neighborhood where my friends are, why do it.

Senator BENTSEN. You will end up paying just as much for another one, or you will pay a very substantial amount of rent, these days.

Mr. FINNELL. Certainly, It is pointless for me to try to do that.

Senator BENTSEN. If we had not been able to pass this pension guarantee system, would your pension have been applicable; would you have been receiving it?

Mr. FINNELL. Well, no, I wouldn't now, since they discontinued it. I received it as long as they were able to pay it, but when they were unable to pay it, why, that was the end of it.

Senator WILLIAMS. Senator Javits?

Senator JAVITS. Mr. Finnell, what we are interested in is the sense of security that you get out of having your private pension assured to you by a U.S. Government corporation which guarantees it. We are interested in your sense of security in your retirement. How is it added to by the private pension?

Now you have your Social Security; you have a little savings and investment. But how does the private pension contribute to your feeling of security now that you are retired?

Mr. FINNELL. Well, considerably, since I would have to pay essentially $1,800 a year to Montgomery County in taxes. That is $1,800 that I might not have. When I get my pension check, I put it in a savings account. Then, during the month of September of each year, I withdraw all of that, and pay my taxes, and it is essentially equal.

Senator JAVITS. So this is a key for you——

Mr. FINNELL. Certainly.

Senator JAVITS. This particular part of your retirement income is a key element in your ability to retire with peace of mind?

Mr. FINNELL. Yes; it is. As I said a minute ago, I could move someplace else, but my friends are here.

Senator JAVITS. And this peace of mind is contributed to by the assurances of the guarantee of the Pension Benefit Guaranty Corporation, is it not?

Mr. FINNELL. Certainly.

Seantor JAVITS. All right. And you feel much better about it than you did when you had to depend solely upon the pension fund and the enterprise for which you worked?

Mr. FINNELL. I have felt much better since this corporation took it over because I did not know, even when I was being paid by the other corporation, I did not know how long it was going to last, but I did not think it was going to last very long.

Senator JAVITS. Good. Thank you very much.

Senator WILLIAMS. It has been most helpful to us, Mr. Finnell. We greatly appreciate your coming here, on pretty short notice, too, as I undertsand.

Mr. FINNELL. Well, they called me at 9 this morning, and I was down here by 10:15.

Senator WILLIAMS. We knew that part of this program has been working to the benefit of many individuals, and we wanted one of them to be here to tell us about it, and you are the one.

Thank you.

Mr. FINNELL. Well, you are certainly welcome. I am certainly one of them, and I think it is a very fine thing that was done.

Senator WILLIAMS. Thank you very much.

We will recess now. There is another vote in progress in the Senate. We will reconvene at 1.

[Whereupon, at 12:15 p.m., the proceedings were adjourned, to reconvene at 1 p.m. this same day.]

AFTERNOON SESSION

Senator WILLIAMS. We are ready to reconvene our Joint Hearing of the Finance Committee and Human Resources Committee on amendments to ERISA.

And we are pleased indeed that our final panel today will consist of those who have served in high office in Government and now are in the private sector, Donald C. Alexander, former Commissioner of Internal Revenue, Rod Hills, former chairman of the SEC; and William J. Chadwick, former ERISA Administrator at the Labor Department.

Mr. Alexander, we appreciate your being here very much, and ask you to proceed first.

STATEMENTS OF DONALD C. ALEXANDER, ESQUIRE, WILLIAM CHADWICK, ESQUIRE, AND RODERICK M. HILLS, ESQUIRE

Mr. ALEXANDER. Thank you, Mr. Chairman.

With your permission, I will not read any part of my statement, but I would like to have it inserted in the record.

Senator WILLIAMS. It will be included in full.

Mr. ALEXANDER. Thank you.

I am Donald Alexander, now in private practice; and I am also vice chairman of the Citizens Committee on Paperwork Reduction; and that is an outgrowth of the Commission on Federal Paperwork, on which I was privileged to serve for almost 2 years.

My testimony this afternoon, Mr. Chairman, will be devoted entirely to only two aspects of the bills before you: first, paperwork reduction; then the difficult question of ERISA jurisdiction.

I was happy to see the fact sheet issued by the White House on August 10, just before these hearings, mentioning what had been done in reducing ERISA paperwork and predicting what would be done in the future. This dimension of what had been done is, I think, slightly overstated.

If I read the fact sheet correctly, it points out that the ERISA reports originally required an estimated 9 million hours of the public's time and now accounts for less than 4 million hours. The report from which those figures were drawn mentions a slightly higher total of somewhat over 5 million hours at present.

ERISA paperwork burdens have been reduced. They will be reduced considerably further by the implementation of the predictions made in the fact sheet about what will be done.

What concerns me as an ex-bureaucrat is that what is done 1 year is not necessarily continued to another year, particularly when the moves that are described in the fact sheet which coincide to a considerable extent with the thrust that you make on paperwork reduction in S. 3017 and in Senator Bentsen's companion bill, S. 3193.

These administrative steps do coincide with some of your statutory initiatives, but your statutory initiatives are necessary. They are necessary to the future. They are necessary to the future conduct by an administrative agency in meeting its responsibilities to require certain information but not too much information.

And section 103 calls for a prolix mass of detail which is not covered by the reports described in the fact sheet.

The way to solve the problem is to have a new legislative thrust which would put the burden on the agencies requiring the submission of information to obtain what information is necessary to carry out their responsibilities, but only that information.

So the second title of your bill, Mr. Chairman, is still necessary. And I hope that your committee, working with the Finance Committee, will proceed to change the law so that the initiatives described in the fact sheet will actually be carried out and continued.

Now, finally, on the jurisdiction issue, I seem to have been discussing this since 1974. Of course, all of us are governed to some extent by our experience.

The Internal Revenue Service and the Department of Labor were given overlapping responsibilities under ERISA and we attempted to carry them out as best we could. And we cooperated, we thought pretty well. And working with Bill Chadwick was a pleasure.

But effective cooperation was spotty. It was difficult to achieve and maintain. What I hope you will do is divide up this jurisdiction in a way that will permit the Internal Revenue Service to carry out its continued responsibilities better.

The Service has to audit tax returns, as Senator Long stated today. Dividing jurisdiction will permit the Department of Labor to carry on its responsibilities, which are great, in this difficult, troublesome, and very important area, but will permit them and IRS to do so without having to watch out for another agency interfering in areas that are primarily of your concern, for which you are primarily responsible.

Now, the administration has produced a reorganization plan, which is a step in the right direction. And I hope through legislation you can go further.

That is all I have to say at this time, Mr. Chairman, having in mind the need to have this hearing proceed. Of course, I would be glad to answer any questions with my fellow panelists.

Senator WILLIAMS. Well, we are very grateful for your thoughtful contribution to our subject—the subjects, rather, before us.

[The prepared statement of Mr. Alexander follows:]

STATEMENT OF
DONALD C. ALEXANDER

OLWINE, CONNELLY, CHASE, O'DONNELL & WEYHER
NEW YORK AND WASHINGTON

BEFORE SUBCOMMITTEE ON LABOR,
COMMITTEE ON HUMAN RESOURCES, AND
SUBCOMMITTEE ON PRIVATE PENSION PLANS AND
EMPLOYEE FRINGE BENEFITS
COMMITTEE ON FINANCE

UNITED STATES SENATE

AUGUST 16, 1978

My name is Donald C. Alexander and I am a partner in the New York and Washington law firm of Olwine, Connelly, Chase, O'Donnell & Weyher. I am also Vice Chairman of the Citizens Committee on Paperwork Reduction. I am appearing at the invitation of the subcommittees to discuss proposed legislation affecting the administration of the pension laws from the standpoint of both a former bureaucrat and current private citizen. I am not appearing on behalf of any client of my law firm or any governmental agency.

When I was Commissioner of Internal Revenue, I also served as a member of the Commission on Federal Paperwork. This Commission sought to reduce the volume, complexity, and onus of red tape as it affected the individuals, businesses, and organizations of this country. The Commission's findings and recommendations serve as a constant reminder of the problems of running a huge bureaucracy. Service on both the Commission on Federal Paperwork and the Citizens Committee on Paperwork Reduction has given me an insight into the problems private business and individuals have in coping with the number of forms and reports which must be filed in connection with ERISA.

This paperwork problem will be the first focus of my discussion today. Basically, I favor legislation that will reduce the volume of paperwork filed to meet the reporting requirements of ERISA and that does not impair the substantive safeguards provided by ERISA.

The second focus of my remarks will be the problems to be encountered if the Securities and Exchange Commission is permitted to exercise concurrent jurisdiction over the reporting and disclosure requirments of ERISA or, conversely, a separate federal agency is created to handle exclusively the administration of ERISA.

PAPERWORK

The Office of Management and Budget's June 1978 report to the President and Congress on federal paperwork entitled, "Paperwork and Red Tape: New Perspectives -- New Directions," listed two ERISA forms as among the 15 most burdensome non-tax forms in the federal bureaucracy. Together, those forms required in the private sector alone more than 5 million man hours a year, or the equivalent of 2,500 people working 40 hour weeks for one year.

A report prepared in 1977 by Price Waterhouse & Co. for the Department of Labor showed that small ERISA plans incur costs averaging $1,378 a year. While the Labor Department questions the accuracy of that figure, feeling that it was based on too small a sample, it nevertheless appears that the recurring costs were substantial.

Strides have been made toward reducing this burden. The Commission on Federal Paperwork made 14 suggestions about reducing duplicative or needless ERISA forms required either by the Department of Labor or by the Internal Revenue Service. Of those 14 suggestions, 11 were implemented, resulting in the elimination of 3 IRS forms, and the establishment of several standard dates for joint filings, among other reforms.

But these efforts are not enough. For example, the information needed to be filed with both IRS and Labor when seeking initial determination of a plan is largely duplicative, as an analysis of Forms EBS-1 and 5500 shows. Similarly, as a result of the termination of a pension plan there must be filed a Form EBS-1, a Form 5500 marked "final," as well as a Notice of Intent to Terminate. These reports contain many duplicate requests and, although there are some provisions for cross-referencing, require unnecessary additional paperwork. These examples reinforce my contentions concerning the paperwork burden and highlight the urgency of reforming ERISA to reduce the burden.

In May, 1977, I testified before a joint hearing of the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Committee on Finance, and the Select Committee on Small Business of the Senate in support of S. 901, Senator Bentsen's Pension Simplication Act. That bill would have given the IRS sole responsibility over the areas of vesting, funding, and participation by deleting sections 201 through 211 and 301 through 306 of ERISA. By eliminating the Labor Department's responsibility over these areas, we would reduce duplicative paperwork, not to mention duplicative administrative oversight.

Similarly, S. 2992, Senator Bentsen's bill to provide for uniform accounting standards for calculating and reporting the assets and liabilities of pension plans would reduce paperwork insofar as the reporting of plan assets and liabilities is concerned. The legislation would also introduce a standardized form for detailing actuarial factors used in these calculations.

Senator Bentsen's proposals in S. 3193 to require a Form 5500 compliance report to be filed every five years rather than annually, and to incorporate a simplified annual report with the employer's tax return are also to be commended for striving to reduce the annual reporting burden.

Also desirable is Senator McIntyre's proposal to consolidate the forms small businesses must file under ERISA, as embodied in S. 1745. This bill embodies the recommendations of the Paperwork Commission about reducing ERISA burdens. His suggestion that a simplified statement of a beneficiary's account to replace the complicated Summary Annual Report provided for in Sections 103(b)(3) and 104(b)(3) of ERISA ought to be extended to all businesses, regardless of their size. In terms of simplifying paperwork while preserving employees' rights to meaningful information, it would be preferable to use a notice posted at the employees' workplace giving a brief description of the current financial status of the pension plan, a copy of the latest Summary Plan Description otherwise required by ERISA, the name of the company official who could provide more information about the plan, and a statement of the employee's rights under the plan as required by ERISA.

The Williams-Javits bill, S. 3017, contains two key provisions from a paperwork-reducing standpoint. The first would eliminate the requirements that a plan must provide a participant with information on accrued and vested benefits on request, if the plan routinely provides this information once a year to all participants. The other improvement would establish special master plans for small businesses. Financial institutions would sponsor plans and take care of most reporting and disclosure requirements thereby giving small employers the option of joining a plan while undertaking a minimal amount of responsibility.

Any compromise reached that embodies the paperwork reforms of all these legislative proposals would go a long way toward reducing the volume of paper which must be filed for ERISA plans. Then perhaps we can stem the tide of two unfortunate developments which have accompanied the enactment of ERISA: an increase in plan terminations and a decrease in the number of newly qualified plans. It is imperative for the future of ERISA that these trends be reversed, and one way to begin reversing them is by reducing the paperwork burden.

JURISDICTION

Last week the Administration submitted a reorganization proposal which does much to resolve duplicate jurisdiction and the delays and burdens which result from it. I am pleased to see this constructive action, and I think it should be helpful and productive as an interim solution. While more can be done, this is a good step. It should permit the introduction of more efficient and less burdensome procedures while Congress considers and acts on proposals for long-range comprehensive solutions.

An alternative plan, embodied in the Williams-Javits proposal to create a separate Employee Benefit Commission within the Department of Labor, seems to me to be counter-productive. I similarly oppose the creation of triple agency jurisdiction by interjecting the SEC into the reporting and disclosure field of enforcement.

The Williams-Javits proposal in S. 3017 would require a complete alteration of the bureaucratic machinery which has been in effect for four years under ERISA, and for 30 years before that in the administration of pre-ERISA pension laws. The Internal Revenue Service has developed the staff, the know-how, and the perspective to administer pension plan laws. To take away that staff in beginning a separate agency would be disruptive of the bureaucracy and may also result in inattention to the needs of pension plan beneficiaries, inasmuch as during the re-alignment, pension plan administration would fall by the wayside. If, as in this situation, there are less drastic solutions, it is not a worthwhile expenditure of human resources to shift people around in the creation of a new agency.

Moreover, the pension plan laws are inextricably interwoven with the tax laws. The tax laws provide an unprecedented benefit to qualified tax plans in the form of tax-free status, immediate deductions to employers and deferral of tax to employees. For the Service to rely on another agency's certification that a plan is qualified is a risky way of safeguarding beneficiaries' rights. And the Service would continue to have audit responsibilities, anyway. It is simply not feasible to remove the Service from the pension plan area. What is needed is a more practical approach to the splitting of Labor's and Treasury's jurisdiction. The overlap between the two agencies has to be reduced by a better definition of each agency's jurisdiction.

There are many examples where Congress has defined the jurisdiction of two agencies over the same area and where the two agencies function reasonably comfortably within their jurisdiction. Both Housing and Urban Development and Transportation plan and develop urban mass transit systems. Both the Internal Revenue Service and the Federal Election Commission administer the election campaign expenditure laws. Both the Justice Department and the Federal Trade Commission administer the laws dealing with unfair competition.

Even less desirable than a single agency overseeing ERISA is the SEC's attempt to regulate the administration of pension plans, as evidenced in the Daniel case. Congress should declare that it intends that the SEC have no jurisdiction over pension plans: in effect, to legislatively overturn the Daniel case. The SEC has enough to do without monitoring pension plan disclosures. The current regulatory structure is sufficient to prevent the unfortunate circumstances that surrounded the Daniel case. The SEC's entrance into pension plan administration and disclosure requirements would create more paperwork, more confusion over jurisdictional boundaries, and more litigation over various rights and remedies under different statutes. The Williams-Javits bill, in Section 271, states categorically that an employee can state no cause of action deriving from the Securities Acts. That provision is to be commended.

In sum, reform of ERISA should be a major goal of Congress. I am glad that these two subcommittees are putting forth such a strong effort to get ERISA down to manageable proportions. And I am hopeful that together they will be able to report a bill which incorporates these suggestions for eliminating paperwork and resolving the jurisdictional overlap between the two agencies.

I will be glad to try to answer any questions you may have.

Senator WILLIAMS. Certainly, on paperwork, I think with our legislation before us, we are all making a good beginning here. We have to of course, put together the various bills and rationalize everything.

On the jurisdictional questions, we are all applauding the efforts that are going forward right now with the reorganization and will watch its development with great interest.

And we are some time from coming to any final decision here, as you can see. But it looks to all of us here that progress is being made in the areas that have been found to be the areas of greatest trouble; and we are encouraged.

As you can see, we have had overlapping responsibilities both here and on the floor for the last hour and a half, which confuses things. And I know that Senator Bentsen and Senator Javits and Senator Long do want to come back if it is possible.

So if you can stay for a bit, we will go now to Mr. Rod Hills. I could take a lot of time to applaud Mr. Hill's work as Chairman of the Securities and Exchange Commission. But that has been done in so many other Government documents that I will not increase our paperwork problem here, except to say how much I have enjoyed our working together.

Mr. HILLS. I hope I did not misunderstand.

Senator WILLIAMS. No, you were right. One o'clock was the return time. We were asked by our friends, visiting us from New York, to start 3 minutes early so they could have a final shot.

You missed your network opportunity. We had no way of reaching you, so we went ahead.

Mr. HILLS. Mr. Chairman, I appreciate the chance to be here. My associates and I have prepared some detailed comments about some specific editing that we think might be useful with respect to the bill. I would rather talk briefly about three topics; first, the status of the so-called *Daniel* case; second, the advisability of creating a new agency to deal with employee benefits and, finally, a topic that I do not think is treated as much as it could be in S. 3017, namely, the potential that this legislation has either for adversely or beneficially effecting capital formation.

I might say that I join with Mr. Alexander and other witnesses to say that it seems to me quite important that legislation of the type that you proposed be passed. Pension funds in this country are so large, growing so fast, and they are becoming so critical to capital formation and to our capital markets, that the existing ambiguities that exist with respect to them simply cannot be perpetuated.

The *Daniel* case, of course, presents the most pressing ambiguity. The decision, Mr. Chairman, presents the SEC's interpretation of it, and the Court's in a classic conflict between two longstanding national policies: on the one hand, the establishment of pension plans and the creation of employee benefits which stem from these pension plans have long been the subject of collective bargaining. The policies which have made collective bargaining a national priority since 1935 are different from and somewhat inconsistent with the objectives of the Securities Acts of 1933 and 1934.

It seems to me that the most significant difference deals with the fact that the Securities Acts were designed to protect individual investors, people who made individual investment decisions. And the effectiveness of those acts and the effectiveness of the SEC depends in a very large part upon litigation by individual investors to protect against wrongs.

The SEC does initiate its own actions, to be sure, but the disclosure system that is managed and was created by the SEC is predicated both upon the willingness and the ability of the individual investor to pursue judicial redress when there has been a material misrepresentation that caused them to make an investment decision.

In contrast, the establishment and the growth of pension funds is largely linked to collective bargaining, which stems from an entirely different tradition. It stems from a tradition that was built around the national priority that we established for collective bargaining as an institution.

If we now permit pension plans and the beneficiaries of pension plans to be governed by the same kinds of laws that protect individual investors, then to some significant degree, the principle of collective representation will be undermined and the value of investments in pension funds will be impaired.

It may not be particularly popular to say that the rights of individuals to sue must be subordinate to collective representation, but that, Mr. Chairman, is the necessary result of congressional policies that began with the Wagner Act.

It is not a complete subordination, of course. There are all kinds of ways in which individuals may seek redress against their employer and against their union for failure of fair representation.

But on balance, collective representation is a broad term that is very important to our society.

More importantly, speaking personally as one who has spent 20 years in this area as a labor lawyer, as a professor, and an employer, and as a government official, it is absolutely true that dealing with the collective bargaining relationship takes a special expertise that does not exist at the Securities and Exchange Commission.

And so I concur with the objective of S. 3017 of removing the SEC from the kind of jurisdiction that they seem to now be asserting.

There are some comments that we have made in the memorandum we filed with this committee: for example, we suggested that the SEC jurisdiction over pension fund investments should depend upon whether the individual participant has in fact made an investment decision, rather than on whether the entire plan is classified as voluntary or involuntary. In short, it may very well be that a larger scope should be taken away from traditional Securities Act protection than the present bill proposes.

Mr. Chairman, despite my disagreement with the *Daniel* decision and its natural results, I do believe that the experiences of the SEC show that pension funds do need additional protection, not through the tools of the Securities Act, but additional protection nonetheless. And I suggest that perhaps a congressional mandate could be included in S. 3017 to suggest a joint effort by the Labor Department, Treasury Department, and perhaps a new employee benefits commission, to begin a new form of enforcement protection.

Let me turn to the subject of the new agency.

I think I probably would have been the last to ever suggest that this Government needs a new agency to do anything during the time that I was in the Government. But it may very well be that at this particular time in the evolution of pension fund management that a new agency should be attempted.

I say that cautiously; but on balance I suggest that the Employee Benefits Commission proposed in the legislation makes some sense. The *Daniel* case merely exacterbates a confusion that has arisen out of the overlap between the jurisdiction of the Treasury Department and the IRS.

Even if the Supreme Court were to reverse the *Daniel* case; even if it becomes clear that the interim effort of the President in his Reorganization Plan achieves some alleviation of the regulatory confusion, it seems to me that in the long run it is necessary to create a new tradition with respect to these pension funds, that really threaten to dominate our capital markets.

I can really add very little, Mr. Chairman, to your comments and those of Senator Javits on May 1 in support of the concept of the Employee Benefits Commission except to say that I think on balance the interests of regulatory reform would be better served by such a Commission.

We have made some comments in the material filed with this committee. We have suggested that perhaps the authority of the IRS should be restricted in some other respects. And again we ask that they be considered.

By no means are we convinced that the proposed bill we have tried to draw the line correctly; It does seem to me that any attempt to draw lines between these agencies that reguate pension plans will not succeed because so long as these are any vestiges of double jurisdiction or triple jurisdiction, those overlaps will continue to grow. As more fund managers tend to manage more kinds of funds, the overlap and the confusion between them are bound to develop.

Some can argue that all the authority that you propose to give to the Employee Benefits Commission could be included within the Labor Department. I must say that not only do I have great respect for the traditions of the Department of Labor, but I have great regard for the present Secretary of Labor and the work that is being done there now with ERISA.

But it seems to me in the long run one could make a good argument that pension funds should not be left to the regulation of the Labor Department.

The steady and consistent objectivity of an Employee Benefits Commission, staffed with highly qualified persons—that are skilled not only in collective bargaining, as are the staff in the Labor Department now, but also in tax law, law enforcement, and capital formation—could be a better vehicle in the long run to deal with the integrity of pension funds than is the Labor Department, which must necessarily be deeply involved in matters of a more partisan nature, both politically and in the labor-management area.

Today, the Labor Department has developed a reputation for the separate integrity of ERISA regulation and perhaps that tradition can be institutionalized, but a separate commission would guarantee that independence.

Above all, if there is to be a new agency, it must be staffed by individuals who understand the practical aspects of collective bargaining so that they can anticipate the interrelationships between collective bargaining and the specific regulatory effects of the agency.

The proposed legislation recognizes that need to some degree. But I suggest that it could go further and the congressional intension to emphasize collective bargaining expertise could be spelled out somewhat more specifically.

The SEC has a great tradition. It was begun by people who started that agency back in the 1930's. They were highly talented and highly motivated. It was their capacity; it was their independence and their dedication, rather than any specific legislative language that has given the SEC its deserved reputation.

The committee may wish therefore to provide some legislative direction to the manner in which the agency staff is accumulated, or if the staff is to be left in the Labor Department, or some place else, how those staffs could be augmented. Perhaps a panel of former Secretaries of Labor and Treasury, together with a few distinguished academicians, could be asked to add their assistance to the recruiting effort so that the staffs of those agencies dealing with our capital funds could have the benefit of the same breadth of experience and the same reputation, as we now have in the SEC.

Let me add finally that more can be done in S. 3017 with respect to capital formation. The avowed purpose of S. 3017 understandably and correctly, is regulatory reform, reduction of paperwork, reduction of delay.

But there is an equally pressing need for pension-fund regulators to anticipate and compensate for the effect of their regulations upon our capital markets. The enormous funds now held by pensions have so great an effect upon capital markets that no regulatory effort, no matter how well motivated, to protect individual rights in these funds, should be launched until its effect on the availability and distribution of capital has been carefully considered.

Economic regulation in the past, in many of our agencies, has too often ignored the parable of the shepherd and his flock—that shepherd, that was so concerned with a single lost lamb that he abandoned and lost his flock just to get the one lamb back.

The SEC, the IRS, the Labor Department, the Justice Department, all understandably want to stop improper behavior in the administration of pension plans. But this Government can draw the regulations so tight and so constrain the investment alternatives of fund managers that the ultimate values of the overall funds and indeed of our capital markets can be seriously impaired.

In our criminal justice system we avoid numerous kinds of police methods that would threaten our personal freedom. To some degree, we know that we will, no matter what kinds of rules we pass, never eliminate all negligence nor will we eliminate all crookedness in the administration of trust funds. Thus, we must accept the point that some misdeeds will continue.

As the chairman will recall, I have suggested before that the SEC could have in the past given greater effort to developing a capacity for economic analysis, upon the impact of Commission actions on the capital markets.

On occasion, concern for individual misbehavior which may have caused a loss to a few persons has caused a regulatory reaction that has caused far more havoc to all who participate in our capital markets.

The Commission's present extended freeze—and I use the word "extended"—on the further development of options trading in this country—may be an example of such a reaction.

I suggest, therefore, that S. 3017 be amended specifically to demonstrate a congressional concern that the new agency both possess and employ a capacity for economic analysis in its regulatory efforts.

I suggest also, Mr. Chairman, that care be taken now to avoid any further unnecessary regulatory impact upon the diversion of capital funds, and I would like to call attention to the fact that S. 3017 does provide an exemption from the Securities Acts and the Investment Company Act to certain pooled investment funds maintained by banks, insurers, and issued to certain employee benefit plans.

Whether or not those pooled investments should be freeded from such regulation is an arguable point. It may or may not be wise to do so. But to do so now would most certainly cause a tendency to divert investment funds from mutual funds to funds maintained by banks and insurance companies.

And unless there is some compelling reason to do it today, it seems to me it might be wise to defer action on that until a broader perspective could be had on the regulatory efforts on all those kinds of funds.

The Senate Securities Subcommittee is currently conducting an in-depth study of bank sponsorship of pooled investment funds for pension plans. Perhaps this proposal could await the outcome of that study.

In fact, there are a number of proposed amendments to ERISA in the proposed bill that could benefit substantially from the completion of that study.

I only had a chance to read the President's proposed reorganization plan briefly, and I would not presume to offer any conclusionary remarks as to whether or not in the long run it is a sensible approach.

It does seem to be an admirable and useful approach, at least on an interim basis.

I do think, however, that the proposed reorganization probably would not create the kind of highly skilled staff that is really needed in the regulation and analysis of pension funds.

I must suggest also that one has to be skeptical about the further balkanization of regulation of funds held for capital investment. And one cannot help but feel some sympathy for the pension fund managers who manage several kinds of funds, to worry as the different traditions evolve from the IRS and the Department of Labor.

I might also say that the notion of having two enforcement capacities that would enforce the regulations of each other's agency strikes me as an unnecessary overlap.

Nonetheless, the President's plan may be a useful interim step, and it is entirely possible that a determined effort by both this administration, aided by the Congress, to supplement the existing well-qualified staff in the Labor Department, with better enforcement capacity and more qualified economic capacity, could accomplish many of the objectives that you seek in S. 3017.

Mr. Chairman, it is easy for all of us to suggest change whenever a unique legislative proposal comes forward. We among others suggest that there is some editing that can take place. But if S. 3017 in its final edited form is viewed as merely the next step in the regulation of pension funds, and if it is accepted by the Congress and by the regulatory agencies as an admittedly partial solution to a problem that will continue to evolve over a period of time; and if the Congress understands that the delicate balance between individual rights in the capital markets cannot be delegated to an independent agency, but must have the continued attention of Congress, then the business community, the financial community—and I think most of all, the labor movement—will benefit from an early passage of an edited version of S. 3017.

Thank you.

[The prepared statement of Mr. Hills follows:]

THE TESTIMONY OF

THE HONORABLE RODERICK M. HILLS

BEFORE THE

COMMITTEE ON HUMAN RESOURCES

UNITED STATES SENATE

Auaust 16, 1978

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I. Introductory Remarks.

Thank you for this opportunity to comment on the various bills before the Senate proposing to amend the Employee Retirement Income Security Act of 1974 ("ERISA"), and particularly upon Senate Bill 3017. As the sponsors of the S.3017 have noted some editing of the proposed legislation is needed, and with the assistance of my associates, we have filed a document which offers several specific editorial comments. I will also have a few comments about the President's Plan to Reorganize Regulation of Pension Plans.

Today, however, I shall concentrate on three aspects of the proposed legislation that involve subjects that have consumed a large portion of my professional life. Specifically, these areas of concern are:

(1) Whether the protection afforded stockholders under the federal securities laws should be extended to beneficiaries of so-called involuntary pension funds;

(2) The advisability of creating a new agency to assume responsibilities for pension fund regulations that are presently delegated to the Department of Labor, the Internal Revenue Service, and the Pension Benefit Guarantee Corporation; and

(3) The proposed legislation's potential for affecting capital formation either adversely or positively.

At the outset it is important to state that legislation amending ERISA is clearly needed, and needed at an early date. In 1950, assets and reserves of private pension plans totaled 12.1 billion dollars. By 1975, pension plan assets and reserves had grown to 216.9 billion dollars. Given the special tax incentives encouraging pension fund investment and organized labor's efforts to increase both the coverage and amount of pension benefits, we can reasonably anticipate that pension funds will continue to grow at a strong pace. These funds are so large, growing so rapidly, and becoming so critical to capital formation that the existing ambiguities afflicting regulation of these funds cannot be perpetuated.

II. Application of Federal Securities Laws to Interests in So-Called Involuntary Pension Plans.

The *Daniel* case presents the most pressing of these ambiguities: should beneficiaries of involuntary pension funds be afforded the protection given investors by the federal securities laws? S.3017 would, quite properly I believe, answer no and thus reverse the decision of the 7th Circuit in *Daniel v. International Brotherhood of Teamsters*.

The *Daniel* case and the SEC's interpretation of existing law presents a classic conflict between two very important but very different long-standing policies of our federal government.

The establishment of pension plans and the creation of employee benefits which flow from these plans have long been subjects of collective bargaining, and those policies which have made collective bargaining a national priority since 1935 are different from and somewhat inconsistent with the objectives of the Securities Acts of 1933 and 1934.

Perhaps the most significant difference is that the Securities Acts were designed in large part to protect individual investors. Their effectiveness depends to a great degree upon litigation by individual investors to redress "wrongs". The SEC, of course, also initiates its own actions, but the disclosure system managed by the SEC is predicated upon the willingness and ability of individual investors to pursue judicial redress for material misrepresentations in disclosure documents.

The establishment and growth of pension funds, however, is linked to <u>collective</u> bargaining. The essence of collective bargaining springs from the entirely different tradition of collective action, of representation of many individuals by a single bargaining agent. If beneficiaries of pension plans are given the same rights to pursue individual actions that have been afforded individual investors under the securities laws, the principle of collective representation will be undermined, and the value of investments in pension funds will be impaired.

It may not be popular today to state that rights of individuals to sue for redress for pension fund mismanagement must be subordinate to collective representation but that is the necessary result of the Congressional policies which originated with the Wagner Act of 1935.

Moreover, as one who spent 20 years in collective bargaining, as lawyer, employer and professor, I suggest that agencies attempting to regulate subjects involving collective bargaining need special expertise, an expertise that does exist at the SEC. I therefore concur with S.3017's additional objective of removing the SEC from the arena of pension fund regulation.

However, as both Senators Williams and Javits have noted, the reversal of Daniel and the striking of the appropriate balance between individual and collective rights involves numerous complex issues. Accordingly, the present form of S.3017 may benefit from some editing. For example, we believe that the SEC's jurisdiction over pension fund investments should depend upon whether the participant has made an investment decision rather than whether the entire plan is "voluntary". In a separate memorandum filed with this Committee, we have made a suggestion in this regard.

Despite my disagreement with the results that would flow from the Daniel decision, I am convinced that the protection of investments in pension funds deserves greater government attention. Sufficient irregularities in the management of pension funds have arisen in recent years to justify the SEC's concern for protecting the interests of pension funds beneficiaries even though the securities laws do not seem to me to be the appropriate tool for doing so. I suggest that further study be directed toward alternative means of providing such protection.

A Congressional mandate could be given in S.3017 to a joint effort by the Labor Department and the new Employee Benefit Commission to suggest a new approach. The Securities and Exchange Commission could provide important support for such a study.

III. The Creation of a New Agency to Deal with Pension Plans.

The overlapping jurisdictions of the Labor Department and the Internal Revenue Service have imposed unnecessary confusion and expense upon the creation and administration of pension funds. The new *Daniel* approach of the SEC thrusts yet another agency into this regulatory thicket and exacerbates the confusion. The important point to be made, however, is that legislation is needed even if the *Daniel* decision of the 7th Circuit is reversed by the Supreme Court.

I can add very little to the May 1, 1978 comments of Senators Williams and Javits in support of the creation of a new Employee Benefits Commission except to submit that my experience at the SEC and at the White House confirm that the existing overlap must be eliminated. I am concerned, however, that S.3017 does not do enough in this regard. For example, the proposed legislation does not place Keogh plans that cover only owner-employers or Individual Retirement Accounts under the new Commission, but leaves them subject to IRS regulation. The confusion of dual jurisdictions will continue under this proposal. For instance, a self-employed, owner-employer with no employees, will be required to report to the IRS. But if he hires a receptionist and adds the receptionist to his plan (as ERISA requires), he will suddenly be within the new Commission's jurisdiction. If he subsequently decides to subcontract receptionist services, he will be under IRS jurisdiction again.

I suggest that no attempt to draw lines between agencies regulating pension plans will succeed. So long as any vestiges of the double and triple jurisdiction under the current regulatory scheme remain, the interests of beneficiaries and the cause of capital formation will suffer.

Some may argue that all regulation of pension plans should be consolidated within the Labor Department and that the last thing this government needs is a new agency. I have great regard for the traditions of the Labor Department and for the present Secretary of Labor, but perhaps the regulation of pension funds should not be left to the Labor Department.

The studied objectivity of an Employee Benefit Commission staffed with highly qualified persons that are skilled in collective bargaining, tax law, law enforcement and capital formation is a better vehicle to deal with the integrity of pension funds than is the Labor Department, which must necessarily be deeply involved in matters of a more partisan nature both politically and in the labor-management area. Today, the Labor Department has developed a reputation for the separate integrity of ERISA regulation and perhaps that tradition can be institutionalized, but a separate Commission would guarantee that independence.

Although the SEC is not the agency to deal with the matters covered by the proposed legislation, it would be well to create the new agency in its mold. In particular, Congress should provide the new agency with the responsibility of developing an expertise in the administration of programs designed to protect individual investments.

Whether the civil law enforcement aspects of such programs should be in the new agency in an enforcement type operation like that of the SEC or left to the Justice Department is a matter on which many will differ. At the very least, however, the new agency should develop a highly qualified group of investigators with legal, economic, business and financial backgrounds that are able to establish appropriate enforcement priorities.

Above all, this agency must be staffed by individuals who understand the practical aspects of collective bargaining to anticipate the interrelationships between collective bargaining and specific regulatory efforts. The proposed legislation recognizes this need in its provision for the appointment of a Chairman from a list submitted by the Secretary of Labor, but the Congressional intention to emphasize collective bargaining expertise could be spelled out with greater force.

The great traditions of the SEC were planted by the very talented and highly motivated people who began the agency in the early 1930's. It was their capacity, independence and dedication rather than any specific legislative language that has made the SEC. This Committee may wish, therefore, to provide some legislative direction to the manner in which the agency staff is accumulated. Perhaps a panel of former Secretaries of Labor and Treasury together with a few distinguished academicians could be asked to add their assistance to the recruiting effort.

As both Senators Williams and Javits remarked in their May 1 comments to the Senate, this new agency will play an even greater role in American society due to the rapidly growing importance of pension funds in the total investment picture and due to the anticipated graying of America.

Accordingly, Congress must make every effort to ensure that the new agency is properly staffed. I have some additional comments about the staffing of the proposed Commission which I will discuss later.

IV. The Proposed Legislation Can Have Considerable Impact on Capital Formation

The primary motivation for the proposed legislation is understandably and properly regulatory reform. However, there is an equally pressing need for pension fund regulators to anticipate and compensate for the effect of regulations upon our capital markets. The enormous funds now held by pensions have so great an effect upon capital markets, no regulatory effort to protect individual rights in these funds should be launched until its effect on the availability and distribution of capital has been carefully considered. For example, there is some evidence that pension funds are less likely to be invested in equity securities, especially equity securities of smaller companies, than other types of investment funds. If this assertion is accurate, and if it can be demonstrated that it is a result of regulatory efforts Congress did not intend, we would be forced to conclude that the regulatory scheme needs adjustment.

Let me be more specific. Economic regulation in the past has too often ignored the parable of the shepherd and his flock. That shepherd so concerned for a single lost lamb abandoned and lost his flock to save the one lamb.

Certainly we wish to protect against improper behavior in the administration of pension plans but we can draw the regulations so tight and so constrain the investment alternatives of fund managers that the ultimate values of the overall funds and indeed of our capital market will be seriously impaired.

In our criminal justice system we avoid numerous kinds of police methods that would threaten our personal freedom. Similarly, we know that we will never eliminate all negligence or all crookedness in the administration of trust funds. Thus, we must suffer some misdeeds to preserve a free enterprise system.

The SEC over the years could have given greater efforts to economic analysis both as to what is occurring in our capital markets and the impact of Commission actions on these markets. On occasion concern for individual misbehavior which may have caused a loss to a few persons has caused a regulatory reaction that has caused far more havoc to all who participate in our capital markets. The Commission's present extended freeze on the further development of options trading may be an example of such a reaction. I suggest, therefore, that S.3017 be amended specifically to demonstrate a Congressional concern that the new agency both possess and employ the capacity for economic analysis in its regulatory efforts.

Care should also be taken now both to avoid any further unnecessary regulatory impact on capital investment and to begin to unravel past unintended diversions of funds. In this regard it should be noted that S.3017 provides an exemption from the Securities Acts and the Investment Company Act to certain pooled investment funds maintained by banks or

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insurers and issued to certain employee benefit plans. S.3017 would thus remove pooled investment funds for corporate plans, Keogh plans and Individual Retirement Accounts from the anti-fraud provisions of the Securities Acts and would permit banks and insurance companies to advertise interests in such funds to Keogh and IRA plans without providing disclosure documents.

The SEC has traditionally regulated these activities and Congress refrained from prohibiting this regulation when it originally promulgated ERISA. Freeing these pooled investment funds from such regulation may or may not be wise but it would most likely result in diverting investment funds from mutual funds to funds maintained by banks and insurance companies.

Unless there is some compelling reason to create this regulatory imbalance, it would be wise to defer action on this aspect of the proposed legislation until adequate studies can be performed regarding the proposal's impact upon investment strategies, the desirability of affording additional protections to beneficiaries of smaller pension plans, and the advisability of allowing banks to advertise interests in pooled funds to pension plans.

The Senate Securities Subcommittee is currently conducting an in-depth study of bank sponsorship of pooled investment funds for pension plans. Consideration of this proposal could be deferred until that study is completed.

The regulation of pension funds is experiencing a period of development just as pension funds themselves are experiencing a period of growth. Proposed amendments to ERISA should recognize that Congress will need to visit this subject regularly. In my view Congress, rather than independent regulatory agencies, must accept this responsibility because the potential conflicts between the need to provide and protect pension funds and the need to encourage capital formation are too great to delegate the responsibility for balancing these interests to an independent agency.

It may be wise, therefore, for this Committee to table several other subjects covered by the proposed legislation for further study and to proceed expeditiously on those matters which demand urgent treatment so that Congress can give adequate attention to all the important issues raised by the proposed legislation.

V. The President's Plan to Reorganize Regulation of Private Pension and Employee Benefits Plans.

I have only briefly studied President Carter's planned reorganization of the regulatory responsibilities created by ERISA and I do not, therefore, feel qualified to offer an opinion as to whether it offers a satisfactory alternative to the proposed new Employee Benefits Commission.

However, the proposed reorganization would not create the highly skilled staff which seems to me to be needed, nor would it give the emphasis to the need for evaluating regulatory impact on our capital markets.

Moreover, one must be skeptical about the further balkanizationof regulation of funds held for capital investment. I cannot help but feel sympathy for those who manage several funds and those who seek capital from funds who would be required to trace different rules that evolve from the IRS and the Labor Department.

The President's plan may be a useful interim step and possibly a determined effort both to supplement the existing well qualified staff of the Labor Department with better enforcement capacity and more qualified economists could accomplish all the objectives of the S.3017. Nonetheless, it will take an unusually dedicated and prolonged commitment to create a properly balanced organization in the existing framework.

Finally, in its present form the reorganization plan will perpetuate some of the confusion about pension plan administration that now exists.

VI. Conclusion.

It is easy to suggest changes in any unique legislative proposal. S.3017 will benefit from editing but it is more important to note strongly that this legislation is urgently needed.

Viewed as the next step in the regulation of pension funds and accepted as an admittedly partial solution to an evolving problem that will need constant monitoring and further legislative attention, business, the financial community and most of all labor will benefit from an early passage of S.3017.

Senator WILLIAMS. Thank you very much.

The third member of our panel is William J. Chadwick, formerly Administrator for the ERISA program in the Labor Department.

Mr. Chadwick?

Mr. CHADWICK. Thank you, Mr. Chairman.

Prior to returning to the private practice of law over 18 months ago, I was involved in the administration and enforcement of ERISA on behalf of both the Labor Department and the Treasury Department.

At the Labor Department, I served as the Administrator of Pension and Welfare Benefit programs, and at the Treasury Department, I served as an Attorney-Adviser with the Office of the Tax-Legislative Council.

I was also involved in the conference committee sessions on H.R. 2, ERISA, and I participated in the drafting of ERISA. I feel that ERISA was and continues to be a significant step in the right direction. However, upon reflection, I also feel that additional steps are necessary.

The focus of my testimony this afternoon is on the jurisdictional matters addressed in your bill, S. 3017, and the jurisdictional matters addressed in S. 901. I think that both of these bills address a problem with significant social-welfare and tax-economic implications; that is, the multifaceted regulatory scheme developed to govern the provision of retirement and health benefits in this country.

I think that the significance of the matters addressed must be underscored. We have to think of the significance in terms of both social welfare implications and tax-economic implications.

In terms of social-welfare considerations, I think we all have to realize that there are over 1.6 million private pension and health and welfare plans in this country, and there are countless numbers of plans maintained by Federal, State and local government entities.

These private plans provide benefits to, approximately 35 million American workers and the public plans provide similar benefits to approximately 16 million American workers.

It means that nearly one-half of all workers in industry and commerce are affected by the regulatory scheme developed to govern the provision of retirement and health benefits.

I think it should be clear that the multifaceted regulatory scheme that we exist under today has very significant social welfare implications.

I think we have to also think in terms of tax-economic considerations. In this regard, I think it is important to note that pension plans hold assets in excess of $400 billion—that is, both insured and uninsured plans. These assets constitute the largest pool of capital in this country. Therefore, there are very significant tax-economic implications.

When somebody thinks about these implications, ideally one would assume that there would be an efficient and effective regulatory scheme. One would think there would be some form of national retirement and health policy; one would think there would be a comprehensive regulatory approach, and that various departments and agencies involved would coordinate their activities toward achieving some national policy goals. As rational as these thoughts might be, very few assumptions could be more erroneous.

Right now there is no national retirement and health policy; there is no coordinated Federal implementation of the various laws relating to the provision of retirement and health benefits; and inevitably, as a result, the Federal departments and agencies involved in the regulation of retirement and health plans publish inconsistent policy and legal guidelines.

I think the principal problem that employers and unions alike face is that today we have approximately 40 Federal laws that govern the provision of retirement and health benefits. These laws have an impact on plan sponsors and participants and beneficiaries as well as on asset managers and other service providers.

These 40 Federal laws are administered and enforced or implemented by approximately 20 Federal departments and agencies. This multifaceted regulatory scheme is incredibly complex.

Compliance with all of the laws is virtually impossible. It is very difficult. In many cases, it is virtually impossible. The reason is because you have so many different laws, because you have so many different agencies.

As I indicated before, we have very inconsistent policies and laws and legal pronouncements. Even if it is possible to comply with all the laws, it is very expensive. We are wasting money. We are not using the money that could be put to providing various benefits to good use.

I happen to feel that the increasing administrative costs have an impact on all businesses and all unions. The problem inherent in the multifaceted regulatory scheme is not limited to small businesses. It has an impact on the larger businesses as well, and it has an impact on unions of all sizes.

Small businesses in many cases have the ability to make a decision either not to establish a plan or to terminate a plan. Thus we have seen, since ERISA's enactment, a number of terminations.

Large businesses, on the other hand, do not have those options. In many cases, given union involvement, they are precluded from making a decision to terminate a plan. That does not mean that the problems just go unnoticed. What is means is that they are very reluctant to increase benefits, very reluctant to expand coverage, very reluctant to add additional benefits.

Thus, the administrative costs have a negative impact on everybody and the administrative costs are inconsistant with the very sound policy goals established in ERISA.

I think we definitely need some type of national retirement and health policy, and I also think we need a coordinated effort to implement the various laws.

I feel that S. 3017 is an important step in the right direction. I think it is an effective and efficient solution to a very important problem and I think it is a solution that applies for the long haul.

I feel that S. 901, on the other hand, is really a short-term solution. And I do not think that it will solve our problems in the long run. And I do not think that it will help develop some type of a national retirement and health policy.

I think that S. 3017 will force the coordination of ERISA's implementation and provide a necessary framework for further policy and legal coordination. S. 901 will solve the problem referred to as "Dual jurisdiction," but I do not think that it will solve the other political and legal problems.

I think the key differences between S. 3017 and S. 901 is that S. 3017 recognizes the scope of the entire problem. It provides a vehicle to coordinate the activities of all the departments and agencies under all the various laws.

I do not think S. 901 does that.

S. 901 tends to focus on ERISA as the only law involved. I do not think ERISA is the only law involved. There are more than 40 others.

I would like to make a few comments briefly on the administration's solution.

It is along the lines of S. 901, and arguably solves some short-term problems by trying to separate out the jurisdictional aspects of ERISA. I think it is a significant step backward in that the quid pro quo, for the division of jurisdiction is to permit the Labor Department to retain veto power over regulations with an impact on collectively bargained plans.

I have a difficult time thinking of any regulation, under parts 2 or 3 of ERISA—or in the 400 sections of the Internal Revenue Code—that would not have an impact on collectively bargained plans.

The administration's solutions is to give the Labor Department, in effect, a veto power over any of those regulations. That is much more power than the Labor Department has today.

Today, whether or not the Labor Department likes a regulation that the IRS is proposing, the IRS, with the Treasury Department, has the authority to propose and finalize that regulation. The same would be true with respect to revenue procedures and revenue rulings.

However, under this proposal, the Labor Department can stop anything that it does not like. I think it will further retard the development of the much-needed regulations under ERISA.

Another problem that I see in the administration's proposal is that it does not address the issue of welfare plans and how administration and enforcement and regulation in general of welfare plans should be governed.

If, for example, I had a client being investigated by the Labor Department, and my client and I thought that in the best interests of everyone involved, the best thing to do would be to enter into some type of consent decree or consent order from the Labor Department, that would be setting my client up for an attack by the IRS, setting my client up for the IRS to come in and revoke the tax-exempt status, the 501 status of that trust.

I think that is a very serious deficiency in the administration's proposal.

Again, I think, in terms of the short-term solution, the administration may be moving in the right direction. I think as a short-term solution that S. 901 may solve some problems. But I happen to feel that in terms of a long-term solution, we need a national retirement income policy, a national health policy; and I think that S. 3017 is the best vehicle.

I sincerely appreciate the opportunity to comment today. I hope my comments prove constructive, and I will be more than happy to answer any questions that you might have.

Senator WILLIAMS. Thank you, Mr. Chadwick. Those were most constructive comments.

[The prepared statement of Mr. Chadwick follows:]

TESTIMONY
of
WILLIAM J. CHADWICK, Esq.
Of Counsel
Paul, Hastings, Janofsky & Walker
Los Angeles, California

BEFORE
THE
SENATE HUMAN RESOURCES SUBCOMMITTEE on LABOR
and the
SENATE FINANCE SUBCOMMITTEE on PRIVATE PENSION PLANS
August 16, 1978

Mr. Chairman Williams, Mr. Chairman Bentsen and members of the Subcommittees:

My name is William J. Chadwick, and I am Of Counsel with the law firm of Paul, Hastings, Janofsky & Walker in Los Angeles, California. Prior to returning to the private practice of law over 18 months ago, I was involved in the administration and enforcement of ERISA on behalf of both the Labor Department and the Treasury Department. At the Labor Department, I served as the Administrator of Pension and Welfare Benefit Programs (and as the Special Assistant to the Administrator). At the Treasury Department, I served as an Attorney-Advisor (Tax Policy) in the Office of the Tax Legislative Counsel. On behalf of the Treasury Department, I attended the Conference Committee sessions on H.R. 2 (ERISA) and I participated in the drafting of ERISA. I feel that ERISA was and continues to be a significant step in the right direction but, upon reflection, I also feel that additional steps are necessary.

My testimony this morning is presented at the request of the Subcommittees. Since I was asked to testify as part of a panel of ex-government officials along with Donald Alexander, former Commissioner of Internal Revenue, and Rodrick Hills, former Chairman of the Securities and Exchange Commission, my testimony is presented in the public interest. My comments are not designed to directly assist any of my clients. Of course, an effectively implemented solution to the problems presented by the existing multi-faceted regulatory scheme will indirectly assist my clients in their efforts to provide retirement and health benefits in compliance with the various laws.

The focus of my testimony this morning is on the jurisdictional matters addressed in S. 3017, the ERISA Improvements Act of 1978, and S. 901, the Pension Simplification Act. These bills address a problem with significant social-welfare and tax-economic implications: the multi-faceted regulatory scheme developed to govern the provision of retirement and health benefits.

The significance of the jurisdictional matters addressed in S. 3017 and S. 901 must be underscored. The significance of these matters must be thought of in terms of social-welfare and tax-economic considerations. They must also be thought of in terms of all the laws and departments and agencies involved.

In terms of social-welfare considerations, it is important to note that there are currently over 1.6 million private pension and health and welfare plans in this country and a countless number of plans maintained by federal, state and local governmental entities. The private plans provide benefits to approximately 35 million American workers and the public plans provide similar benefits to approximately 16 million American workers. This combined total of 51 million workers does not include the number of workers covered by old age, survivors and disability insurance or the social security system. Nearly one-half of all workers in commerce and industry in this country, and close to three-fourths of all government civilian personnel, are covered by private and public plans other than social security.

It should be clear that the regulation of retirement and health benefits has had and will continue to have significant social-welfare implications.

In terms of tax-economic considerations, it is important to note that these plans hold assets in excess of $450 billion. These asset holdings represent one of the largest pools of capital in this country.

It should be equally clear that the regulation of retirement and health benefits has had and will continue to have significant tax-economic implications.

After pondering the social-welfare and tax-economic considerations, one would think that there would be an efficient and effective regulatory scheme. Ideally, one would think that there would be a national retirement and health policy. One would think that there would be a comprehensive regulatory approach and that the departments and agencies involved would coordinate their activities to realize the national policy goals. As rational as these thoughts might be, very few assumptions could be more erroneous.

There is no national retirement and health policy. There is no coordinated federal implementation of the various laws relating to the provision of retirement and health benefits. Inevitably, the federal departments and agencies involved publish inconsistent policy and legal guidelines.

There are approximately 40 federal laws relating to the provision of retirement and health benefits. These laws have an impact on plan sponsors and participants and beneficiaries as well as on asset managers and other service providers. These 40 federal laws are administered and enforced or implemented by approximately 20 federal departments and agencies.

This multi-faceted regulatory scheme is incredibly complex. Compliance with all of the laws is difficult and, in some cases, impossible. As I indicated before, different laws as implemented by different departments and agencies inevitably lead to inconsistent policy goals and legal interpretations. Where compliance with all of the federal pronouncements is possible, it is only realized after unnecessary expense.

The increasing administrative cost of providing retirement and health benefits has an impact on all businesses and unions. The problems inherent in the multi-faceted regulatory scheme are not limited in their impact to small businesses. The problems are felt by large businesses and unions of all sizes. Small businesses decide either not to establish new plans or to terminate existing plans. The plan termination statistics over the last few years indicate that ERISA has not realized one of its statutory goals: to maintain an environment in which private employee benefit plans continue to grow and flourish. While large businesses are arguably in a position to absorb the cost of compliance, these costs definitely have an impact on the provision of retirement and health benefits (as well as broader economic implications). In a competitive environment, small and large businesses alike can only absorb limited costs for the provision of retirement and health benefits. When these costs reach a certain level, a company will be extremely reluctant to expand coverage or to provide an increase in existing benefits or add new benefits.

If increased administrative and compliance costs represented dollars efficiently and effectively spent, the complaints of business and labor would not be no piercing. However, these dollars are, in many cases, wasted in an attempt to comply with inconsistent governmental directives.

We definitely need a national retirement and health policy and a coordinated effort to implement the various laws. S. 3017 is an important step in the right direction. It is a long term solution to a significant long term problem. S. 901, while a short term solution, will not solve our long term problems nor assist in the development or implementation of a national retirement and health policy.

S. 3017 will force the coordination of ERISA's implementation and provide a framework for further policy and legal coordination. S. 901 will solve the problem referred to as "dual jurisdiction", but it will not solve other political and legal problems.

The key difference between these two bills is that one (S. 3017) recognizes the scope of the problem while the other (S. 901) does not. ERISA has focused our attention on the regulation of retirement and health benefits, but ERISA is clearly not the only law involved. Also, ERISA is no more a tax law than it is a labor law. While ERISA represents a merger of laws that were developed along tax and labor lines, the merger is socio-economic in orientation. This orientation is positive in terms of efficiently and effectively regulating the provision of retirement and health benefits. The public will not be well served if we revert to a pre-ERISA jurisdictional scheme.

I appreciated the opportunity to testify this morning. I hope you will view my comments as constructive and I hope that they will lead to a better regulatory system. At this time, I will be pleased to answer any questions you may have about any of the bills pending before the Subcommittees. Thank you.

Senator WILLIAMS. Senator Javits.

Senator JAVITS. I am overdue everywhere I am supposed to be.

I have such great regard for Rod Hills and for Mr. Alexander. I also know Mr. Chadwick is a very able and intelligent individual.

I just wanted to come and pay my respects. I have already had a briefing about what you said, and I will read it with the greatest care. I know it will be very profitable and useful, not only for this legislation—which is important enough—but in other legislation which we are facing.

Thank you very much.

Thank you, Mr. Chairman.

Senator WILLIAMS. I wonder if you could wait just a minute, Jack?

Rod Hills suggested that we might want to consider the forms of protection in this area. This followed after he explained the differences between the collective situation we have with pensions and the individual investment situation we have within the SEC framework.

I just wonder if you could amplify on that a little bit, Rod. It might be an area that Senator Javits particularly is concerned about.

Mr. HILLS. I think, Mr. Chairman, there is no particular evidence, for example, that a large number of individuals—I do not mean to speak about Mr. Daniel's case, because that is a specific case—but there is no evidence that a large number of individuals have been misled by their labor unions or misled by their employers about their benefits. I do not mean to say that that is not an important matter. There should, of course, be disclosure documents.

An agency with good economic capacity and an agency with good enforcement capacity—and I must say that although I disagree with many things, I have a great admiration, tremendous admiration, for the capacity, for example, of the SEC Enforcement Division which could very well determine measurements for Government concern where a pension plan is not performing for the benefit of its beneficiaries.

In other words, if we are to look at all the funds in this country, one has to look at them in a collective form, not from the standpoint of looking to individual people, an approach which would further clog our Federal courts with individual lawsuits.

I do think we have to develop an alternative to individual lawsuits by individuals who really do not have the economic capacity—unless we use more class actions—and do not have the understanding of how our pension plans and how our capital markets work.

We have to develop a governmental capacity to go after those funds that are violating fiduciary responsibilities.

We can do a better job. I do think that some things that the SEC has done—has pointed out the need to do those things.

I am not wise enough to know, for example, whether it should be in the Justice Department for enforcement procedures—I suspect it ought to stay in the Justice Department—or whether in a new Employee Benefits Commission.

But there ought to be a highly skilled number of people to develop a better standard of choosing priorities as to which funds should be investigated.

One of the most important rules of a Government investigator is to make each entity feel that these is a good chance that they are going to be investigated. And if you have an agency that, with the aid of computer technology, for example, can see some funds are doing some things differently, some abberations, they can better select their targets. Too often we investigate too late.

That is really what I meant in terms of trying to find a sophisticated set of priorities for determining how Government resources should be used to seek and redress breaches of the law with respect to the management of pension funds.

Mr. ALEXANDER. If I could comment for a moment, I think Mr. Hills has done an excellent job of describing the way the Internal Revenue Service has gone about, is going about, and will go about the job of enforcing the tax laws with respect to pension funds.

The creation of a new agency does not mean that a new highly skilled staff springs full blown from the ground. The creation of a new agency, in my judgment, is highly disruptive of the efforts of that present highly skilled staff in the Department of Labor and the present highly skilled staff and experienced staff in the Internal Revenue Service.

Senator JAVITS. Thank you very much, Mr. Chairman.

Thank you very much, gentlemen.

Mr. ALEXANDER. Thank you, Senator.

Senator WILLIAMS. Mr. Chadwick described the numbers of working people who are included in pension plans, and it comes to about 50 percent of those who are employed, public and private, who are presently providing for retirement through a plan.

We recognize that; and we recognize that some ERISA-related problems probably have indeed discouraged the creation of plans, and that the complexity and difficulty of meeting all of the laws and regulations is a part of that.

I think this has a damaging effect. What we are trying to do now is to develop some ideas that will reverse that, and stimulate or encourage more coverage through private pensions plans.

For example, we know that tax policy can be used for many things, and we have included some tax incentives as stimulants in our bill. Without a stick, we have offered the carrot of special startup and plan improvement treatment under tax law.

I wonder if any of you have thought of how we might, through our opportunities in the law, encourage the creation of more coverage and better pension plans? Does anyone want to offer——

Mr. CHADWICK. I really feel, in terms of dealing with my clients—which include companies really of all sizes—that the most frustrating thing to them is the various administrative problems.

I do not think more tax incentives are necessary. I do not think more labor incentives are necessary. I think what is necessary—I think you have tried to do this in S. 3017—is just some type of an organization so that there are rules, and companies can comply with the rules, within reasonable cost limits.

An example that is just shocking, in terms of someone who might approach me—oh, let us say about a month or so ago, when the Supreme Court rendered a decision in the *Marie Manhart* case, involving title VII, sex discrimination in the context of pension plans—and somebody would come up to me—either a client or not a client—and say, "Did you read about that decision? Very significant implications."

"Yes, yes. I read about it. It does have significant implications."

"Well, can you tell me what we ought to do about it?"

Well, in responding to that question, I have to sit back and say, well, there are certainly title VII problems that we have to address. Then we have, in terms of addressing problems, the Equal Pay Act, and then we run into ERISA and then we run into the Internal Revenue Code. And I am supposed to be sitting there as an expert adviser and I do not have the faintest idea what the answer is. There is no advice that I can give a client so that the client can bring the plan in compliance with the state of the law.

That I think is by and large the most traumatic thing, you know, to somebody who is maintaining a plan, particularly if it is a company of 10 or 15 employees. And they find out that it is going to cost $2,000 or $3,000 to comply with the Supreme Court decision.

At that point, they are generally quite frustrated, ready to throw up their hands and walk away. So I think the solution, the bottom-line solution, is really the coordinating mechanism, that once the coordinating mechanism is in place—like it would be through S. 3017—I think the reporting and exposure problems would go away. I think a lot of the conflicts and participation in the accrual area and in the prohibitive transactions area as well will go away. And I think we will be able to coordinate the activities of agencies with responsibilities under other laws.

That to me will stop, I think, in large part, the termination of plans and make people feel freer to go forward to adopt new plans.

Senator WILLIAMS. Anything further?

Mr. HILLS. Mr. Chairman, I would just comment—entirely endorsing those comments. But we must recognize that our national tax policy now tells individuals they are better off saving for their investment in a collective plan than individually, because we have tax incentives to gather these funds, and that we have, therefore, put the dominant force in our capital market in pension funds.

And it might very well be that many—maybe even most—of the functions of the IRS can be preserved. But I think that the point just made is the important one: A central coordinating function that can make these decisions efficiently is what is needed; because so many small employers would much rather give their employees a check at the end of the year and say, "Go about your business; I cannot afford a pension plan and become involved with something that could give me a form of liability that I never expected."

As the Senator knows, in the recently concluded exacerbated strike in the coal industry, one of the terrible problems there was that the parties could do nothing about the perfectly immense liability that has accumulated, with no one there to pay it off. Nobody did that on purpose. It was the unintended effect of an uncoordinated national policy with respect to pension plans.

Mr. ALEXANDER. A few comments.

First, in the administration's factsheet as well as in several of the bills under consideration at this hearing, there is an effort to provide simple plans for smaller employers. The administration would do it through a simplified bond purchase plan. Other routes include a simplified centralized reporting by someone having a new-type form of master or prototype plan for small employer, and these are very helpful initiatives.

The thought that we can solve all these problems by having a single agency is a suggestion that, having been 4 years in Government, I find to simplistic to be acceptable.

If there is a law that has an impact throughout employment, it does not stop at the edge of retirement planning but instead covers not only compensation and working conditions relating to retirement planning, but those relating to areas beyond the scope of any new retirement commission or the scope of the present agencies jurisdiction.

To suggest that the problems will be resolved by giving a single retirement agency jurisdiction over 40 or so laws fragments the administration of those laws. It changes perhaps the areas of difficulty but does not and will not eliminate them.

Government, regrettably, is a means of different departments, different agencies and groups within departments attempting to work together with not a great measure of success.

One way to try to meet the problem at the threshold is to enact a lockstep simplified arrangement, like the individual retirement system in the Internal Revenue Code, like the Keogh plans, to some extent, in the Internal Revenue Code, and order hands off to everyone else.

And this approach is in some of the bills, as well as in the administration's initiative, I think is a way to try to provide broader based retirement coverage.

But retirement plans, as Mr. Hills has mentioned, and as Mr. Chadwick mentioned, are given massive tax subsidies now, unprecedented tax benefits, and the provision of more benefits is probably not the way to meet the problem.

Mr. Chadwick. One additional comment, if I may.

I am not necessarily advocating the physical consolidation of every agency or portions of every agency that has something to do with benefits or one of the laws. I think something quite simple could be done that would greatly simplify the system. If there were a mere clearinghouse for regulations, prior to proposal, a clearinghouse that would have a limited staff with expertise in various areas, so that the limited staff could at least look at the regulations and point out actual or potential conflicts, so that if there is a conflict between something EEOC might be doing under title VII and ERISA or the code, that conflict might at least be noted in the preamble to the regulation so that the public has an opportunity to comment on it so that there is some attempt to resolve the conflict.

In order to go that route, people have to be aware of it. I know for my own self that the Labor Department, with the best of intentions, in many cases, would be putting together a regulation, not knowing what another agency was doing.

I think the Government and the public would benefit greatly just through awareness. In my case, it would not have been that difficult to note in the preamble there may be a conflict with such and such a law, and other input from others. Maybe you could resolve that conflict.

I do not think it has to be, you know, a mass consolidation, but I really feel that there has to be some effort to coordinate whatever you are doing.

Mr. ALEXANDER. I am firmly in favor of coordination.

Mr. HILLIS. If there is not to be a merger, by no means is it necessary to merge—there has to be a final decision authority. Even my brief assignment to the White House convinced me that the President of the United States cannot force resolution of those conflicts—particularly because Congress has a legitimate interest in many of these programs.

So it would be inappropriate for the President to try to exercise a final-decision authority where the Congress has tried to give independent responsibility to agencies like the IRS or the SER. I do think there has to be a final-decision authority handling pension fund investments, whether that is a merger of the IRS staff and the Labor Department, or whether it is a new commission that has the authority to resolve these conflicts. The principal benefit of S. 3017 is to provide that mechanism.

Senator WILLIAMS. Gentlemen, I will detain you no further, but hope that we as we struggle onward here, we can call on you again sometimes, if not formally, then informally.

Thank you very much.

We will meet again at 9:30 tomorrow morning.

[Whereupon, at 1:50 p.m., the subcommittee adjourned, to reconvene tomorrow, Thursday, August 17, 1978, at 9:30 a.m.]

ERISA IMPROVEMENTS ACT OF 1978

THURSDAY, AUGUST 17, 1978

U.S. Senate, Subcommittee on Labor of the Committee on Human Resources; and Subcommittees on Private Pension Plans and Employee Fringe Benefits of the Committee on Finance,

Washington, D.C.

The subcommittee met in joint session at 9:40 a.m., in room 4232, Dirksen Senate Office Building, Senator Harrison A. Williams, Jr. (chairman, Subcommittee on Labor of the Committee on Human Resources), and Hon. Lloyd Bentsen (chairman, Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Committee on Finance) presiding.

Present: Senators Williams, Bentsen, and Javits.

Senator Williams. We will come to order.

This is the third day of our hearings on legislation to amend ERISA.

Today we will hear from professional associations, financial institutions, religious organizations, and the Association of Private Pension and Welfare Plans.

We also, I believe, will be hearing testimony from Mr. Lawrence Walner, who is counsel for Mr. Daniel.

Our first panel of witnesses will be representatives of professional associations which are involved with employee benefits plans: the American Bar Association, American Academy of Actuaries, American Society of Pension Actuaries, and the American Institute of Certified Public Accountants.

Gentlemen, you are all present and accounted for. We are ready to proceed.

You are closest to the microphone and right at center stage there, Frank, so please proceed.

Senator Bentsen. Before you start, I would like to acknowledge that I have one of my previous associates here, who is executive director of the American Academy of Actuaries, Mr. Steve Kellison. We worked together for a number of years.

I see a number of the other witnesses who have testified before my Subcommittee on Finance. I am very pleased to see you before us again.

Senator Williams. Fine. We are glad to see you all.

We have asked Mr. Cummings to lead off. He is a member of the alumni of this association.

STATEMENTS OF FRANK CUMMINGS, CHAIRMAN, COMMITTEE ON PENSION, WELFARE AND RELATED PLANS, SECTION OF LABOR RELATIONS LAW, AMERICAN BAR ASSOCIATION; PRESTON C. BASSETT, VICE PRESIDENT, AND STEPHEN G. KELLISON, EXECUTIVE DIRECTOR, AMERICAN ACADEMY OF ACTUARIES; J. WILLIAM CLOER, PRESIDENT, AMERICAN SOCIETY OF PENSION ACTUARIES; ANDREW J. CAPELLI, MEMBER, EMPLOYEE BENEFIT PLANS AND ERISA COMMITTEE, ACCOMPANIED BY JOSEPH E. ELMLINGER, MEMBER, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. CUMMINGS. Good morning, Mr. Chairman.

I am an attorney in private practice, with the law firm of Marshall, Bratter, Greene, Allison, and Tucker. I am Chairman of the Committee on Pension, Welfare and Related Plans of the American Bar Association's Section on Labor Relations Law.

I appear before you today on behalf of the whole American Bar Association.

My testimony is limited to one subject matter of the many before you. That relates to the question whether pensions are securities for any purpose, including securities fraud.

I will not read our prepared testimony to you as you already have it, but request that it appear in the record.

Senator BENTSEN. Without objection, it will be done.

Mr. CUMMINGS. Mr. Chairman, I have the very, very brief brief, which the American Bar Association filed in the *Daniel* case. It is only 25 pages, shorter than most testimony, and I would also request that that be in the record.

Senator BENTSEN. We would be pleased to have it.

[The brief referred to is being held in the files of the Human Resources Committee, 4230 Dirksen Senate Office Building, Washington. D.C.]

Mr. CUMMINGS. Our position, Mr. Chairman, is that pensions are not securities. Pensions should not be securities. The Congress built Federal pension law on the assumption that Federal securities laws did not apply to pensions except in a very limited few cases which we all know very well and which have always treated that limited class of cases as being securities.

Indeed, the SEC told you that it did not want jurisdiction of Federal pension law when the Senate Labor and Public Welfare Committee considered the old Welfare and Pension Plans Disclosure Act back in the late fifties. And why? Because the SEC had no expertise in labor law, which they announced to this committee.

Further, private industry and labor built the private pension system on the legal understanding that securities laws did not apply.

This Congress has built a structure of labor laws and uniformly has made them different and deliberately different from commercial laws on analogous or even the same subject matter.

To give you just a few examples. When you sue for breach of contract, you sue at common law or under the Sales Act in a commercial transaction. But as to breach of labor contracts, you passed a separate section 301 of the Taft-Hartley Act to deal with that.

Justice Douglas announced it was "common law of the shop" that governed enforcement of labor contracts, not the ordinary common law.

When you came to structure of labor organizations, relations between members and labor organizations, you passed the Labor Management Reporting and Disclosure Act, which governs that, and not the ordinary law of private association.

When you got to industrial safety, you passed OSHA and made that govern safety in the workplace, not the Consumer Product Safety Act.

When it came to damages for negligence, you got rid of common law negligence and replaced it with Workers Compensation.

Indeed, when it came to the jurisdiction of the Federal courts themselves, you supplanted the ordinary notions of equity, for purposes of equitable relief, with specific labor standards set forth in the Norris-LaGuardia Act. This was not just the work of one committee. The Norris-LaGuardia Act did not come out of this committee. It came out of the Judiciary Committee.

The Congress has recognized that when it comes to labor, labor is different, and ERISA was certainly no exception.

You looked at the pension law, you decided what the rules should be, and you put them in ERISA. You considered the question of retroactivity and you decided on a very limited amount of retroactivity.

You assessed the cost and made a judgment as to how much cost this system could bear at one time, and you concluded that you had gone as far, not only as you could go, but as the system could go.

Now, Mr. Chairman, consider where we are as of now, given the decision of the Court of Appeals in the *Daniel* case.

First, I want to say right up front that we all bleed for John Daniel. Indeed, the problems that gave rise to Daniel's claim are the same problems that gave rise to ERISA. The Daniel story must seem all too familiar to you, Mr. Chairman. You heard it a thousand times in the hearings on ERISA. You addressed the question of retroactive relief and decided against it.

But Daniel is not lost by a long shot if he does not win his securities law claim. I have a copy of his complaint in my briefcase. I would be glad to hand it up to you. I am sure you have seen it before. He has five causes of action. Three of them having nothing whatever to do with securities violations. One of them is garden variety, good old-fashioned common law fraud. It has always been there. If he can prove it, presumably he has proved a violation of the common law and is entitled to damages to the same extent as he would be under 10(b)(5).

But look at what it means, not if he wins on that ground, but if he wins on the securities law ground that is under consideration in the Supreme Court right now. You have the special study done by the Buck Co. for the Department of Labor, which I am sure has been presented to you, which estimates the potential liabilitiy in accrued class actions based upon the *Daniel* precedent as upward to $39 billion.

Where is the money? I have not found it.

Further, the *Daniel* case is a hard case, but the precedent does not just cover hard cases. It covers any case, and I put it to you, it covers every case. Take today's best plan, your plan, the ERISA compliance plan. Take a plan with 10-year vesting, 1-year break in service, that is considered a good plan, that complies with the law you passed.

Now, take any employee with a 1-year break in service. Suppose he works 4 years, undergoes a 1-year break in service, and therefore forfeits his accrued 4 years. Ask yourself what is it that gives that person today—and everyone into antiquity who has the same claim—a prima facie nondismissable claim for securities fraud. What is the prima facie case?

First, he alleges he was hired. That is a "sale" according to the court of appeals. The point of hire is the point of sale. Nobody ever thought of that before.

Second, he alleges there is a pension plan. Everybody knew that. But what he has just alleged is that there is a "security." Surprise.

Haven't alleged that he was hired and there is a pension plan, he has now alleged there was a "sale" of a "security."

Third, he alleges: "I was not told the morning line—the odds—the actuarial probability of vesting.

That is an easy allegation. I have never met an employee who was told the actuarial odds on the day he was hired. How do you avoid this prima facie violation?

There is a wonderful description, in a book about the history of the Longshoremen's Union, about how a longshoreman gets hired. He goes to the docks. In New York it would be in the west 20's. It is about 5 in the morning. It is raining. It is cold. People have their pea jackets pulled up and there is a hiring boss standing on the back of a trailer. He points. He says, "you over there, and you over there."

They scurry off to unload the ship.

Then suddenly this hiring boss, who is a long way from being an investment expert and certainly is not an actuarial expert says: "But before you go, I want to explain a few things to you about actuarial assumptions, investment policy, the depth of funding, the break in service rules." [Laughter.]

You know how long and complex that is, because the regulations alone on this subject fill volumes.

I put it to you that it not only should not be done, it cannot be done.

Yet, there is a prima facie case, nondismissable, triable to a jury, with a class action, where we lawyers make a fortune, win or lose, if that claim is under the securities laws. Everybody can sue everybody.

Did Congress ever bargain for that?

Did you ever legislate or would you ever legislate that? We think not.

But if you want to legislate, then at least treat it as a legislative matter. Remember what the record is before the Supreme Court. There is no trial; there is no evidence. There is a bill of complaint, an allegation. There was a motion to dismiss, denied, and an interlocutory appeal granted; and the case is pending on nothing but the complaint.

So the kind of evidence that you will hear from this panel and the other panels is inadmissible in the Supreme Court. Arguments are admissible. There are *amici* crawling out of the woodwork over there. But the evidence—what it really costs, what the practicalities of it are, what particular people can tell you about whether this thing will work or will not work—is not in the record because there is no record and consider what is involved. Get the evidence, and then decide appeal.

If you are going to do something like this—which I do not recommend to you, but of course it is a fair legislative issue—then make it a legislative judgment. If you wish, put a bill in that John Daniel should get the money as a matter of Federal law; hold hearings on it, and consider what is involved. Get the evidence, and then decide whether you want to do it. But I do not think it is an appropriate thing to be decided on the basis of an abstract pleading which, if sustained, would create a revolution in pension law.

ERISA was an extensive reformation of this system. It was designed to improve it, but not to smother it in litigation.

I conclude, therefore, as follows, Mr. Chairman. We have asked the Supreme Court to reverse the *Daniel* decision, not throw Daniel out of court but put him back in court on his other cases of action where, if he can prove common law fraud, he can win.

We have asked the Supreme Court to reverse because we believe that a new, inappropriate, and retroactive additional layer of Federal regulation ought not be imposed upon the private pension system already blanketed with so much Federal law.

We hope and expect that the Court will reverse. But, in any event, we believe that the position presented in our brief, which we have just handed to you, represents the congressional understanding which formed the basis for previous congressional action. It would therefore be proper for Congress to act, if necessary, to cure any misinterpretation of your understanding.

The section in your bill, Mr. Chairman, which accomplishes that result is, in our judgment, an adequate statement of your original congressional understanding, and we have devoted some part of our prepared statement to the constitutionality and propriety of approaching it that way.

Finally, we wish to reiterate the limit of our position. We do not oppose Mr. Daniel's other claims for relief—under other laws, including labor laws. There has yet to be a trial on those claims which are still pending in the U.S. District Court waiting for the Supreme Court to decide the interlocutory appeal.

If evidence proves a valid claim under those laws, he has a remedy. But the remedy need not and should not subject the entire private pension system to securities law regulation which just does not fit.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Cummings follows:]

AMERICAN BAR ASSOCIATION

Statement of

FRANK CUMMINGS, CHAIRMAN
COMMITTEE ON PENSION,
WELFARE AND RELATED PLANS
SECTION OF LABOR RELATIONS LAW

on behalf of the

AMERICAN BAR ASSOCIATION

before the

SUBCOMMITTEE ON LABOR
COMMITTEE ON HUMAN RESOURCES

and the

SUBCOMMITTEE ON PRIVATE PENSION
PLANS AND EMPLOYEE FRINGE BENEFITS
COMMITTEE ON FINANCE

of the

UNITED STATES SENATE

concerning

AMENDMENTS TO THE EMPLOYEE RETIREMENT
INCOME SECURITY ACT OF 1974 (ERISA)

AUGUST 17, 1978

I. Introduction

I am Frank Cummings, an attorney in private practice, and Chairman of the Committee on Pension, Welfare and Related Plans of the American Bar Association's Section on Labor Relations Law.

I am pleased to appear before you today as designated representative of the American Bar Association to present the ABA's views on the application of federal securities law to employer benefit plans.

My testimony represents the position of the American Bar Association, as developed by the Section of Labor Relations Law and presented on behalf of the ABA in an Amicus Curiae brief to the United States Supreme Court. Copies of the brief have been submitted to the Committees.

I might add that although the Section of Labor Relations Law only rarely takes or presents a position on a disputed question of law, because the Section is divided between lawyers representing management and lawyers representing unions, the position developed by the Section on the issue of pensions as "securities" is strongly supported by both management and union attorneys.

II. Economic Reality

In our judgment, and as a matter of established Supreme Court precedent, the "economic reality of the transaction" should govern whether anything is considered a "sale" of a "security". United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852.

The economic reality of pensions is that a worker whose compensation package includes participation in a compulsory non-contributory pension plan has not purchased a security within the meaning of the 1933 and 1934 Acts. It defies economic reality to contend that by accepting and continuing in employment, a worker has made an investment decision. Nor does it make sense to think that employment under such a plan involves a "sale".

In economic reality and in a worker's own understanding, pensions are deferred compensation, not securities. If regulation is needed, it should arise under employment laws and not under securities regulation.

III. The Pattern of Separate Legislation Governing Employment

Securities law regulation of pensions would be inconsistent with the pattern of existing federal employment legislation. That pattern deals separately with pension rights. That pattern shows a clear Congressional design to regulate labor problems separately. That pattern evidences a clear Congressional understanding that securities laws do not apply.

A. Separate Laws for Labor Problems Generally.

The law of labor-management negotiations generally is the National Labor Relations Act, and not the law of sales. The law of relations between unions and members is the Labor-Management Reporting and Disclosure Act, not the law of private associations and corporations. The law of labor contracts is the "common law of the shop" developed under Section 301 of the Labor-Management Relations Act, United Steelworkers v. Warrior & Gulf Nav. Co., 363 U.S. 574, 580; Textile Workers v. Lincoln Mills, 353 U.S. 448, and not the law of commercial contracts and commercial arbitration. Tort law applies in the market place, but in labor it is Workers' Compensation. Ordinary antitrust law is replaced by special secondary boycott rules under the National Labor Relations Act. Safety standards for consumers under the Consumer Product Safety Act are different from labor safety standards under OSHA. And the federal courts' own power to grant injunctions in ordinary equity cases is supplanted by special labor standards prescribed under the Norris-LaGuardia Act.

B. Separate Laws for Pensions, Without Retroactive Application, and with an Understanding that Securities Laws did not Apply.

As to pensions, of course, ERISA is a specific and separate code whose fiduciary and disclosure standards are administered by the Department of Labor, not the SEC.

When Congress chose to regulate pension problems comprehensively under ERISA, you chose to do so without imposing retroactive liability.

And you passed WPPDA and ERISA, we believe, with an understanding and belief that you were legislating on a blank slate, and that securities laws did not already apply.

IV. Practical Difficulties in Securities Regulation of Pensions

In our judgment, the creation of a private right of action under the securities laws in these circumstances would have serious adverse and unacceptable practical consequences. There would be a serious risk of "strike suits" and the potential for unbridled perjury upon the trial of "hazy issues of historical fact the proof of which depends almost entirely on oral testimony", developing a scope of potential liability "in an indeterminate amount for an indeterminate time to an indeterminate class". Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 741-748.

A recent study commissioned by the Department of Labor shows potential liability in the tens of billions of dollars. That should be a warning that Congress was right in the first place when it determined not to impose retroactive liability under ERISA. The same policy judgments would apply to the application of retroactive liability under the securities laws.

Even as to prospective liability, Congress has already considered what the scope of required disclosure and fiduciary standards ought to be in the future, and has codified that in ERISA. Eight years of careful legislative development ought not to be overruled by an unexpected application of securities laws never designed to deal with pension rights.

Finally, we do not mean to imply a lack of concern for John Daniel or others similarly situated.* Indeed, the

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* The complaint in the Daniel case is not just a securities complaint. Breach of the duty of fair representation and common law misrepresentation are also alleged, and these claims have yet to be tried. Vindication of such claims, however, would not superimpose a new structure of securities regulation upon the private pension system. We take no position as to those other claims.

considerations which led John Daniel to bring his lawsuit were the very same considerations which led Congress to enact ERISA. But those considerations did not lead you to make ERISA retroactive. If tens of billions of dollars of additional liability are imposed by surprise upon the private pension system, where will the money come from? Congress concluded that the private pension system would have trouble enough meeting the new funding and administrative standards imposed in 1974. If additional liabilities are to be imposed, Congress should make a legislative judgment, on a careful legislative record, before taking such a step. Unexpected and massive retroactive liability under inappropriate securities laws would be inconsistent with your established legislative pattern.

V. Proposed Curative Legislation -- Constitutionality of Retroactive Nullification of a Statutory Cause of Action

One of the pending bills, S. 3017 (Section 274), would legislatively overrule the precedent set by the Court of Appeals in Daniel (and the precedent which a Supreme Court decision -- if the Court should affirm Daniel -- would set). Thus, S. 3017, § 274, is substantially in accord with our position on the merits of the issue now pending in the Daniel case.

The bill, I believe, would be a proper exercise of legislative power to achieve the result Congress intended in the first place.

Further, the effect of the bill upon any accrued claims under prior law is not altogether unprecedented.

The bill evidently tracks the provisions of the Portal-to-Portal Act, 29 U.S.C. § 251 et.seq., 61 Stat. 84 (1947). That Act amended the FLSA to render ineffective the Supreme Court's decision in Anderson v. Mt. Clemens Pottery Co., 328 U.S. 680, 66 S. Ct. 1187, 90 L. Ed. 1515 (1946). While the Supreme Court never ruled on the constitutionality of the Portal-to-Portal Act, every lower Federal Court which considered the issue upheld the Act, and virtually every Circuit considered the issue. In Battaglia v. General Motors Corp., 169 F.2d 254 261 (2d Cir. 1948), cert. denied, 335 U. S. 887, 69 S. Ct. 236, 93 L. Ed. 425 (1949), the Court held that even if the Mt. Clemens decision had created vested rights:

> "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. It cannot be said that, in so doing, Congress acted arbitrarily. It is not even suggested that it acted discriminatorily. Clearly the Act did not violate the Fifth Amendment in so far as it may have withdrawn from private individuals, these appellants, any rights they may be said to have had which rested upon private contracts they had made."

Additional Federal Court precedent stems from the 1949 amendments (P.L. 177 and P.L. 393, 29 U.S.C. 207(d)(5), (d)(6)(d)(7) and (g)) to the Fair Labor Standards Act removing liability for "clock overtime" imposed by the Supreme Court in Bay Ridge Operating Co. v. Aaron, 334 U.S. 446, 68 S. Ct. 1186, 92 L. Ed. 1502 (1948). These retroactive amendments were upheld in Addison v. Huron Stevedoring Corp., 204 F.2d 88 (2d Cir. 1953), cert. denied, 346 U.S. 877, 98 L. Ed. 384 (1953).

As a matter of constitutional law, Congress' power to enact retroactive legislation and to remove Federal Court jurisdiction over substantive issues is subject to the Due Process clause of the 5th Amendment. However, as the Supreme Court has recently stated: "It is by now well established that legislative acts adjusting the burdens and benefits of economic life come to the Court with the presumption of constitutionality... and this Court long ago upheld against due process attack the competence of Congress to allocate the interlocking economic rights and duties of employers and employees...regardless of contravening arrangements." Usery v. Turner Elkhorn Mining Co., 428 U.S. 1,15, 49 L.Ed. 2d 752, 766, 96 S. Ct. 2882 (1976). The Court thus upheld an Act which required coal operators to compensate employees who had terminated work prior to passage of the Act as a "rational measure". Turner v. Elkhorn thus supports the propositions that: (1)) retroactivity is not per se unconstitutional; (2) Congress in the economic area generally -- and the employee area in particular -- may make policy choices which the Court will accept; and (3) Congress has the power to deal with economic needs and to allocate economic burdens.

The case for valid curative legislation is even stronger here than in the case of the Portal-to-Portal Act. In the earlier cases the Supreme Court had held that employees had a contract right which Congress later overruled. The Daniel case, however, does not even involve a contract right but rather an alleged statutory right to damages. As the Court in Battaglia said: "powers derived wholly from a statute are extinguished by its repeal", quoting Flanigan v. City of Sierra, 196 U.S. 553, 560. Battaglia, supra., 169 F.2d at 259.

VI. Conclusion

In sum, we have asked the Supreme Court to reverse the Daniel decision because we believe a new, inappropriate and retroactive additional layer of federal regulation ought not to be imposed as a private pension system already blanketed with so much recent federal law. We hope and expect that the Court will reverse.

But in any event, we believe that the position presented in our brief to the Court represents the Congressional understanding which formed the basis for previous Congressional action. And it would be proper, therefore, for Congress to act, if necessary, to cure any misinterpretation of that understanding.

Finally, we wish to reiterate the limits of our position. We do not oppose Mr. Daniel's other claims for relief under other laws (including labor laws). There has yet to be a trial on those claims, which are still pending in U. S. District Court. If the evidence proves a valid claim under these laws, he has a remedy. But the remedy need not, and should not, subject the entire private pension system to securities law regulation.

Senator WILLIAMS. Thank you very much, Mr. Cummings.

When this case is argued, how are those chosen to take part in the oral presentation to the Supreme Court?

Mr. CUMMINGS. Mr. Chairman, it is an appeal by the respondents, the Teamsters and the fund to the Supreme Court; not really an appeal, it is on a petition for *certiorari.* The only real parties there are the petitioner and Daniel. In addition, there are *amici curiae.* The last list I saw included about 17 who had filed *amicus* briefs.

Senator WILLIAMS. Out of that group how do they choose people that can be heard?

Mr. CUMMINGS. I would be rather surprised. Mr. Chairman, if any *amici* were permitted to argue, though traditionally the Solicitor General has been permitted. But it is up to the Court.

Our amicus brief was originally rejected on a question of timeliness.

Senator WILLIAMS. The American Bar Association was late? I do not mean to embarrass you.

Mr. CUMMINGS. Mr. Chairman, we were not only late, but given the amount of time that it took to get permission to file it from the board of governors and permission for me to be here from the board of governors—I was not altogether sure I was going to be here this morning. Fortunately, attorneys in private practice who do not represent large membership organizations have the freedom to set their own time limits. But when you are dealing with the board of governors, and committees and so on, sometimes you are a little late.

That is the burden of our motion for reconsideration now pending.

Senator BENTSEN. Mr. Chairman, let me say, talking about the man to present the oral argument, I would think Mr. Cummings could do a superb job of it. If you would excuse me, we have a rather minor, but possibly somewhat controversial matter being submitted to the Finance Committee by Secretary Blumenthal this morning. That is the administration's position on taxes. I will try to get back.

Senator WILLIAMS. Thank you.

We will turn to the American Academy of Actuaries, Mr. Bassett and Mr. Kellison.

Mr. KELLISON. My name is Stephen Kellison, and I am the executive director of the American Academy of Actuaries. With me today is Preston Bassett, a vice president of the academy.

The American Academy of Actuaries appreciates the opportunity to present this statement on seven bills designed to improve various aspects of ERISA. The membership of the academy includes Actuaries with a wide range of views on many of the nonactuarial issues being discussed at this hearing. Accordingly, our statement is limited to commentary on items which have actuarial implications.

Although we will not specifically address ourselves to many of the proposals, we are supportive of the general thrust of most of them. ERISA was a most complex piece of legislation which has produced implementation problems. The academy applauds the intent of these bills to resolve these problems.

The academy is particularly pleased to see the Declaration of Policy contained in section 201(a) of S. 3017 which would add the following to Section 2 of ERISA:

"It is hereby further declared to be the policy of this act to foster the establishment and maintenance of employee benefit plans sponsored by employers, employee organizations, or both."

The academy statement today is directed toward the actuarial aspects of the seven bills before the subcommittees. We have not attempted to develop a comprehensive list of other suggested amendments to ERISA. However, the academy has accumulated a number of such suggestions from individual actuaries. With the permission of the chairman, we would like to provide these in a second submission for inclusion in the record.

Senator WILLIAMS. We will receive it, and it will go in the record immediately after the full text of your statement.

[The prepared statement of the American Academy of Actuaries and information referred to follow. Appendix E—Brief for the American Academy of Actuaries as *amicus curiae* before the United States Supreme Court in *IBT* v. *Daniel*—and items B, C, and E, listed in Appendix H, are being held in the files of the Human Resources Committee, 4230 Dirksen Senate Office Building, Washington, D.C. 20510.]

STATEMENT OF THE AMERICAN ACADEMY OF ACTUARIES

JOINT HEARINGS ON ERISA REVISIONS

SENATE HUMAN RESOURCES SUBCOMMITTEE ON LABOR

SENATE FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLAN AND EMPLOYEE FRINGE BENEFITS

August 17, 1978

Preston C. Bassett, Vice President
Stephen G. Kellison, Executive Director

I. INTRODUCTION

The American Academy of Actuaries ("Academy") appreciates the opportunity to present this statement on seven bills designed to improve various aspects of the Employee Retirement Income Security Act of 1974 ("ERISA"). The Academy is a professional organization of actuaries whose members are deeply involved with the implementation of ERISA and the private pension system in general. Appendix A provides some background information on the Academy.

The membership of the Academy includes actuaries with a wide range of views on the many issues being discussed today in the private pension field. Certain of the more controversial of these issues are not primarily actuarial in nature. Accordingly, this Academy statement is limited to commentary on items which have actuarial implications and on which we believe either a reasonable consensus of opinion exists within the actuarial profession or items of an informational nature on which no opinion is expressed.

Although the Academy statement will not specifically address itself to many of the proposals involved in these various bills, we are supportive of the general thrust of most of them. ERISA was a most complex piece of legislation which has produced implementation problems. The Academy applauds the intent of these bills to resolve such problems as multiple-agency administration and the complex reporting and disclosure requirements of ERISA. A worthwhile objective of these bills is to extend the benefits of the private pension system to a larger group of Americans, both by reducing the number of plan terminations and increasing the number of new plan formations. The disappointing statistics involving both plan terminations and new plan formations since the passage of ERISA indicate the Congressional attention to these problems is warranted. The intention of the bills being discussed at this hearing is compatible with these goals.

The Academy is particularly pleased to see the declaration of policy contained in Section 201(a) of S. 3017 which would add the following to Section 2 of ERISA:

> "It is hereby further declared to be the policy of this Act to foster the establishment and maintenance of employee benefit plans sponsored by employers, employee organizations, or both."

This statement of public policy is vital, and is a most important addition to ERISA.

One of the lessons ERISA has taught us is that efforts to close loopholes and prevent abuses also create complexity and extra costs. At some point such efforts, worthy as they may be, become counterproductive if they result in increased plan terminations and decreased new plan formations. Thus, certain complex requirements which do not have major significance for most plans may create more negative than positive results, even though conceptually the requirements appear desirable. In considering simplifications to EF.ISA Congress should thus evaluate proposals with the balance between benefits and costs clearly in focus.

The Academy statement is directed toward the actuarial aspects of the seven bills before the Subcommittees. We have not attempted to develop a comprehensive list of other suggested amendments to ERISA. In Section III we do propose some minor changes in the statute in connection with ambiguities that have arisen with respect to "enrolled actuaries" and the Joint Board for the Enrollment of Actuaries ("Joint Board").

However, the Academy has accumulated a number of suggested changes to ERISA over the years from individual actuaries active in field. These suggestions are being submitted to the Subcommittees in a second submission for your consideration. It is important to note that the views expressed in these suggestions are entirely those of the individuals making them and are not necessarily those of the Academy. These suggestions from individual actuaries should be a valuable resource of ideas for the Subcommittees and staff. A description of these additional items is contained in Appendix H, Items A, B, and C.

The Academy is continually striving to involve our membership in the development of proposed changes to ERISA. For example, in the June, 1978 issue of the Enrolled Actuaries Report, a newsletter for enrolled actuaries published by the Academy, we have invited our membership to send their suggestions to us. The second submission mentioned above includes those letters received to date.

The Academy intends to make subsequent letters available to appropriate committees of the Congress as deliberations on ERISA revisions proceed.

II. COMMENTARY ON BILLS

We would now like to comment on the following seven areas involved in the bills before the Subcommittees:

A. Disclosure of Accrued Benefits
B. Opinions of Actuaries and Accountants
C. Joint and Survivor Annuities
D. Funding Standard Account
E. Impact of Inflation on Retirement Benefits
F. Preemption of Securities Laws
G. Deduction for Employee Contributions
H. Uniform Accounting

A. Disclosure of Accrued Benefits

Disclosure of accrued benefits to plan participants is addressed by two of the bills being discussed at this hearing. Section 4 of S. 1745 would amend Section 104(b)(3) of ERISA, while Section 221 of S. 3017 would amend Section 105 of ERISA.

Section 4 of S. 1745 would require a detailed statement of benefits to be disclosed to each participant as part of the summary annual report. This would represent a marked departure from ERISA Section 105 which allows this information to be provided on a request basis.

It should be noted that providing this information to all participants may entail significant administrative costs for many plans. Some plans routinely produce this type of information, but not all do. Although it would be possible for actuaries, or others, to produce this information routinely, the additional administrative costs involved should be considered. Post-ERISA experience has shown that only a very small, almost insignificant, minority of participants ever request such statements in most plans. Accordir·ly, the Academy questions the value of requiring that this information be provided to everyone, since it is available on a request basis. The objective of Congress should be to lessen the burden of administrative costs in areas where abuses are not present. In this connection, it should be noted that virtually every employee in the private sector is a participant in the Social Security program and yet a detailed statement of benefits provided by that system is available only to those who request such information.

Paragraph (3)(B)(i) of Section 4 is ambiguous as to whether "current benefits" means the benefits accrued during the one year in question or all benefits derived from prior service. Paragraph (3)(B)(ii) would introduce a new concept involving the projection of future benefits anticipated under the plan. This requirement is a marked departure from the disclosure currently being required and goes far beyond the disclosure of accrued benefits. Such information is highly speculative, for any particular individual, often involving such factors as estimated future salary increases, projection of Social Security benefits (for integrated plans), etc., and creates expectations among employees which will not be correct because of the various uncertainties involved. For example, what potential liability would a plan sponsor face if he projected a benefit which assumed (promised?) future pay increases of, say, 5% per year? Such salary increase assumptions, which are entirely appropriate and necessary for the projection of plan costs for an overall group of employees, are clearly not suitable for projecting individual benefits by the plan sponsor. The best insight available to employees who wish to project future benefits is a thorough understanding of the benefit formula as it applies to their own particular situation.

The provisions of Section 221 of S. 3017 seem to us to be preferable to Section 4 of S. 1745. As described above, the request basis of disclosing accrued benefit information is more economical than the universal basis for many plans. Also, the questionable concept of requiring disclosure of hypothetical future benefit accruals is not contained in S. 3017, which limits itself to the disclosure of benefits accrued to date. Finally, Section 105 would appear to be the appropriate section in which to consider changes in the disclosure of accrued benefits rather than Section 104.

A question could also be raised as to the necessity of providing such information to short-service, high-turnover participants. Although the information is obviously useful, is it worth the cost of providing it? The information is really not very significant until the participant approaches vesting. One compromise approach might be to provide such information on a request basis to any participant within a few years, say 3 or 5, of the earliest vesting date (partial or total). This approach would provide useful information to those participants nearing vesting, but would lessen the administrative burden for short-service, high-turnover participants.

The concerns expressed above involving administrative costs are of greater significance for small plans than for large plans.

Reasonable attempts should be made to ease the administrative burdens, particularly in the small plan area.

Despite our reservations about Section 4 of S. 1745, the Academy wishes to commend the report of the Commission on Federal Paperwork. The report of this Commission made a number of constructive suggestions which are incorporated in S. 1745. The work of this Commission has been very valuable in focusing attention on the administrative burdens created by ERISA.

B. Opinions of Actuaries and Accountants

Section 226 of S. 3017 would make some fundamental changes in the relative roles of actuaries and accountants in connection with annual reports for plans and the Academy strongly endorses this Section of the bill. ERISA currently provides that the accountant may (emphasis added) rely on the work of the actuary, and conversely. S. 3017 would change "may" to "shall", which would provide for compulsory reliance (in both directions, i.e. reliance on actuaries by accountants, and conversely).

Section 103 of ERISA appears to create a division of responsibility between actuaries and accountants. The actuary's report is concerned with such items as the determination of plan liabilities for future benefit payments and the various computations required to determine whether the plan complies with minimum funding requirements. The accountant's report is concerned with a proper presentation of the financial status of the pension fund itself.

Despite this apparently clear division of responsibility contemplated by ERISA, some differences of opinion have arisen between actuaries and accountants concerning their relative roles under the Act. The major area of controversy has involved the wishes of the accounting profession to include actuarial liabilities in the financial statements of the plan. The dialogue on this issue has largely been focused on the exposure draft of the Financial Accounting Standards Board issued in April, 1977 which attempts to define "generally accepted accounting principles" for pension plans. That exposure draft, if implemented without change, would lead to the reporting of two sets of liability figures which are likely to differ substantially---one by the accountant in the plan's financial statements and the other by the actuary in the required actuarial statement. This unfortunate result would produce considerable confusion among plan participants, plan sponsors, investors, and others.

The provisions of S. 3017 to require reliance by each profession on the work of the other in their respective defined areas of practice would be quite beneficial in resolving the difficulties which have arisen in this area.

As indicated at the outset the Academy strongly endorses Section 226 of S. 3017. We also feel that some additional amendments could be made to further clarify the relative roles of the two professions. These amendments are consistent with the division of responsibility between the two professions which we believe was contemplated by ERISA. These amendments are submitted for the consideration of the Subcommittees in Appendix B. These amendments, coupled with Section 226 of S. 3017, should resolve the differences which have arisen in this area.

The proposed amendments in Appendix B have been exposed to a large number of actuaries representing a good cross-section of the membership. A nearly unanimous consensus emerged supporting them. These amendments have also been submitted to the U.S. Department of Labor Advisory Council on Employee Welfare and Pension Benefit Plans. We recommend them for the consideration of the Subcommittees.

C. Joint and Survivor Annuities

Section 238 of S. 3017 makes two significant changes to the joint and survivor annuity requirements in Section 205 of ERISA. First, the date of applicability is changed from the later of the earliest retirement age in the plan or ten years before the normal retirement age to the earliest age at which the vesting percentage is 50% or higher. Second, the benefit is no longer optional with the employee, but would be automatic.

This provision of S. 3017 would significantly alter the nature of the required joint and survivor benefit. ERISA provides for an optional benefit to the employee (automatic, at normal retirement age, if no other optional form of annuity is elected), the cost of which may be paid by the employee (by means of an actuarial reduction from the normal form of annuity). S. 3017 appears to provide for a mandatory death benefit paid for by the employer.

Joint and survivor annuities may be socially desirable in protecting family members of a deceased plan participant. However, it is important to note that this provision would mandate additional benefit costs on any employer not already providing these benefits at employer expense. In many instances, the additional cost burden would be significant.

It is also important to remember that the additional benefits being provided are basically life insurance benefits. Many employers currently provide similar benefits through group life insurance programs for their employees. The additional benefit required by S. 3017 would be superimposed on top of any existing group life coverage. Many will question the logic of requiring death benefits under the pension plan and not recognizing similar death benefits provided by the plan sponsor under other programs. Some employers may find it difficult to coordinate the total life insurance benefits being provided from all benefit programs in this event. For example, an unmarried employee would suffer a loss of benefits, if an employer reduced the amount of group life coverage in order to coordinate with the mandated additional death benefits to be provided through the pension plan. A question could be raised as to whether pension plans are the best vehicle to impose a requirement that additional death benefits be provided.

It might also be noted that this provision would place an extra burden on the generosity of those employers who have voluntarily provided more favorable vesting conditions than required by law. These additional costs must be expended as a result of this generosity.

D. Funding Standard Account

Section 251 of S. 3017 would add a new provision to Section 302(c)(1) of ERISA concerning computations in the funding standard account. Specifically, it would require the actuary to

> ". . . take account . . . of all provisions of the plan, including provisions which have not yet affected any participant as to entitlement to, or accrual of, benefits."

The Academy believes that the language proposed in Section 251 is confusing and that clarification would be desirable. We are uncertain as to the intent of this Section.

One possible applicability of Section 251 would be to a rather common type of 3-year negotiated contract in which the benefit formula was, say, $8 per month per year of service for participants retiring in the first year of the contract, $9 for the second, and $10 for the third. The intention may well be for employer contributions to increase in a step-rate fashion over the 3-year period as benefits and payroll costs go up.

Section 251 might be interpreted as requiring immediate recognition of the cost of the $10 benefit, the ultimate amount (theoretically) for third and later years. In this event, the operation of the funding standard account would involve a level-dollar funding of these benefits over the 3-year period. If an employer wished to use a step-rate contribution schedule, there would be a risk of an accumulated funding deficiency at the end of the first and/or second years.

If the intent of Section 251 is to require the type of level-dollar, rather than step-rate funding, described above, then it would overturn IRS Rev. Rul. 77-2. This Revenue Ruling clearly sanctions a contribution schedule in step with benefit increases in this context. A copy of Rev. Rul. 77-2 is attached as Appendix C (see particularly Sec. 4, Ex. 1). Although no actuarial problems would be created by Section 251, the Academy does not see any compelling reasons to overturn Rev. Rul. 77-2 with a statutory change. (We again stress that we are not certain that overturning Rev. Rul. 77-2 is really the intent of Section 251.)

We are also puzzled by the last sentence of Section 251:

> "A provision adopted but contingent on a future event shall be deemed not to be in effect as a provision of the plan prior to the occurrence of that event."

This provision is quite perplexing and seems to be at odds with the rest of the Section.

Consider, for example, a plan with an automatic cost-of-living feature. This is a benefit "contingent on a future event;" namely, the rate of inflation in years hence. Does this sentence prohibit the actuary from assuming a cost-of-living increase in future benefit projections? If it could be interpreted in that manner, the results would be most unfortunate. The possibility of massive under-funding for such a plan would be great. Also, it would essentially force an actuary to violate Section 103(a)(4)(B)(ii) requiring him to make his ". . .best estimate of anticipated experience under the plan."

A related illustration involves the maximum benefit limitations contained in Section 415 of the Internal Revenue Code (which was a

...

new section of the Code added by ERISA). The benefit limitations contained in Section 415 are indexed by changes in the cost-of-living. In an unnumbered Private Letter Ruling issued by the IRS on January 18, 1978, the IRS took the position that an actuary cannot project future increases in the maximum benefit limitations in computing the costs for the plan (a copy of this Private Letter Ruling is attached as Appendix D). If the actuary assumes an inflation factor in projecting benefits under the plan, then an internal inconsistency in the valuation procedure results. This is an existing example of a benefit "contingent on a future event," which the actuary may not take into account in his valuation procedures. Imposing restrictions of this type, while simultaneously requiring the actuary to make his "best estimate," places the actuary in a very difficult position in forcing him to use an internally inconsistent procedure.

In general, the Academy believes considerable clarification of Section 251 is needed. The last sentence is particularly disturbing. Also, the need to overturn Rev. Rul. 77-2 by statute (if that is the intent) is not evident.

E. Impact of Inflation on Retirement Benefits

Section 273 of S. 3017 provides that the Secretary of Labor ". . . conduct a study of the feasibility of requiring employee pension benefit plans to provide cost-of-living adjustments to benefits payable under such plans." This study would be conducted during the 24-month period following the enactment of the bill.

Adding a cost-of-living adjustment provision to the typical defined benefit pension plan as an additional benefit results in a dramatic increase in benefit costs. Even if limitations are placed on the amount of increases (e.g. an annual limitation, a cumulative lid on total increases, etc.) the cost impact can still be large.

Mandating cost-of-living benefits involves profound philosophical, economic, and actuarial considerations. Proper recognition of future rates of inflation is one of the most difficult, but important, challenges facing the pension actuary today. Obviously, cost-of-living benefits are extremely sensitive to future rates of inflation.

The Academy believes that a cost-of-living requirement would involve major actuarial considerations. Accordingly, if the study contemplated by S. 3017 is conducted by the Department of Labor, the actuarial profession should be deeply involved in the study.

F. Preemption of Securities Laws

Section 274 of S. 3017 provides for a preemption of the Securities Act of 1933, the Securities and Exchange Act of 1934, and the Investment Company Act of 1940 by ERISA as they relate to private pension plans (with the exception of an eligible individual account plan in which participation is voluntary). The Congressional interest in this preemption has undoubtedly been sparked by the well-publicized case of Teamsters v. Daniel which is presently before the U.S. Supreme Court.

The Academy has filed an amicus curiae brief with the Supreme Court on this case. This brief primarily addresses the issue of disclosure of the "actuarial probability" of receiving a benefit from a plan. Secondarily, it also discusses the question of a "sale" of pension plan interests to covered employees. A number of severe actuarial problems would result in both areas, if the lower court decision in the case, as worded, is allowed to stand. These difficulties would be resolved by enactment of Section 274 of S. 3017 and, therefore, the Academy stronly supports this section.

A copy of the Academy brief is attached as Appendix E.

G. Deduction for Employee Contributions

Section 303 of S. 3017 provides tax deductibility for employees of certain employee contributions to qualified retirement plans. The annual deduction is limited to 10% of gross income or $1000, whichever is less, and is reduced or eliminated if the adjusted gross income exceeds $30,000 per annum.

The tax deductibility of employee contributions under qualified retirement plans is a public policy issue not within the realm of actuarial science. Accordingly, the Academy takes no position on this proposal.

However, if Congress decides to provide tax deductibility for employee contributions, the Academy does endorse the simple approach of a percentage limitation. Other approaches have been suggested, e.g. offsets of employer contributions against IRA limits. These other approaches would not only be much more complex to administer, but would also be of questionable validity in view of the contingent nature of benefits derived from employer contributions.

A straight percentage limitation has much to commend it in terms of simplicity and individual equity in comparison with complicated offset provisions. We note the recent Treasury Department qualified support for S. 3288, which contains a straight percentage limitation of 10% of compensation or $1000, whichever is less, at a public hearing on July 24, 1978.

H. Uniform Accounting

S. 2992 would require ". . . uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions used in such calculations."

The Academy has previously submitted extensive testimony on S. 2992. Appendix F is the Academy statement presented to the Private Pension Plans and Employee Fringe Benefits Subcommittee of the Senate Finance Committee on June 14, 1978. The Academy also submitted some additional material to this Subcommittee on July 14, 197P. This additional material is being provided to the Subcommittees in a second submission. A description of these additional items is contained in Appendix H, Items D, E, and F.

The following is an extract from the attached statement on S. 2992:

> "In general, the Academy supports what we believe is the intent of the bill. However, we believe that further clarification is needed to be sure that this intent is properly carried out. We also believe that to do so would require certain changes in other parts of ERISA and in the Internal Revenue Code. We would add further that we believe that the apparent intent of the bill may, in fact, be accomplished without this specific legislation."

Action at the present time on S. 2992 may well be premature. The Department of Labor, together with the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, and the American Academy of Actuaries have made substantial progress in resolving the issues in this area. This joint effort, if successful, would eliminate the need for legislation. At this time the prognosis for mutual resolution of the differences still remaining in this area is promising.

III. PROPOSALS INVOLVING "ENROLLED ACTUARIES"

Sections 3041 and 3042 of ERISA created the Joint Board for the Enrollment of Actuaries to enroll actuaries to perform services required of actuaries under the Act. We would like to comment on two unintended developments which have occurred involving "enrolled actuaries" since the passage of ERISA.

The first is the very name "enrolled actuary" itself. Enrollment under ERISA involves rather narrow credentials to perform certain specific functions, such as providing the actuarial statement required by Section 103(d) of ERISA (contained in IRS/DOL Form 5500 Schedule B). The regulations promulgated by the Joint Board to implement Sections 3041 and 3042 have required satisifaction of certain examination and experience standards involving basic actuarial mathematics and pension actuarial topics related to ERISA. However, the Joint Board has not required evidence of education and/or experience in a variety of other areas of actuarial practice not directly related to ERISA.

Unfortunately, since enrollment essentially involves licensing of actuaries by the Federal government (albeit licensing in a narrow area to perform only a small number of well-defined functions), "enrolled actuary" status has understandably been interpreted by many non-actuaries as evidence of broad qualifications as an actuary more generally. This is not to say that many enrolled actuaries do not possess broader credentials as an actuary, since most do. However, nothing involved in becoming an enrolled actuary is evidence of such broader training and experience per se.

Accordingly, the Academy proposes that the term "enrolled actuary" be changed to "enrolled pension actuary" throughout ERISA. This revised term is much more descriptive of the training and experience inherent in the enrollment process and should lessen the confusion and ambiguity which has occurred.

The second involves the performance of actuarial services for welfare plans (see Section 3(1) of ERISA for a definition of "welfare plan"). Although ERISA affects both welfare plans and pension plans (the latter to a much greater extent), no actuarial statements or reports for welfare plans are required by the Act or subsequent regulations.

The Joint Board requires evidence of both education and experience in pension actuarial matters in order to meet the standards for enrollment. The Joint Board does not require any evidence of either education or experience on welfare plans in order to meet these standards. The Joint Board does not require such evidence in its enrollment regulations, understandably because nothing is required by the government of an actuary on a welfare plan.

This situation involves potential problems of both inclusion and exclusion. On the one hand, the designation "enrolled actuary" does not provide any assurance that the individual in question has competence to perform actuarial services on welfare plans. On the other hand, a number of actuaires that are not enrolled because of lack of education or experience in pension matters may be highly qualified to perform services on welfare plans. Certain problems may arise from this anomaly, since the users of actuarial services are often not aware of these subtleties. For example, cases have been called to the attention of the Academy in which auditors do not rely on the work of an actuary on a welfare plan unless the actuary is enrolled.

The confusion in this area has arisen from the language in Section 3042(a):

> "The Joint Board shall, by regulations, establish reasonable standards and qualifications for persons performing actuarial services <u>with respect to plans to which this Act applies</u>. . ."
>
> (emphasis added)

The Academy proposes an amendment to clarify that enrollment involves only pension plans and not welfare plans. This proposal is quite compatible with the first proposal to change the term "enrolled actuary" to "enrolled pension actuary".

Appendix G contains proposed amendments to implement these two clarifications.

IV. SUMMARY AND CONCLUSIONS

In summary, the Academy commends the intention of the introducers of these various bills to resolve the difficulties created by ERISA. Many of the proposals in these bills are highly constructive in this regard. The comments presented in the Academy statement are being offered in the same constructive spirit.

The Academy appreciates the opportunity to appear at these hearings. Actuaries have a vital interest in the development of amendments to ERISA and the Academy has a continued interest in this area. Representatives of the Academy are available to meet with the Subcommittees or staff at your convenience to discuss these, or other, proposals in more detail.

Thank you.

INDEX TO APPENDICES

APPENDIX A

BACKGROUND INFORMATION ON THE AMERICAN ACADEMY OF ACTUARIES

The American Academy of Actuaries is a professional organization of actuaries which was formed in 1965 to bring together into one organization all actuaries in the United States and to seek accreditation and greater public recognition for the profession. It includes members of four constituent organizations - the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, the Fraternal Actuarial Association, and the Society of Actuaries. These organizations, or their predecessors, date back many years, one of them to the late 1800's, so that despite the relatively short duration of its formal existence, the Academy, its constituent organizations and their predecessors have represented the actuarial profession in the United States for over 80 years.

The Academy is unique as the national accrediting actuarial organization for actuaries in all areas of specialization. Requirements to become a Member of the Academy can be summarized under two broad headings: (1) education and (2) experience; an individual must satisfy both in order to be admitted. At the present time, the education requirements for full Membership can be satisfied only by passing professional examinations given either by the Casualty Actuarial Society or the Society of Actuaries. The experience requirement consists of five years of responsible actuarial work.

As of December 31, 1977, Academy membership stood at 4,418. These actuaries have a variety of types of employment, including insurance organizations, consulting firms, academic institutions, and government. Well over 90% of those individuals who have satisfied the rigorous education and experience requirements of the Academy do, in fact, join the Academy. The

APPENDIX A

entire Academy membership is subject to rigorous guides to professional conduct and standards of practice.

APPENDIX B

PROPOSED AMENDMENT ON OPINIONS OF ACTUARIES AND ACCOUNTANTS

Sec. 103(a)(3)(A) Except as provided in subparagraph (C), the administrator of an employee benefit plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the ~~plan~~ fund, and of other books and records ~~of the plan~~, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements of the fund and related ~~and~~ schedules required to be included in the annual report by subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards, [except to the extent required by subparagraph (B),] and shall involve such tests of the books and records of the ~~plan~~ fund as are considered necessary by the independent qualified public accountant. The independent qualified public accountant shall also offer his opinion as to whether the separate schedules specified in subsection (b)(3) of this section and the summary material required under section 104(b)(3) present fairly, and in all material respects the information contained in the annual report ~~therein when considered in conjunction with the financial statements taken as a whole~~. The opinion by the independent qualified public accountant shall be made a part of the annual report. In a case where a plan is not required to file an annual report, the requirements of this paragraph shall not apply. In a case where by reason of section 104(a)(2) a plan is required only to file a simplified annual report, the Secretary may waive the requirements of this paragraph.

Sec. 103(a)(3)(B) In offering his opinion under this section the accountant [~~may~~ shall] rely on the correctness of any actuarial matter certified to by an enrolled actuary [~~, if he so states his reliance~~].. The opinion of the accountant under this section is limited to the status and operations in respect to the assets of the fund and excludes actuarial matters certified to by the enrolled actuary. "Actuarial matters" may be further defined by regulation by the

APPENDIX B

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Secretary and shall include, with respect to a pension benefit plan, the items required to be included in the actuarial statement under paragraphs (3) through (11) of subsection (d) of this section.

Sec. 103(a)(4)(D) In making a certification under this section the enrolled actuary [~~may~~ shall] rely on the correctness of any accounting matter under section 103(b) as to which any qualified public accountant has expressed an opinion [~~, if he so states his reliance~~].

Sec. 103(b) An annual report under this section shall include a financial statement containing the following information:

(1) With respect to an employee welfare benefit plan: a statement of assets and non-actuarial liabilities of the fund; a statement of changes in fund balance; and a statement of changes in financial position. In the notes to financial statements, disclosures concerning the following items shall be considered by the accountant: a description of the plan including any significant changes in the plan made during the period and the impact of such changes on benefits; a description of material lease commitments, other commitments, and contingent liabilities; a description of agreements and transactions with persons known to be parties in interest; a general description of priorities upon termination of the plan; information concerning whether or not a tax ruling or determination letter has been obtained; and any other matters necessary to fully and fairly present the financial statements of the ~~plan~~ fund.

(2) With respect to an employee pension benefit plan: a statement of assets and non-actuarial liabilities of the fund; and a statement of changes in net assets available for plan benefits which shall include details of revenues and expenses and other changes aggregated by general source and application. In the notes to financial statements, disclosures concerning the following items shall be considered by the accountant: a description of the plan including any significant changes in the plan made during the period and the impact of such changes on benefits; the funding policy (including policy with respect to prior service cost), and

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any changes in such policies during the year; a description of any significant changes in plan benefits made during the period; a description of material lease commitments, other commitments, and contingent liabilities; a description of agreements and transactions with persons known to be parties in interest; a general description of priorities upon termination of the plan; information concerning whether or not a tax ruling or determination letter has been obtained; and any other matters necessary to fully and fairly present the financial statements of such pension ~~plan~~ fund.

(3) With respect to all employee benefit ~~plans~~ funds, the statement required under paragraph (1) or (2) shall have attached the following information in separate schedules:

(A) a statement of the assets and non-actuarial liabilities of the ~~plan~~ fund aggregated by categories and valued at their current value, and the same data displayed in comparative form for the end of the previous fiscal year of the plan; ----

NOTE: Amendments contained in brackets are those contained in S. 3017. All other amendments are proposed by the American Academy of Actuaries.

APPENDIX C

Rev. Rul. 77-2: I. R. B. 1977-1, 9.

Charges and credits to funding standard account for changes in benefits effective after valuation date.—A change in the benefit structure of a qualified pension plan that becomes effective in a plan year subsequent to the plan year for which charges and credits to the funding standard account are being computed shall not be considered in the computation.

Section 1. Purpose.

The purpose of this Revenue Ruling is to provide guidelines for determining the charges and credits to be made to the funding standard account to reflect changes in benefits that become effective after the valuation date.

Sec. 2. General Rule.

.01 In the case of a change in the benefit structure that becomes effective during a plan year subsequent to a given plan year for which the charges and credits to the funding standard account are being computed, such change in benefit shall not be considered in determining the charges or credits to the funding standard account for such given plan year.

.02 In the case of a change in the benefit structure that becomes effective as of a date during a plan year (but subsequent to the first day in such plan year), the charges and credits to the funding standard account (1) shall not reflect the change in such benefit structure for the portion of such plan year prior to the effective date of such change, and (2) shall reflect the change in such benefit structure for the portion of the plan year subsequent to the effective date of the change.

.03 For purposes of this section, the effective date of the change in benefit structure shall not be later than (1) in the case of a collectively-bargained plan described in section 413(a) of the Internal Revenue Code of 1954, and which includes more than one collectively-bargained unit, the date such change with respect to benefits of participants included within any unit becomes effective with respect to any individual who is or could be both a participant in the plan and in such bargaining unit, and (2) in the case of any other plan, the date such change becomes effective with respect to any individual who is or could be a participant in the plan.

Sec. 3. Changes Not Adopted As of the Valuation Date.

In the case of a change in benefit structure that becomes effective in a plan year and that is not adopted on or before the valuation date in such plan year, in lieu of using the rule described in section 2.02 such change in benefit structure may not be considered in determining the charges and the credits to the funding standard account for such plan year. Whichever method is adopted may not be changed for such year once the annual return described in section 6058 of the Code is filed.

Sec. 4. Examples.

The guidelines provided in this revenue ruling may be illustrated by the following examples:

Example 1. An employer adopts an amendment on the first day of year 1 that provides benefit structures b_1, b_2, and b_3 which becomes effective on the first day of years 1, 2, and 3, respectively. In computing the charges and the credits to the funding standard account for years 1, 2, and 3, benefit structures b_1, b_2, and b_3 would be reflected in the respective plan years during which they become effective.

Example 2. A collectively-bargained plan provides for a single benefit structure for years 1, 2, and 3 under an arrangement in which the employer contributions to fund such structure are increased in each of three years. The charges and the credits to the funding standard account must be computed on the basis of such single benefit structure using a funding method not designed to reflect such negotiated phase-in of contribution increases. If the contributions in year 1 (determined without regard to the contributions negotiated for years 2 and 3) are insufficient to prevent an accumulated funding deficiency, the minimum funding requirements are not satisfied.

APPENDIX D

Unnumbered IRS Private Letter Ruling, 1-18-78—Defined benefit plan may not contain language automatically adjusting maximum dollar limitation under IRC § 415 upward with cost of living adjustments; actuary cannot take future increases in dollar limitation into account when figuring defined benefit plan contributions if plan has not been amended to incorporate increases.—

* * * * * * * * * * * * *

In your letter of November 16, 1977, you asked certain questions concerning the cost of living adjustments to the dollar limitation on benefits under section 415 of the Internal Revenue Code.

Your first question asked whether or not a defined benefit plan may contain language that automatically adjusts the maximum dollar benefit upwards with the cost of living adjustment to the maximum section 415 limit as determined by the Internal Revenue Service.

The position of the Service is that a defined benefit plan may not contain language that provides for an automatic adjustment of the dollar limitation. This position is clearly stated in section 5.02 of Revenue Ruling 75-481, 1975-2 C.B. 188, and in IR-1681. If a plan does provide such language, then it does not satisfy the requirements of section 415 of the Code, and therefore does not constitute a qualified plan under section 401(a) of the Code. If a plan sponsor wishes to adjust the maximum dollar benefit upwards, an amendment must be made each year. Note, however, that IR-1782 provides that a new determination letter should not be requested if the amendment merely reflects the new limits.

Your other questions basically asked whether or not an actuary may take into account future increases in the dollar limitation when computing the contributions that are to be made to a defined benefit plan.

An actuary must base his cost calculations on the benefits provided by the plan. If a qualified defined benefit plan cannot provide for an automatic cost of living adjustment to the section 415 dollar limitations, then an actuary cannot assume that the plan will be amended to incorporate those increases. If the actuary does so, the contribution may not be deductible.

Sincerely yours, Winfield C. Burley, Chief, Pension Actuarial Branch.

APPENDIX F

STATEMENT OF THE AMERICAN ACADEMY OF ACTUARIES

TO

THE PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS SUBCOMMITTEE

OF THE SENATE FINANCE COMMITTEE

ON S. 2992

June 14, 1978

Edwin F. Boynton, President
Preston C. Bassett, Vice President
Stephen G. Kellison, Executive Director

The Academy appreciates the opportunity to present this statement to the Subcommittee on S. 2992, a bill which would have a significant impact on the work of Enrolled Actuaries under ERISA. It provides that the Secretary of Treasury shall promulgate uniform standards for the calculating and reporting the assets and liabilities of pension plans and for disclosing actuarial assumptions used in such calculations.

Because of the short time period between the date when the hearings were first announced and today's hearing, our statement today will be fairly brief and only outline the major points to be made by the Academy. We understand that the record will remain open for a few weeks so as to permit a more comprehensive statement to be submitted, including some pertinent exhibits. In particular, the Academy has under way a study on presentation of actuarial liabilities which is very pertinent to this particular bill and which will be completed within the next few weeks. We plan to attach this special study by the Academy to our more complete written statement to be filed later.

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As the Committee is aware, the American Society of Pension Actuaries (ASPA) represents a significant number of pension actuaries who are not members of the Academy. The two organizations combined represent approximately 93% of Enrolled Actuaries. Representatives of ASPA have reviewed this statement and have advised us that they fully agree with the position taken by the Academy on S. 2992. Accordingly, although the Academy representatives cannot speak for ASPA, this statement can be taken as representing the common position of both organizations.

In general, the Academy supports what we believe is the intent of the bill. However, we believe that further clarification is needed to be sure that this intent is properly carried out. We also believe that to do so would require certain changes in other parts of ERISA and in the Internal Revenue Code. We would add further that we believe that the apparent intent of the bill may, in fact, be accomplished without this specific legislation.

We are obviously aware of the adverse publicity given to private pension plans recently in the press. The most recent of these stories which reflect adversely on private pensions generally have appeared in such publications as Fortune, the New York Times, U.S. News and World Report, and Forbes magazine. Unfortunately, much of the information in these articles appears to be based on misinformation and lack of understanding on the part of the authors as to the nature and purpose of various actuarial funding methods. On the other hand, we would acknowledge that the variation of actuarial funding methods available to pension plans, to be used for different purposes, has compounded the problem and led to great confusion and misunderstanding on the part of the plan participants, the press, as well as legislators and regulators. Certainly one of most misunderstood items appearing in pension plan reports is what is often called the "unfunded liability". It is this item in particular which has given rise to so much misunderstanding because there are admittedly a wide range of interpretations of the "unfunded liability" item.

Actuarial liabilities are calculated for three general purposes, and the particular purpose intended will dictate the kind of actuarial methodology which is used. The three general purposes for the development of these actuarial liabilities as as follows:

(1) as a means of determining the annual contributions to be made to the plan so as to provide for orderly funding of the benefits;

(2) as a measurement of the funding progress of an ongoing plan based upon the benefits which have been credited to participants up to any particular date (this might contemplate either the value of accrued benefits for all persons who are vested or retired, or for all accrued benefits of the plan, whether or not vested);

(3) as a measurement of liabilities that would emerge for the plan in the event of plan termination. (This measurement is significantly affected by the termination insurance program established under ERISA which sets up priority allocations in the event of termination).

There are several funding methods available for the first purpose defined above, that of determining annual contributions for proper funding of the plan. This is necessary and will be discussed later. For the purpose described in the second and third items above - that of measurement of funding progress on a "ongoing plan" basis, or as a measurement of the termination liabilities of the plan, the Academy believes there is considerable merit in having consistent methodology to be used in development of such values. Adoption of a uniform methodology would go a long way toward reducing some of the misunderstandings which have occurred in the past through the use of incorrect types of figures to represent plan liabilities.

For example, many of the articles appearing in the press over the years have called attention to the wide variations in unfunded liabilities among companies in the same industry and even from year to year in the same company. This is often due to focusing on the wrong kind of actuarial values. Although we are not familiar with the source of information which has been used in some of the recent articles, we understand that often the unfunded liability figures used in such articles were taken from the reports filed with the SEC pursuant to Regulation S-X. This information is provided pursuant to SEC regulations which request "the estimated amount that would be necessary to fund . . . the past service cost of the plan". This rather vague description leads to rather wide variations in the values reported to the SEC. We believe the amounts reported often come directly from actuarial values prepared by the actuary for the purpose of determining annual contribution levels to provide for the long range funding of the plan, and not for the purpose of measuring the value of accrued benefits. The figures derived from actuarial values used for determining annual contribution levels may be totally misleading in terms of suggesting that this represents a true unfunded liability of the company. Such values are often only actuarial or mathematical tools used to derive a funding level which will remain reasonably constant as a percentage of payroll over a long period of time. In other words, the so-called "unfunded liability" developed by the actuary for the purpose of determining annual contribution levels is often not a true unfunded liability at all. It does not represent the value of benefits accrued to date or the value of benefits that will be payable if the plan terminated. For reasons that will be discussed later, we do believe that flexibility in the funding methods used for determining the contribution is a highly desirable and necessary tool of the actuary to provide advice on the proper funding of pension plans.

Returning to the bill itself and the desirability of having uniform standards for the purpose of reporting the value of accrued benefits or the termination values of plans, we believe that uniform methodology would be a highly desirable feature so as to avoid misunderstanding by plan participants, the press, legislators, etc. For example, the development of the value of accrued benefits on a "going plan" concept could have the following useful purposes.

(1) It could be used as a statement of the actuarial condition of the plan as a substitute for the present Section 103(d)(6) of ERISA, which is so complicated to administer that the Labor Department has continued to waive the requirements that such information be reported.

(2) It could be used for the purpose of reporting, on a uniform basis among various companies, the amount of unfunded actuarial liabilities to be used in the footnotes of the financial statements of the Company, as required by the SEC.

(3) It could be used for the purpose of meeting the test required in Section 414(l) in the Code and in Section 208 of ERISA in the event of mergers, terminations, or spin-off of plans. (i.e. this measurement, which is established to protect the rights of participants in the event of plan mergers or spin-offs, could be simplified considerably without diminishing the protection to participants).

(4) If the Financial Accounting Standards Board (FASB) continues to hold the view that the financial statement called for by Section 103(b) of ERISA should include actuarial values, this type of measurement would be appropriate for that purpose.

We believe that one single methodology could be developed with enough flexibility to handle varying plan conditions for all four purposes.

We are pleased to see the bill acknowledge the importance of not requiring the Secretary to prescribe a single set of actuarial assumptions, since such assumptions must of necessity be varied to meet varying plan conditions. For example, turn-over rates, rates of retirement, disability rates, assumed return on investments, rates of pay increases and other factors vary widely among companies. Therefore, the actuary must have the flexibility to select assumptions appropriate not only to the features of the plan itself, but to these other conditions. ERISA recognizes this by requiring that the Enrolled Actuary select actuarial assumptions and methods which, in the aggregate, are reasonable and offer the actuary's best estimate of anticipated experience under the plan.

The bill would provide for the Secretary of Treasury to promulgate standards for the valuation of both assets and actuarial liabilities.

We do not believe that the value of assets to be used in the presentation of these measurements should be standardized, such as at market value, but rather should be the value of assets used by the actuary. We have no quarrel with the idea that the market value of assets be used in the presentation of the financial statement prepared by the Administrator pursuant to Section 103(b), but when the actuarial value of liabilities is presented, the value of assets should be prepared on a consistent basis. That is, when the actuary sets forth the actuarial status of the plan for any of the purposes mentioned above, he is considering the projection of these actuarial values on a long range basis, averaging out potential future variations in experience, both in the investment returns and in other actuarial factors. Accordingly, it would be misleading, to plan participants and others who would read such actuarial statements, to be required to match these actuarial values with, say, the market value of the assets, which can exhibit wide variations over the short term. Since pension plan obligation is a long range one with an orderly cash flow out of the fund in the form of benefit payments, a more stable asset value is desirable to match up more properly with the determination of the actuarial values.

As mentioned earlier, an Academy Committee is currently at work on a project which is quite consistent with the intent of this bill as we see it. The Committee on Actuarial Principles and Practices for Pension Plans, after discussion with the Financial Accounting Standards Board, has prepared an interpretation of the Academy's actuarial principles for pension plans which basically sets forth a recommended methodology to be used in determining the value of accrued benefits in connection with the actuarial values to be associated with the financial statement required by Section 103(b) of ERISA. While the Academy does not believe it is necessary or appropriate to include this actuarial value as part of the ERISA financial statement, that decision is the prerogative of the FASB and we are merely complying with their request that a reasonable method of determining such liability be developed by the actuarial profession. This particular paper is in the final stages, and at this point we do not know whether the FASB will accept the recommendations or not. In any event, as soon as the paper is finalized we will see that the Subcommittee is provided with a copy of it.

As indicated, we question whether legislation is currently needed to provide for the desired uniformity in the presentation of actuarial values. However, if Congress should decide that legislation is necessary, we believe the bill, as drafted, needs some clarification and expansion. For example, from the standpoint of the Internal Revenue Code, the requirement for uniform standards could be linked specifically to Section 414(1) where this kind of standardized methodology would be very appropriate. In addition, it should be recognized that there is a problem of dual responsibility between the Finance Committee and the Labor Committee, since this problem also encompasses the reporting requirements of Section 103 of ERISA. Therefore, certain other sections of ERISA should be likewise amended to adopt consistent language and provide for this uniform methodology to be applicable for other purposes. For example, Section 103(d) of ERISA, which calls for the presentation of certain actuarial values in accordance with the termination priorities of Section 4044 of ERISA, could be amended to call for presentation of the actuarial values in accordance with the uniform methodology prescribed in this bill. As noted earlier, Section 103(d)(6) has been so difficult to administer that the Secretary of Labor has waived the requirements for the past two years and now is proposing an alternative presentation consistent with the ideas expressed by the Academy. If legislation is to be enacted in this area, we would be happy to discuss with the staff the specifics of the language and any other changes which might be required for consistency.

While we support the concept of establishing a uniform methodology for the presentation of the value of accrued benefits, we do question the need for this specific legislation at this time. We believe that many of the problems created by different methods of reporting "unfunded liabilities" can be resolved under existing regulatory authority. In fact, there are several current developments that would lead us to believe that the objective of more uniform reporting of actuarial liabilities will be accomplished in the relatively near future without additional legislation. Among these are:

(1) The revised Schedule B proposed by the administration for joint reporting to the Internal Revenue Service and the Department of Labor which incorporates the ideas proposed by the Academy in this area and substitutes more reasonable requirements for the burdensome actuarial reporting requirements of Section 103(d)(6);

(2) The exposure draft prepared by the Academy Committee on Actuarial Principles and Practices for Pension Plans which does set forth recommended standards for the presentation of the actuarial liabilities of a pension plan;

(3) The view of the FASB that the actuarial liabilities attached to the plan's financial statement be calculated by a uniform methodology;

(4) Section 6059 of the Internal Revenue Code, which provides for periodic reports by the Actuary, appears to give the Secretary of Treasury the authority to issue such regulations, if deemed necessary;

(5) The Securities and Exchanga Commission, we believe, also has authority under existing law to prescribe uniform methodology for the reporting of unfunded actuarial liabilities (such as the Academy's recommendation).

Accordingly, the Academy does not believe that legislation of this type is needed at this time in order to accomplish the desired goals that we believe is the intent of this bill.

The Academy support for the concepts in the proposed bill is based on the assumption that the development of any uniform standards for actuarial methodology would be limited to those kinds of situations described earlier which call for a display of the statement of the value of accrued benefits under the plan, either on an on-going basis or in the event of plan termination, so as to fairly present the actuarial position of the plan. We would not support the adoption of uniform standards of actuarial methodology for the calculation of the minimum or maximum funding requirements of ERISA. That is, the actuarial methods to be used to develop the minimum contribution requirements to provide for sound and orderly funding of the plan are often different than those used for the purposes described before, and we would hope that there is no intention to prescribe a standard methodology for purposes of determining the minimum funding requirements of ERISA. The present structure of ERISA and the background committee report certainly support the concept that there should be flexibility in funding methods and assumptions. It leaves the actuarial basis for funding levels to the discretion of the Enrolled Actuary to select the method and assumptions that are most appropriate for the particular plan, and as indicated earlier, ERISA specifically requires this.

The selection of the funding method for the purpose of determining annual contribution levels should reflect the variation in plan provisions as well as variations in the potential economic conditions of the employer. With respect to this latter point, certain industries, such as utilities, have a very stable cash flow and therefor less flexibility is needed in the funding program designed for such a company than would be in the case of, say, a steel company which is subject to substantial fluctuations in its cash flow patterns over the years. Similarly, the type of plan has an influence on the selection of an appropriate funding method. A typical career-average pension plan financed by a deferred group annuity contract of a life insurance company has traditionally been funded by the unit purchase funding method; this has proven to be a very sound method for this situation. On the other hand, in selecting the funding method for a final average pay plan, the actuary will often want to use one of the "projected benefit" family of methods, since it provides for more flexibility in the establishment of an orderly funding program to recognize the significant elements in the pension formula.

We recognize that these differences in funding methods can lead to differences in annual contributions and in "unfunded liabilities". It is for this reason that we support the concept in the bill that whenever the "unfunded liabilities" are to be displayed (to participants, the public, in financial statements, etc.) they should be calculated in accordance with a uniform methodology.

As a matter of related interest, we will be submitting as part of our more complete statement a pension discussion document prepared by a research accounting group in the United Kingdom dealing with financial reports for pension funds. One of the major conclusions of this accounting research group is that a part of the comprehensive report which the Trustees should provide to participants in the plan should be prepared by the actuary regarding the overall funded position of the plan. It notes particularly that this should be presented in parallel with, rather than part of, the financial statement prepared by the accountant. We would certainly endorse this approach with regard to the preparation of statements under ERISA and would be very pleased to review further proposals regarding the manner in which this might be implemented.

We thank you very much for the opportunity to present this statement and, as indicated, we will file a supplemental statement within a few weeks when some additional source material becomes available.

APPENDIX G

PROPOSED AMENDMENT INVOLVING "ENROLLED ACTUARIES"

Sec. 3042(a) The Joint Board shall, by regulations, establish reasonable standards and qualifications for persons performing actuarial services with respect to pension plans to which this Act applies and, upon application by any individual, shall enroll such individual if the Joint Board finds that such individual satisfies such standards and qualifications. The term "enrolled pension actuary" means an actuary thus enrolled. With respect to individuals applying for enrollment before January 1, 1976, such standards and qualifications shall include a requirement for an appropriate period of responsible actuarial experience relating to pension plans. With respect to individuals applying for enrollment on or after January 1, 1976, such standards and qualifications shall include --

(1) education and training in actuarial mathematics and methodology, as evidenced by --

(A) a degree in actuarial mathematics or its equivalent from an accredited college or university,

(B) successful completion of an examination in actuarial mathematics and methodology to be given by the Joint Board, or

(C) successful completion of other actuarial examinations deemed adequate by the Joint Board, and

(2) an appropriate period of responsible actuarial experience.

Notwithstanding the preceding provisions of this subsection, the Joint Board may provide for the temporary enrollment for the period ending on January 1, 1976, of actuaries under such interim standards as it deems adequate.

Sec. 3042(b) The Joint Board may, after notice and an opportunity for a hearing, suspend or terminate the enrollment of an individual under this section if the Joint Board finds that such individual --

(1) has failed to discharge his duties under this Act, or

APPENDIX G

-2-

(2) does not satisfy the requirements for enrollment as in effect at the time of his enrollment.

The Joint Board may also, after notice and opportunity for hearing, suspend or terminate the temporary enrollment of an individual who fails to discharge his duties under this Act or who does not satisfy the interim enrollment standards.

Conforming Amendments

All references to "enrolled actuary" in ERISA are changed to "enrolled pension actuary".

APPENDIX H

INDEX OF MATERIALS TO BE INCLUDED IN SECOND SUBMISSION

A. Submission to the Pension Task Force of the House Committee on Education and Labor dated June 13, 1978.

B. Transcript of "Session on Oversight Legislation" - Meeting for Enrolled Actuaries - March 1, 1977.

C. Letters from actuaries containing proposed ERISA amendments.

D. Letter to Senator Bentsen on S. 2992 dated July 14, 1978.

E. Interpretation 2 of the Academy Committee on Actuarial Principles and Practices in Connection with Pension Plans dated June 30, 1978.

F. Report of the Pensions Research Accountants Group on Financial Reports for Pension Funds released jointly by the National Association of Pension Funds and the Pensions Research Accountants Group in Great Britain.

AMERICAN ACADEMY OF ACTUARIES

1835 K STREET, N.W. • SUITE 515 • WASHINGTON, D.C. 20006 • (202) 223-8196

STEPHEN G KELLISON, M.A.A.A.
EXECUTIVE DIRECTOR

August 17, 1978

Mr. Steven Sacher
Special Counsel
Senate Human Resources Committee
4230 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Sacher:

Enclosed for inclusion in the official record of the ERISA hearings are two copies of our second submission referred to in both our statement of August 17, 1978 and oral statement presented at the public hearing on that date. The following items are enclosed:

1. Submission to the Pension Task Force of the House Committee on Education and Labor dated June 13, 1978.

2. Transcript of "Session on Oversight Legislation" - Meeting for Enrolled Actuaries - March 1, 1977.

3. Letters from actuaries containing proposed ERISA amendments.

4. Letter to Senator Bentsen on S. 2992 dated July 14, 1978.

5. Interpretation 2 of the Academy Committee on Actuarial Principles and Practices in Connection with Pension Plans dated June 30, 1978.

6. Report of the Pensions Research Accountants Group on Financial Reports for Pension Funds released jointly by the National Association of Pension Funds and the Pensions Research Accountants Group in Great Britain.

Sincerely,

Stephen G. Kellison

Stephen G. Kellison

SGK:cs

Enclosures

AMERICAN ACADEMY OF ACTUARIES

1775 K STREET, N.W., SUITE 215, WASHINGTON, D.C. 20006. (202) 223-8196

EDWIN F. BOYNTON, M.A.A.A., PRESIDENT
C/O THE WYATT COMPANY
1620 K STREET, N.W.
WASHINGTON, D.C. 20006
(202) 452-0060

June 13, 1978

Honorable John H. Dent, Chairman
Pension Task Force
Committee on Education and Labor
U.S. House of Representatives
Room 112, Cannon Office Building
Washington, D.C. 20515

Dear Congressman Dent:

This is in response to your letter of May 3, 1978 inviting the American Academy of Actuaries to submit proposals for revisions in ERISA. Mr. Stephen Kellison, Executive Director of the Academy, acknowledged your letter and indicated we would be responding by the middle of June with as much material as we could prepare by that time.

I am pleased to enclose a statement prepared by the Academy's Pension Committee which suggests a series of specific recommendations to ERISA to correct problems that actuaries have run into in the course of working with the new law. For simplicity, this is an organized in outline form with relatively little discussion. We thought this form of presentation might be easier to work with than the usual type of written statement with a long discussion. However, Academy representatives would be happy to meet with staff or the Committee to discuss the reasons for these specific proposals.

I would add that because of the timing for submission of these comments these should not be taken as official representations of the Academy per se. Rather they are a collection of proposed changes prepared by the Academy's Committee on Pensions reflecting the views of practitioners with long experience in the field.

I trust that these suggestions will be helpful to your committee in coming up with proposed revisions to ERISA. If we can be of further assistance, please do not hesitate to call upon us.

Sincerely,

Edwin F. Boynton

Edwin F. Boynton

EFB:ta

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
3(2)		(i) Amend Section 3(2) to exclude discretionary supplemental payments by plan sponsors to existing retirees from the definition of a pension plan.
		(ii) Amend Section 3(2) to exclude severance payments from the definition of a pension plan.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
3(22)		Section 3(22) should be amended to exclude disability benefits from the term "normal retirement benefits."

Presently, disability benefits in excess of the basic pension amount are subject to the accrual requirements of the Act. There are a number of plans where the disability retirement benefit is determined independently of the basic pension benefit and is in excess of the prospective basic pension benefit. Such disability benefits are intended for the specific contingency of disability and do not have income deferral characteristics or any of the basic features of pension plans. Unless disability benefits are excluded from the term "normal retirement benefits", employers with arrangements of this type will be encouraged to provide disability benefits outside the pension plan which may not be in the interest of employees.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PRCPOSED AMENDMENT
3(24)		Permit normal retirement age to be - (i) first of month following 65th birthday (ii) any date in month in which 65th birthday occurs (iii) contract anniversary of the year in which 65th birthday occurs

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
103(a)(3)		Amend requirements in Section 103(a) (3) (A) for statement by an independent qualified public accountant in connection with Annual Reports and require accountants to rely on the certification by an enrolled actuary, certified bank and insurance company reports.

The activities of accountants should be limited in scope to a thorough review of the assets, benefit payments, and other financial aspects of the pension fund. Generally, accountants have ignored Section 103(a) (3) (B) of the Act which states that the accountant has the right to rely on the certification of an actuary. As a result, accountants have taken the position that not only the transactions of the fund, but the actuarial assumptions, methods, procedures, etc. must be reviewed. The added cost in duplication of work is considerable.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
103(c)(4)		Amend Section 103(c)(4) to eliminate the requirement to report a change of enrolled actuary when the change is due to a reassignment of enrolled actuaries within the same firm or when the enrolled actuary remains the same but the firm changes.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
103(d)(6)		Delete paragraph (6) of ERISA Section 103(d) requiring that the Annual Report include the present value of all of the plan's liabilities for nonforfeitable pension benefits allocated by the termination priority categories in Section 4044. The calculation of the amount of liability by all of the PBGC termination priority categories rules and procedures would be extremely complex and quite costly and is of little, if any, significance with respect to an ongoing plan. Any set of such calculations will be extremely transient, and unintelligible to virtually all participants, and will be purely academic for plans which are not about to terminate in the immediate future. A more practical disclosure would be the present value of accumulated benefits and the actuarial assumptions used in these computations.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
104 (a)		Amend Section 104(a)(1)(C) to delete the requirement of filing with the Secretary of Labor a summary plan description at the time it is requested to be furnished participants and beneficiaries. Also delete requirement in Section 104(a)(1)(D) that modifications and changes to the summary plan description be filed with the Secretary of Labor within 60 days after the modification or change is adopted or occurs. Recommendations are the same as recommendations no. 1 and 2 of the report of the Federal Paperwork Commission.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
104(b)		Amend Section 104(b) to abolish the requirement that plan administrators provide employees with a summary of the annual report (Form 5500).

Except in unusual circumstances, the summary annual report does not provide any information which is of assistance to participants. The experience to date is that employees regard this as "junk" to be thrown away. Yet it has a cost which either directly or indirectly reduces the amount available to provide benefits.

The complete annual report is available to all participants upon request. Therfore there is no need to provide a summary annual report, and the requirement for it should be deleted from ERISA.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
105		Amend Section 105 to specifically allow plan sponsors to provide plan participants once a year a computerized employee statement containing the required information computed as of the same date for all participants.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
202(a)(1)(A)	410(a)(1)(A)	Permit employees to become plan participants not later than the beginning of the plan year following the date on which the employee attains age 25 and completes one year of service.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
202(a)(3)(A) 203(b)(2)(A)	410(a)(3) 411(a)(5)(A)	Expressly permit the elapsed time method of measuring service as authorized by the regulations. Further provide that under elapsed time, no credit has to be given for periods when the employee is not actively employed by the employer.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
203(a)(2)	411(a)(2)	Provide that the IRS may not require a plan to provide a more stringent vesting schedule than one contained in Section 411(a)(2) of the Code unless there has been a judicial finding that such schedule discriminates in favor of the "prohibited group".

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
203(c)(1)(B)	411(a)(10)(B)	Eliminate the requirement of providing former plan as vesting alternative to five-year employees if amended plan improves vesting or does not adversely affect anyone's vesting position.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
204(b)	411(b)	Permit years of service to be rounded to the nearest tenth, month, or other reasonable unit in calculating the benefit.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
204(d)(1) 204(e)	411(a)(7)	(i) Amend Section 204(d)(1) of ERISA and Section 411(a)(7)(B) of the Code to eliminate entirely the $1750 rule for pre-retirement payouts for defined contribution plans. (ii) Amend Section 204(e)(3) of ERISA and Section 411(a)(7)(C)(iii) of the Code to limit the "buy back" period to two years after resuming employment.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
205(a)	401(a)(11)(A)	Provide that the joint and survivor annuity requirements do not apply to an individual account plan in which (i) the participant has the right to elect to receive his benefit in a form which is independent of life contingencies, and (ii) upon the death of an employee who has the right to elect early retirement, if any, the employee's account balance is vested in his designated beneficiary.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
205(b)	401(a)(11)	Amend Sections 205(b) of ERISA and 401(a)(11) of the Code to provide that a disability benefit will not be considered an early retirement benefit.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
205(c)	401(a)(11(C)	(i) Provide that the plan may take into account, in determining the qualified joint and survivor annuity required to be paid hereunder, the equivalent value of any company - provided death benefits, from group insurance or otherwise, paid on account of the participant's death. (ii) Provide, subject to Section 205(f), that any option election period terminates on the date annuity payments start.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
206	411	Allow pension plans to reduce pensions by any state unemployment compensation benefits payable

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
206(b)	401(a)(15)	Clarify that, notwithstanding anything to the contrary, a plan may adjust benefits of such a participant, subject to the integration rules, by reason of any increase in the benefit levels or wage base under Title II of the Social Security Act, if such increase occurs before the earlier of the participant's date of separation from service or annuity commencement date.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
208	401(a)(12) 414(l)	(i) Revise these two sections to read substantially as follows: "A trust which forms a part of a plan shall not constitute a qualified trust under section 401 and a plan shall be treated as not described in section 403(a) or 405 unless in the case of any merger or consolidation of such plan to, any other trust plan after the date of the amendment to this subsection, the ratio of assets to the present value of accumulated benefits for each participant in the plan is equal to or greater than the ratio immediately before the merger, consolidation, or transfer. This subsection shall apply in the case of a multiemployer plan only to the extent determined by the Pension Benefit Guaranty Corporation." (ii) Section 208 of ERISA should also be revised to reflect the same change to the use of a funded ratio for purposes of mergers and spin-offs. (iii) Clarify that the section does not apply to de minimis transfers of employees between plans within the same controlled group regardless of whether assets, liabilities, both, or neither are transferred.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
209(a)(1)		Revise 209(a)(1)(B) to exclude non-vested employees from the requirement. Delete (209)(a)(1)(C).

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
302(b)(2)(D)	412(b)(2)(d)	In connection with the use of the alternate funding standard account, change the period for making up any deficiency upon return to the regular funding standard account from the current five years to a much longer period, e.g., 15 to 30 years.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
302(c)(5)	412(c)(5)	Eliminate the requirement for changes in the funding method or plan year to be approved by the Secretary of Treasury. It is sufficient just to report ther· and allow the Secretary to challenge them.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
	415(c)(1)(B)	Provide that the 25% limitation does not apply to target benefit plans.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
503		Clarify that the plan need not contain the claims procedure so long as it is communicated to the participant in the summary plan description.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
	404(a)(7)	Provide that upon termination of a plan that has been in existence for 5 years or more, any contribution to the plan which does not exceed the excess, if any, of the value of the guaranteed benefits over the plan assets is deductible.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
	6058(b)	An actuary can not certify to the assets 30 days before the date of merger. Change "30 days before" to "180 days after".

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
	415(d)	Allow plan language to provide for automatic cost of living adjustments.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
Title IV		The PBGC will soon submit its report on CELI and multiemployer plans to Congress. In preparing the report, the PBGC has consulted with various actuaries among others. We urge Congress to give serious consideration to the PBGC recommendations. The Academy will be pleased to offer comments on such recommendations when available. Thus, no attention has been focused on major issues under Title IV at this time. Suffice it to say that serious consideration is required with respect to: 1) the levels of guaranteed benefits; 2) residual obligations of participating employers in multiemployer plans; 3) CELI; and 4) providing greater availability of assets by encouraging accelerated funding.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
4022(b)(8)(B)		Eliminate $20 per month; and clarify that social policy does not require guarantees of benefits payable prior to age 65 in excess of the comparable percentage of the accrued benefit available under the Social Security system.

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
4044(a)		Simplify allocation (especially Section 4044(a)(3)) and provide that no non-guaranteed benefits may be allocated assets before all guaranteed benefits are allocated assets.

33-549 O - 78 - 42

ERISA SECTION	CODE SECTION	DESCRIPTION OF PROPOSED AMENDMENT
		Amend ERISA, or any applicable law, if necessary to reverse the recent Daniels Decision by the Court of Appeals of the 7th Circuit.

AMERICAN ACADEMY OF ACTUARIES
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STEPHEN G KELLISON, M A A A
EXECUTIVE DIRECTOR

July 14, 1978

Senator Lloyd M. Bentsen,
Chairman
Subcommittee on Private Pension Plans and
Employee Fringe Benefits
Committee on Finance
United States Senate
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Bentsen:

The American Academy of Actuaries was pleased to present a written statement at the public hearing on S.2992 on June 14, 1978. We understand that this statement will become part of the official record of the hearing and are enclosing another copy for your convenience.

The last paragraph of our June 14 statement indicated that the Academy planned to "... file a supplemental statement written a few weeks when some additional source material becomes available". We understand from the Subcommittee staff that the record is remaining open through July 14, 1978.

The additional source material mentioned above is now available and is enclosed with this letter for the record. This material consists of two documents.

The first is Interpretation 2 released on June 30, 1978 by the Academy Committee on Actuarial Principles and Practices in Connection with Pension Plans. This committee is the group officially charged by the Board of Directors of the Academy to examine and develop actuarial principles and practices for actuarial calculations with respect to pension plans. The context of this Interpretation and its relevance to S.2992 was described on pp. 7-8 of our June 14 statement as follows:

> "As mentioned earlier, an Academy Committee is currently at work on a project which is quite consistent with the intent of this bill as we see it. The Committee on Actuarial Principles and Practices for Pension Plans, after discussion with the Financial Accounting Standards Board, has prepared an interpretation of the Academy's actuarial principles for pension plans which basically sets forth a recommended methodology to be used in determining the value of accrued benefits in connection with the actuarial values to be associated with the financial statement required by Section 103(b) of ERISA. While the

Senator Lloyd M. Bentsen -2- July 14, 1978

Academy does not believe it is necessary or appropriate to include this actuarial value as part of the ERISA financial statement, that decision is the prerogative of the FASB and we are merely complying with their request that a reasonable method of determining such liability be developed by the actuarial profession. This particular paper is in the final stages, and at this point we do not know whether the FASB will accept the recommendations or not. In any event, as soon as the paper is finalized we will see that the Subcommittee is provided with a copy of it".

The second is "The Report of the Pensions Research Accountants Group on Financial Reports for Pension Funds" released jointly by the National Association of Pension Funds and the Pensions Research Accountants Group in Great Britain. This document was mentioned on p. 12 of our June 14 statement as follows:

'As a matter of related interest, we will be submitting as part of our more complete statement a pension discussion document prepared by a research accounting group in the United Kingdom dealing with financial reports for pension funds. One of the major conclusions of this accounting research group is that a part of the comprehensive report which the Trustees should provide to participants in the plan should be prepared by the actuary regarding the overall funded position of the plan. It notes particularly that this should be presented in parallel with, rather than part of, the financial statement prepared by the accountant. We would certainly endorse this approach with regard to the preparation of statements under ERISA and would be very pleased to review further proposals regarding the manner in which this might be implemented".

In closing, we are pleased that we were able to provide these two additional documents to the Subcommittee in time for inclusion in the record. The Academy stands ready to participate in further deliberations on S.2992 and related legislation. Thank you for your consideration of these materials.

Respectfully yours,

Stephen G. Kellison

Stephen G. Kellison

SGK:gdb

cc: Mr. Edwin F. Boynton
Mr. Preston C. Bassett

notes on pensions number 6

A Discussion Document

The Report of the Pensions Research Accountants Group on Financial Reports for Pension Funds

A Joint NAPF/PRAG Publication

Financial Reports for Pension Funds

FOREWORD

PRAG: A Discussion Document

The NAPF have been delighted to agree with the Committee of PRAG – the Pensions Research Accountants Group – that in order to assist in the circulation of their Report on the preparation of Pension Fund Accounts, it should be included in the Notes on Pensions Series and issued to all members.

Although PRAG includes a number of NAPF members it is independent of the NAPF. Nevertheless we consider this report of such importance that we decided to circulate it to all NAPF members as a Discussion Document.

In this way we hope that the Report will achieve wide circulation amongst the various responsible professional bodies. Hopefully, it may prove possible that a mutually agreed code of practice as to the manner of Pension Fund Accounting can be established, setting out the separate and joint responsibilities of Auditors, Actuaries, Pension Fund Managers and Trustees.

K. G. SMITH
Chairman

CONTENTS

SUMMARY OF CONCLUSIONS

1. Occupational pension schemes in the United Kingdom have grown very rapidly to a position of national importance, but their financial reporting methods have not developed correspondingly.

2. The traditional balance sheet produced by accountants is a source of confusion. PRAG suggests that it be replaced by a net assets statement.

3. As part of a comprehensive annual report trustees should provide members of the scheme and other interested parties with a suitable report from the fund's actuary on the overall financial situation. This should be presented in parallel with, rather than as part of, the financial accounts.

4. Adopting these proposals would help to solve the present demarcation problems experienced by auditors and actuaries, to the advantage of all concerned.

5. Members of schemes should normally be offered a simplified report, with access to the full version on request.

6. Trade unions recognised by the employer should be provided with full information about the scheme.

7. Where insurance policies form a means of funding, periodical valuations are required in order to provide more satisfactory financial reports on such schemes.

8. An adequate report on the fund's investment objectives and achievements is essential. PRAG's proposed format for the annual accounts provides a good framework for such a report.

INTRODUCTION

1. Pension funds occupy a prominent place of increasing importance in the national economy; almost half the working population is in membership of occupational pension schemes, the benefits and contributions of which are now key features of industrial negotiations. However this increasing social and economic impact has not been matched by work in the field of pension fund reporting and many of those most closely involved have for some time considered this to be an unsatisfactory situation.

2. It was considerations such as these that led to the formation in July 1976 of the Pensions Research Accountants Group ('PRAG'). Those attending the first meeting adequately represented most professional interests likely to have views on how pension fund reporting might be improved. Both public and private sector schemes were represented as well as those with professional involvement in the actuarial valuation and auditing of pension schemes. This nucleus of people quickly agreed that there was much work to be done if a new impetus is to be given to pension fund reporting and the first task should be to publish a study on the annual reports of pension funds.

3. The inaugural meeting was accorded an appropriate degree of publicity in the professional press and enquiries were received from some who were not present but none the less had something to offer the project. As a result five working parties, selected to cross professional boundaries, were formed with clearly defined areas of research; their preliminary findings were subsequently sifted and collated by a drafting committee. The recommendations made in this study therefore represent a consensus emerging from a wide range of professional interests over the past 12 months.

4. This – the first report of PRAG – is addressed primarily to practitioners with responsibility for pension fund reporting and accounting; but the Group hope that its conclusions will be of interest to pension fund trustees, to those with managerial responsibility for pension administration, to trade union representatives (who are paying an increasingly active role in pension fund matters) and, not least, to members and students of those professional bodies which require an understanding of pension fund reporting. The underlying purpose of this research is to influence thinking and the development of accounting for pension funds. It is seen as a logical development from the Government's White Paper on the disclosure of information and member participation (Cmnd. 6514).

5. The Group readily acknowledges the support of individual members, and of their employers, in the production of this study; its conclusions and recommendations should not however be regarded as representing their individual views.

HISTORICAL BACKGROUND TO PENSION FUND REPORTING

6. Occupational pension schemes in the United Kingdom have largely been a development of the twentieth century. Prior to this time pension arrangements, if any, were usually on an ad hoc basis, although there were notable exceptions; for example a comprehensive non-contributory Civil Service scheme was established in 1834. Since the 1930's there has been a phenomenal growth in the spread of occupational pension schemes and recently there were estimated to be about 20,000 employers who have schemes with ten or more members.[1]

7. Employee involvement in the running and trusteeship of schemes has traditionally been minimal, particularly in the private sector. However, historically a number of private sector companies have taken a paternalistic attitude and given priority to the welfare of their employees, in particular by looking after their interests long after they have ceased to be in employment.

8. From a legal point of view most schemes are trusts and under trust law trustees are accountable to the beneficiaries of their trusts. In addition pension arrangements are forming an increasingly important part of employees' conditions of employment. Although the practice was normally to prepare audited accounts, it was not usual for copies of these or any form of trustees' report to be available to the beneficiaries. Of course there have always been a significant number of exceptions, particularly where the trustees had a duty under the rules to circulate certain financial and other information to members. (This particularly applied to those schemes which were registered under the Superannuation and Other Trust Funds (Validation) Act 1927).

9. The special nature of pension funds has to some extent been recognised by the professional accounting bodies, and the latest advice from the Institute of Chartered Accountants in England and Wales to practitioners, is set out in recommendation N21. However, this recommendation was issued in 1960 and since then the pensions industry has seen substantial development in step with the march of social and economic events.

[1] Department of Employment Gazette – May 1977

CURRENT THINKING ON PENSION FUND REPORTING

10. The Occupational Pensions Board (OPB) in its report on the question of Solvency, Disclosure of Information and Member Participation in Occupational Pension Schemes (Cmnd.5904) pointed out the lack of specific legal requirement as to disclosure of financial information and recommended that on request each member and beneficiary of a pension scheme (unless fully insured) should be given a copy of an annual report which should contain the annual accounts, the auditors' report, details of the scheme's investments, a certificate prepared by the actuary at the latest valuation, showing the extent to which accrued benefits would be secured on the immediate discontinuance of the scheme, and a statement by the actuary giving his recommendation, at the most recent valuation, on the rate of contribution to be paid, the bases used in making this recommendation, and the level of funding which this was intended to achieve. It was envisaged that all this information would be presented in a form laid down by the Board.

11. The Government, in accepting these recommendations, also felt that the annual report should indicate, in general terms, the investment policy being followed.[2] They have since indicated that in practice they propose to leave the form and content of the annual accounts to be settled by the professional accounting bodies.

12. The Employment Protection Act, 1975 gave independent trade unions a right to information necessary for collective bargaining. In some circles the present thinking is that the right to receive a pension in retirement from an occupational pension scheme is deferred pay and should fall within the scope of collective bargaining. This is certainly the view of the Trades Union Congress who in their book on occupational pension schemes[3] stated:

> 'Pensions, in the past, have too frequently been regarded as a gift granted in respect of long and faithful service as an act of benevolence by the employer. This view is unacceptable to trade unionists but pension schemes developed under the influence of such attitudes, and there remains a heavy legacy from the past which at present too often prevents their proper use. This is now changing, largely due to the influence of trade unions but supported by legislation such as the Social Security Pensions Act. Money set aside to provide for future benefits is as much earnings of the worker as the money in his wage packet. Pension schemes therefore should be the result of freely negotiated joint decision by a group of workers to set aside part of the income currently available to them and to save it, collectively, for their future use'.

This obviously supports the idea that financial information should be available to recognised unions as well as to members.

[2] Command 6514 — Occupational Pension Schemes
The role of members in the running of schemes

[3] Occupational Pension Schemes — A TUC Guide

13. In view of the interest being shown by the various parties already mentioned, the Group set out to ascertain whether the members of schemes generally showed interest in accounting information. A survey among Group members produced remarkably consistent findings which were:

(a) when abbreviated accounts were issued to members with an offer to supply the full version no requests were received;

(b) members did not understand why, with the apparently large amount in the fund, there could be any difficulty about giving much needed current pension increases.

This seems to bear out a general impression that, as presently constructed, pension scheme reports give little satisfaction.

PRINCIPLES GOVERNING PRAG'S APPROACH

14. Before summarising what the Group thinks is good practice, it is right to outline the considerations which have shaped the proposals.

15. First, it is taken for granted that UK pension schemes are, for the most part, funded rather than pay-as-you-go, and will remain so in the foreseeable future. Hence it will continue to be important for any financial reporting system to deal with the solvency of the scheme. This means presenting figures derived from two rather different disciplines: accountancy and actuarial, and differing opinions are held as to their relative scope and emphasis.

16. The Group takes as its starting point the relationship between the trustees and the other interested parties (mainly the members and the employer). The trustees are regarded as the principal party; they employ the scheme's officials (at least functionally) and they are effectively the client so far as auditors and actuaries are concerned. Hence, the OPB's suggestion that the framework of the financial report should be a trustees' report, with the other necessary components attaching thereto, is entirely helpful. In the Group's view if each party's relationship to the trustees is clear, there should be no demarcation problems between the various professional advisers.

17. This leads to the conviction that actuarial information should be presented in parallel with, rather than as part of, or subordinate to, the accounting information, and that the auditors' report should not normally refer to the substance of the actuarial report. Whilst emphasising that this seems the only practical way forward, the Group notes that amongst a number of auditors there is the sincerely held view that despite anything the client (i.e. the trustees) may say, the auditors' own professional standards will compel them to review the actuarial information (and presumably to comment if necessary) on the grounds that their name will be associated with the whole set of financial statements in the minds of members and other users. The Group is bound to acknowledge that the exercise of independent judgement by professional men has been a force for good in the regulation of commerce. In this case, however, the result has been considerable misunderstanding and confusion about the financial affairs of pension funds.

18. The Group believes the focus of confusion has been in the use of the conventional balance sheet, where the reader may be misled into thinking that for a pension scheme the balance sheet describes the 'state of affairs'. Indeed it has often been the endeavour of the auditors to report whether the balance sheet represents a 'true and fair view of the state of affairs' of the scheme. Such an approach which is derived too slavishly from Companies Acts requirements is inappropriate and, in practice, harmful.

19. The annual accounts of a commercial organisation are designed to show how the company has managed its affairs during the review period and whether it has generated a profit or a loss as a result of its activities. Its balance sheet is a 'snapshot' of its financial position on a particular date. Accounting practice has focussed on 'state of affairs' reporting to shareholders and company auditors have very properly emphasised the importance of this concept in the phrasing of their audit reports.

20. These concepts are meaningless in the management or understanding of pension funds, which occupy a fundamentally different position from commercial organisations. Pension funds are essentially devices for matching long term commitments to pay pensions and other benefits with the assets which will create the financial capacity to meet these long term liabilities. A pension fund's liabilities cannot be determined by conventional accounting practice, nor can the fund be adequately described in accounting terms which pay attention to facts rather than probabilities.

21. The underlying financial position of a pension fund is revealed in the actuarial valuation report which is concerned with the ability of the fund to meet its long term liabilities. As part of this process the report may show that the fund is in 'surplus' or 'deficit' — but these terms are not used in the normal commercial sense — they indicate a probability rather than an accounting certainty.

22. Since the objectives of pension funds are so fundamentally different from those of commercial organisations it is unrealistic and unfair to expect them to report on a commercial basis. The Group holds the view that the short term financial reporting arrangements for pension funds should be designed to show how the trustees have discharged their responsibility for the stewardship of the money under their control and the way in which the assets of the fund have been managed and deployed. These aspects can be incorporated in accounts comprising an income and expenditure statement together with statements showing net assets movements and net assets, all of which are described in greater detail in the next section. These reports have been designed to show those things which are most relevant to the particular accounting period and the Group is content to leave the actuarial valuation report to bring out the long term financial position of the fund.

23. While the Group earnestly commends the general approach outline in this report, it does not suggest that a standard presentation is appropriate or desirable. For the present, experiment deserves to be encouraged to discover what the users of financial statements find understandable and helpful.

24. In summary therefore the Group believes that the annual report of a pension fund should comprise the following:

(a) Trustees' report

(b) Actuarial report

(c) Accounts

(d) Auditors' report

25. The above documents may well be lengthy and complex. The Group therefore commends the practice of preparing a simplified report for issue to the members of the scheme the aim of which should be to communicate to members in a simple and straightforward manner the financial position of the fund. In particular, it should show how the income of the fund is disbursed, and invested, and reassure the members that the fund is being properly managed. The simplified report should comprise an abbreviated version of the income and expenditure account, together with

the net assets movements and net assets statements indicating the split of investments. A brief resumé should be made of the reports of the trustees, the actuaries and the auditor of the fund. Whilst we commend the practice of making a simplified report available to all members, this should not preclude any member who so wishes, from obtaining a copy of the detailed annual report.

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ANNUAL ACCOUNTS AND AUDIT

26. As already indicated, the stewardship concept of pension fund accounts can be demonstrated by an account which records the income and expenditure during an accounting period together with statements of changes in net assets during the period and of net assets at the end of that period. An example is given in Appendix 1. An advantage of this presentation is that the information disclosed corresponds simply with the investment section of the trustees' report, showing the way in which the assets and money available for investment have been deployed in pursuance of the investment policy.

27. The presentation of the information to be given in the accounts and its completeness are of vital importance. As the accounts may be read by members of pension schemes they should be presented in a form that is readily understandable by them. The terminology should not be capable of misinterpretation and words with a particular accountancy meaning should be explained. The accounts should set out to be informative and care should be taken in deciding the information to be included in annexed explanatory notes.

28. The suggested minimum information to be given in an income and expenditure account is as follows:

- (a) Contributions, divided between members and employers; special payments and voluntary contributions to be shown separately.
- (b) When charged to the fund, administration costs including professional fees split between operating and investment costs.
- (c) Transfers to and from other funds. Because the actuarial basis of computation varies, individual, transfer club payments and bulk transfers to be shown separately.
- (d) Benefit payments divided between pensions, lump sum retirement benefits, lump sum death benefits, refunds, etc. so that the utilisation of the funds can be seen.
- (e) Investment income divided in the same manner as the investments.

29. The net assets movements statement is a simple document setting out the overall changes in the fund's net assets during the accounting period.

30. The net assets statement presentation recommended in this study does not require any change in the customary manner of recording the transactions of the fund in its books of account. So far as accounting disclosure is concerned the degree to which assets should be detailed in the assets statement is a matter for the trustees to decide; a minimum requirement is likely to be a statement which provides an analysis by different types of investment together with a clear indication of the liquidity of the fund, and Appendix 2 suggests a division which is likely to be sufficient in such cases. Some trustees may wish to go much further and to publish a detailed breakdown of their investments to the point where individual holdings are disclosed.

31. Traditionally, pension funds have tended to use book costs as the basis on which assets should be shown. Whilst book costs are readily available, and can be derived in a very simple manner from the normal accounting records of the trustees, an increasing number of pension fund accounts are showing assets based on market values. It is argued that current market values are more appropriate since they have a direct relevance to the current economic situation, whereas book costs merely display an accident of history which is quite irrelevant to the current financial health of the fund. Although the Group has a preference for a current market value method of presentation, it is mindful of the difficulties in determining market values for some assets such as properties and insurance policies.

32. The Group considers it essential that the consequences of a fund investing in insurance policies should be disclosed in the annual accounts. This may well involve procedures which, hitherto, have not been customary, especially in the establishment of realistic values for the purpose of the net assets statement. The suggested accounting treatment and procedures are given in Appendix 3.

33. In the particular case of leasehold property, adoption of the market value basis for the annual accounts does not invalidate the conventional system of recording cost and amortisation figures in the books of account. However, the amount set aside for amortisation for the year does not appear separately in the accounts, being subsumed in the figure for change in market value.

34. Although it can be expensive to have a valuation of certain assets such as properties and insurance policies, it is recommended that all such assets should be valued at least every three years — the basis used being explained in the accompanying notes to the accounts.

35. Irrespective of the method by which the assets are introduced into the net assets statement, the supporting notes should show, comparatively, both book cost and market values, so far as the figures are available. Where a full schedule of investments is not given, it is desirable to disclose any investment amounting to more than 5% of the total assets of the fund (by market value). If the fund owns more than 5% of a particular business this should also be disclosed.

36. The other net assets of the fund will need adequate disclosure in the notes if not in the net assets statement. A note should disclose balances with the employer and any investments in the employer's business, including property on lease and loans (indicating whether or not secured).[4]

37. The amount of money held on trust by the trustees awaiting the exercise of their discretion (e.g. lump sum death benefits) should be shown as a note to the accounts if not already disclosed separately in sundry creditors.

38. A statement of accounting policies is axiomatic and should be drawn up in simple terms. This statement should follow immediately after the accounts, ideally

[4] Occupational Pensions Board Memorandum 43 (paragraph 44)

on the page opposite. The statement should cover those areas that might be accorded differing treatment and where relevant the following information is considered essential:

(a) Whether the accounts are prepared on an accruals or cash basis.

(b) Where asset market values are shown, the method of assessment of these values; for example a mid market basis of valuation of quoted securities and the basis on which any premium content of overseas stocks has been included.

(c) The method adopted for asset amortisation.

(d) The treatment of foreign currency conversions.

(e) Changes in accounting policies.

39. The Group supports the usual accounting custom of showing in the accounts comparable figures for the previous period. Where, due to a change in circumstances or to a change in accounting policy, a comparison of the figures for the two periods does not provide a fair indication of what has happened, an explanation should be provided by way of note to the accounts. Some funds have made a practice of including in their accounts a historical summary of the figures in the income and expenditure account. The Group is not convinced that, given inflation, such summaries are generally meaningful but would favour experiments in presentation technique whereby the long term trends underlying any fluctuating investment results could be brought out, thereby avoiding over-emphasis on the results for a particular period.

40. The Group recommends in paragraph 48 the inclusion of a statement of the actuarial position in each annual report. It is essential that a reference to this statement is included in the annual accounts and the following example is suggested:

> 'These accounts record the transactions of the XYZ Pension Fund during the period ended............and they give details of the net assets at the end of the period. For a statement of the long-term financial position, reference should be made to the actuarial statement on page..........'

The current practice of including an all too brief summary of the actuarial position as a note to the accounts would not then be necessary.

41. The responsibility for issuing accounts lies clearly with the trustees, and this fact should be formally acknowledged by their signing the net assets statement. Depending on whether the fund has individual or corporate trustees, the statement should be signed by at least two persons, being either directors of the corporate trustee body, or individual trustees of the scheme.

42. Having considered the accounting aspects of pension funds we now turn to the role of the auditors whose responsibilities can be summarised as follows:

(a) Reviewing compliance with appropriate legislation, Inland Revenue approval and the requirements of the trust deed and scheme rules.

(b) Reviewing the adequacy of internal control and systems.

(c) Ascertaining that transactions have been duly authorised.

(d) Examining and reporting on the annual accounts.

(e) Examining the data supplied to the actuary as the basis of periodic valuations.

A more detailed summary of the work normally covered in audit programmes is given in Appendix 4. It is of course open to the trustees to request the auditors to perform additional work and to report thereon.

43. The Group believes that the auditors' responsibilities should relate primarily to the stewardship of the assets. With this in mind they recommend that the auditors' report should be broadly as follows:

> 'In our opinion the accounts on pages.......to.......give a true and fair view of the transactions of the fund for the period ended..................and of the disposition of the fund at that date'.

44. The auditors should take note of the latest actuarial report and review the extent to which the trustees have adopted the actuary's recommendations arising from both the periodic valuations and other advice given from time to time. Failure to comply, together with the reasons, should be noted in the accounts. If such failure is not disclosed the auditors may be expected to refer to the fact in their report.

ACTUARIAL REPORT

45. In paragraph 24 the Group recommends that the actuary to a pension fund should provide a separate report to the trustees of the fund for inclusion in the annual report. In particular it was concluded that, although the actuary is normally engaged by and reports to the trustees and employer, the beneficiaries of the trust should have the right to a statement of the conclusions and agreed recommendations contained in the actuary's formal report.

46. To prevent any misunderstanding, the actuary's report to members should be phrased in a way which would avoid the use of technical and emotive terms. In particular the actuary should avoid terms such as 'deficiency' or 'surplus' without defining what he means. In making a valuation the actuary has to make a large number of assumptions about the future (such as future rates of investment return and salary increases) and therefore any deficiency or surplus is only meaningful if all the major financial assumptions made are given. An objective test of a fund's solvency is by reference to the position if it were to be wound up and it is thus normally helpful in the report to members to make a reference to the discontinuance position, in addition to the going concern position. In this connection the Group believes that care should be taken not to imply that a fund which can just meet the discontinuance liabilities is fully funded; it is, therefore, considered undesirable to publish a precise percentage figure which purports to show the degree of funding.

47. The actuary's report should state the planned amount of the funding required in order to enable the fund to meet its present and future liabilities. If the employer is not making funding arrangements which are acceptable to the actuary, this should be stated in the report to the beneficiaries, as they are the persons affected.

48. Following a formal valuation and the acceptance of the actuary's formal report and recommendations by the trustees and employer, the actuary should present to the trustees a statement for publication in the fund's next annual report. As a minimum this should contain the following elements:

(a) A valuation was carried out at (date).

(b) A stated rate (or rates) of contributions to the fund which has (have) been recommended by the actuary to meet the fund's liabilities and has (have) been accepted by the employer.

(c) A statement as to whether or not the assets of the fund at the valuation date were adequate to meet the accrued liabilities for benefits incurred by that date and if not what action, if any, was required to meet the shortfall (including a statement as to what is meant by accrued liabilities and how it is assumed they will be secured).

(d) That the next valuation under the rules is due at (date).

49. If required by the trustees, the content of the report could be wider than the minimum described above. It could, for example, include details of the actuarial method and bases used for the valuation and any major events since the previous

valuation which have had a significant effect on the financial position of the fund. A summary of the full valuation report might be suitable in some cases.

50. Full actuarial reports are normally prepared triennially unless a major event has occurred which required the trustees (or employer) to commission a full reassessment. For those years where no full valuation is published, it is considered that there should be an up-dated actuarial report, and not merely a statement of the position at the last valuation date without further comment. This report should normally include an approximate indication of the discontinuance position at the year end. For most funds this would only involve the fund's administrator in providing the actuary with a few aggregate statistics. The actuary could then produce a statement similar to that suggested in Appendix 5.

51. The above comments apply in the main to funds providing final pay types of benefit. For other benefit structures, other than fully insured funds, it is recommended that similar considerations should apply.

TRUSTEES' REPORT

52. The Group considers that a trustees' report should provide the facility for disclosure of matters not directly relevant to the annual accounts but yet important enough to be drawn to the members' attention. In addition, the more general information which members would expect to be interested in, such as details of membership, should also be shown. Such a report would accompany the annual accounts in conjunction with the other reports referred to in paragraph 24.

In practice, a 'trustees' report' often takes the form of a report by a Committee of Management, or it may be the report by the pensions manager to the trustees according to the practice of the fund concerned. In the opinion of the Group the trustees' report should be addressed to members, beneficiaries and participating companies, since all these parties have a direct interest in the activities of the fund. Whilst a trustees' report will give more detailed information than the average member requires, unions and consultants representing them will expect to be given full information about the fund.

Such a report should therefore be in addition to, and not replace, any simplified versions of annual reports and accounts distributed to members. In the first instance the report should be distributed to the secretary of each participating company and to each recognised trade union. Members and beneficiaries should be advised that copies are available on request.

53. The Group considered whether any exception on account of size or status of the fund should be accepted, but came to the conclusion that regardless of size, trustees should provide the suggested information, although the quality and method of presentation might be varied to suit the circumstances. Likewise, whether the scheme is contributory or non-contributory and whether it is contracted out of the State scheme, is irrelevant, since the parties concerned have the same degree of interest in the activities.

54. The Group considers that every trustees' report should contain information about the financial background of the fund.

The basis of the employer's contributions should be stated, and whether it is a fixed rate or whether the employer pays the balance of the cost. Any changes in contribution rates should be reported. As is indicated in paragraph 36 the annual accounts should disclose any material indebtedness with, and/or investments in, the employer at the year end. However this may not reflect the situation during the year and if it fails to do so appropriate disclosure should be made in the trustees' report; for example if there is a serious or consistent delay in paying over contributions to the fund by the employer or the lending of money to the employer. Where the employer bears the administration expenses of the fund this fact should be recorded.

55 Because they are matters of general interest to participants of the fund the following should be stated:

(a) The basis of appointment of the trustees and/or the committee of management, with a list of their names. (The same principles would apply in the case of directors of a corporate trustee.) Any changes during the year and the relevant dates should be given. The name and address of the secretary to these bodies should also be shown.

(b) A list of participating employers with changes during the year, if any.

(c) The names of professional advisers, and of all persons to whom the trustees have substantially delegated their investment powers.

56. As the readers of the report need to appreciate the size and activity of the scheme the numbers of members (distinguishing between males and females), pensioners and deferred pensioners should be given, together with changes (deaths, retirements, leavers etc.) during the year.

57. An outline of changes to the rules during the year should be given, split between voluntary changes and those brought about to comply with legislation. For practical reasons these may be covered, as to detail, by referring to the announcements made at the time of the changes. Any discretionary increases in pensions should be stated, with the rates and effective dates.

58. The method of investment should be shown i.e. self administered or insured. If the fund is self administered information on investments should be presented with a description of the investment policy and strategy followed during the year. From the net assets statement exemplified in Appendix 1 a suitable table can be developed for the trustees' report showing the categories of assets at market value at the commencement of the year, the deployment of new money arising within the fund during the year, and the changes resulting from sales and the fluctuation in market values. An example using figures that link with Appendix 1 is given below and it will be seen that these figures reconcile with the market value of the assets held at the year end.

	Market Value 5.4.76	Deployment of money available 1976/77	Change in Market Value	Market Value 5.4.77
	£'000	£'000	£'000	£'000
INVESTMENTS AT MARKET VALUE				
Fixed interest securities	8,481	13,705	1,093	23,279
Equities and convertibles	14,494	(3,203)	4,792	16,083
Short term loans and deposits	1,550	(590)	–	951
Freehold and long leaseholds	16,941	1,194	3,519	21,654
Short leasehold property	1,895	446	(258)	2,083
Annuity policies	851	47	127	1,025
Uninvested	456	(300)	–	156
	44,668	11,290	9,273	65,231
OTHER NET ASSETS	360	(260)	–	100
TOTAL	45,028	11,030	9,273	65,331

(Brackets indicate negative)

In addition, if the trustees have appointed external fund managers then each should be asked to submit for publication a separate report on their investment policy and strategy during the year with reference being made to it in the trustees' report. In the case of an 'in house' manager the information could either be treated similarly or incorporated in the trustees' report.

59. The Group is of the opinion that, interpreted correctly, comparative investment performance measurement offers trustees a useful vehicle for discussing the fund's performance with their investment managers. Whilst the trustees' report should state whether such measurement takes place detailed disclosure of the results might be misleading.

THE FUTURE

60. The Group is very conscious of the fact that this study has done no more than scratch the surface of a subject area which is rapidly becoming more involved. It is considering further research into related subjects such as:

(a) Comparative investment performance measurement methods.

(b) Standardised terminology in connection with pension fund accounting and reporting.

(c) The provision of information by insurance companies as a basis for placing values on pension contracts.

(d) The consideration of presentation techniques to display more effectively the long term trends underlying fluctuating investment results during inflationary periods.

Appendix 1

SPECIMEN ACCOUNTS

X Y Z PENSION FUND

Accounts for the year ended 5 April 1977

INCOME AND EXPENDITURE

1976		1977	
£'000		£'000	£'000
	CONTRIBUTIONS RECEIVABLE:		
1,832	Normal – Members	3,149	
2,840	– Companies	4,881	
54	Special	315	
306	Voluntary Scheme	347	8,692
274	TRANSFER VALUES RECEIVABLE (Note 1)		807
5,306			9,499
	Less		
	BENEFITS PAYABLE		
711	Pensions to retired members	1,413	
153	Lump sums on retirement	631	
184	Pensions and allowances to widows	215	
274	Death benefits	377	
268	Refunds of contributions	302	2,938
139	TRANSFER VALUES PAYABLE (Note 1)		178
36	INSURANCE PREMIUMS – term life assurance		47
3,541	CONTRIBUTIONS *less* BENEFITS		6,336
	INCOME FROM INVESTED FUNDS:		
1,089	Fixed interest securities	1,937	
894	Equities and convertibles	871	
271	Short term loans and deposits	146	
1,336	Freehold and long leasehold property	1,541	
97	Short leasehold property	107	
77	Annuity policies	92	4,694
7,305	MONEY AVAILABLE FOR INVESTMENT		11,030

NET ASSETS MOVEMENTS

1976		1977
34,296	AT 5 APRIL 1976	45,028
7,305	Money available for investment	11,030
3,427	Changes in investment market values during year	9,273
45,028	AT 5 APRIL 1977	65,331

NET ASSETS AT 5 APRIL 1977

1976		1977
	INVESTMENTS AT MARKET VALUE	
8,481	Fixed interest securities	23,279
14,494	Equities and convertibles	16,083
1,550	Short term loans and deposits	951
16,941	Freehold and long leasehold property	21,654
1,895	Short leasehold property	2,083
851	Annuity policies	1,025
456	Uninvested	156
44,668		65,231
360	OTHER NET ASSETS (Note 2)	100
45,028		65,331

Signed on behalf of the trustees

....

....

Appendix 1
Sheet 2

X Y Z PENSION FUND

Notes to the accounts for the year ended 5 April 1977

Note 1 – TRANSFER VALUES

The fund pays and receives transfers on a number of different bases. Details are as follows:

1976			Transfer values 1977	
Receivable	*Payable*		Receivable	Payable
£'000	*£'000*		£'000	£'000
37	*–*	Bulk transfers	401	26
117	*16*	Under transfer club rules	193	63
120	*123*	Individual	213	89
274	*139*		807	178

Note 2 – OTHER NET ASSETS

1976			1977
£'000		£'000	£'000
298	Contributions due from Company		73
25	Bank account working balances		30
70	Sundry debtors: Transfer values	52	
15	Other	5	57
408			160
	less Sundry creditors:		
15	Members' refunds	12	
27	Death benefits	40	
6	Other	8	60
360			100

(Note: Accounting policies would be listed in accordance with paragraph 38 of this report)

Appendix 2

SUGGESTED ANALYSIS OF ASSETS

(a) **Fixed interest securities**
- UK Government
- Overseas Governments
- Industrial:
  - UK
  - Overseas

(b) **Equities and convertibles**
- Equities:
  - UK listed
  - Overseas listed
- Convertibles:
  - Unlisted
  - Listed

(c) **Short-term loans and deposits**
- Loans – UK
- Loans – Overseas
- Deposits – UK
- Deposits – Overseas

(d) **Freehold and long leasehold property**
- Freehold
- Long leasehold
- Property Unit Trusts

(e) **Short leasehold property**

(f) **Insurance policies**
- Annuity
- Other

(g) **Uninvested**
- Bank balance
- Indebtedness re stockbrokers, agents etc.

Managed Funds and Unit Trusts would be shown under an appropriate heading.

Appendix 3

INSURANCE POLICIES

1. This appendix considers how insurance policies might be treated in the annual accounts.

2. In the past schemes have frequently been categorised as 'insured' or 'self administered'. This distinction is now much less clear because:

(a) Many large self administered funds have taken over funds with insurance policies.

(b) Insurance policies have become much more flexible and truly comprehensive insurance of pension benefits has largely disappeared.

(c) Whilst retaining an insurance base some funds which were formerly in the insured camp have increasingly participated in the direct investment market.

(d) The role of the consulting actuary has expanded and extended to many of the former insured schemes, and insurance companies have made their actuarial expertise more readily available to pension funds.

3. Whilst insurance policies form a decreasing proportion of the total assets of the pension funds they are still important and should be reflected in the annual accounts of a fund. In principle the decision to pay a premium to an insurance company is no different from any other investment decision. In general premium payments should be treated as an increase in assets in the net assets statement and if nothing more was done this would result in a gradual build up in the assets statement of the insurance policy at book cost. However, whenever a claim is paid part of this asset is realised and it will therefore be necessary to adjust the asset value downwards from time to time. This can be done on some book cost formula by a process of amortisation or by revaluation on a market value/actuarial basis.

4. Attributing a fair value to an insurance policy is no different in principle from the valuation of other fund investments. It is a function the actuary would need to carry out as part of the regular valuation of the fund and in most cases would be done at least every three years. Between formal valuations a simple net payment adjustment would be a satisfactory method of updating the asset value until the completion of the next full valuation.

5. Slightly different considerations apply in the case of short term insurance. For example, many trustees insure lump sum death benefits on a year to year basis and in this case it is entirely appropriate to show annual premiums paid to the insurer and sums received in settlement of claims as transactions within the income and expenditure statement. Sums received from insurers (such as the proceeds of a policy on its maturity) should be treated in the same way as income from any other sort of investment.

6. Some trustees pass the pension liability on retirement legally and irrevocably to an insurance company. In cases where the liability is so transferred any premium paid will appear as expenditure within the income and expenditure statement and no transaction will appear in the statement of assets. No further record is necessary as the pensioner has no subsequent claim to benefit from the fund even if the insurance company defaults.

Appendix 4

AUDIT PROCEDURES – CHECK LIST

The following check list assumes a properly constituted, funded and approved pension scheme, with separate accounting records, giving rise to accurate accounts, prepared on accepted accounting principles. The recommendations are concerned only with principles and are not intended to represent an exhaustive list of detailed audit procedures.

1. Authority

The auditor should examine and note the terms of the Trust Deed, (including all Supplemental Deeds), rules, Inland Revenue approval, minutes of trustees, investment and any other relevant committees and the record of trustees' appointments and resignations. In particular, the following should be checked while performing the various audit procedures:

(a) That the trust deed and rules have been complied with in all material respects.

(b) That contributions and benefits have been calculated and received or paid in accordance with the trust deed and rules.

(c) That all appropriate transactions have been authorised by minute, and all such authorisations have been complied with.

(d) That relevant legislation has been complied with.

(e) That the appointment and resignation of trustees and committee members has been properly actioned and recorded.

2. Internal control

The auditor should investigate and assess the adequacy of systems in operation, noting particularly the following:

(a) Control over calculation, receipt and subsequent recording of contributions receivable, investment income receivable and any other relevant recurring items which should be received.

(b) Control over calculation, payment and recording of all types of benefits payable and any other recurring payments, noting that such items are properly authorised and actioned promptly.

(c) Control over custody and title of scheme's assets and purchases and sales thereof.

(d) Adequacy of the books of account and of various membership records.

Based upon the outcome of this review, the scope of the required audit testing can be determined and the appropriate action taken if weaknesses are identified.

3. Verification

The volume of testing and precise documents to be examined will vary from scheme to scheme, the following procedures are concerned primarily with the principles involved.

(a) *Receipts in the year*

Ascertain that members and the company have contributed at the appropriate rates.

Ascertain that the scheme's assets have generated the proper amount of income and that gains and losses on sales of investments have been properly treated.

Ascertain that the appropriate amounts have been received from insurance companies.

Ascertain that any other appropriate receipts which are due have been accounted for.

Ascertain that the above transactions have been properly recorded within the scheme's records, including the members' contribution records.

(b) *Payments in the year*

Ascertain that benefits paid were in fact due, have been properly calculated, correctly authorised and paid to the correct person.

Ascertain that benefit payments due have in fact been actioned.

Ascertain that other payments made were proper charges on the scheme or were approved investment transactions, have been correctly authorised and that the correct amounts have been paid to the appropriate persons.

Ascertain that the above transactions have been properly recorded within the scheme's records.

(c) *Year end accounts*

Ascertain that investments represent bona fide assets to which the scheme has good title, are properly classified and correctly shown on a reasonable basis, consistent with previous years. Where appropriate, ascertain that adequate provision has been made for permanent diminution of value.

Ascertain that receivables stated in the accounts are correctly calculated, represent bona fide debtors of the scheme, are properly classified and shown on a basis consistent with previous years and that adequate provision has been made for irrecoverable items.

Ascertain that required receivables are disclosed in the accounts.

Ascertain that significant liabilities of the scheme are stated in the accounts and are properly classified and shown on a basis consistent with previous years.

Where appropriate, confirmation should be obtained from third parties and reference should be made to relevant specialist documents (e.g. Stock Exchange data).

Detailed reviews of the income and expenditure, net assets and net assets movements statements are required.

(d) *Other procedures*

Other relevant procedures must be carried out, depending upon the circumstances. For example, where a scheme holds insurance policies these must be examined, the terms ascertained and scrutinised to ensure that policy requirements have been met.

Ascertain that the operation of the scheme continues to meet Inland Revenue requirements for approval.

4. Actuarial matters

(a) The auditor should be satisfied as to the quality of the membership and other data supplied by the trustees to the actuary as the basis for the periodic valuations.

(b) The auditor should take note of the latest actuarial report and review the extent to which the trustees have complied with the actuary's recommendations and advice.

Appendix 5

REPORT OF THE ACTUARY

1. We made a valuation of the XYZ Pension Fund as at 5 April 1975. As a result of this valuation we have recommended that contributions of x% of pensionable salaries should be paid to the Fund by the Company, in addition to those payable by members, to provide the pensions and other benefits for which the Fund is liable. We have been advised that contributions have been made by the Company at this rate since 6 April 1975.

2. We also considered the position if the Fund had been discontinued as at 5 April 1975. At that date we estimated that the market value of the assets was more than adequate to secure accrued benefits to that date (i.e. pensions in course of payment, deferred pensions in respect of former members and deferred pensions in respect of persons in service based on pensionable salaries and service to the valuation date, without making allowance for any increase to pensions in payment or deferred pensions in deferment other than those guaranteed under the rules).

3. We have not made a detailed examination of the Fund at 5 April 1977, but approximate calculations that we have made indicate that a similar statement to that set out in 2 above could be made as at 5 April 1977.

Appendix 6

CITATIONS AND BIBLIOGRAPHY

	Paragraph
[1] Department of Employment Gazette – May 1977	8
[2] Command 6514 – Occupational Pension Schemes The role of members in the running of schemes	4 and 11
[3] Occupational Pension Schemes – A TUC Guide	12
[4] Occupational Pensions Board Memorandum 43 (paragraph 44)	36
Superannuation and other Trust Funds (Validation) Act 1927	8
Recommendation N21 (1960) – Institute of Chartered Accountants in England and Wales	9
Command 5904 – Report of the Occupational Pensions Board – Solvency, disclosure of information and member participation in occupational pension schemes	10
Employment Protection Act, 1975	12

PENSIONS RESEARCH ACCOUNTANTS GROUP

Formed in 1976, the Group consists of the accountants or managers of some of the leading UK occupational pension schemes, together with practitioners in the actuarial and auditing professions who are interested in the financial administration and reporting of pension schemes.

The Group exists to sponsor research in fields directly of concern to the members and to act as a forum for discussion of current developments.

Although virtually all the funds represented belong to the National Association of Pension Funds, and many of the individuals concerned are members of the Pensions Management Institute, the activities of PRAC and the views expressed are independent of these bodies.

Details of membership may be obtained from the Hon. Secretary

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Mr. KELLISON. At this time we would like to comment on eight areas involved in the bills before the subcommittees.

A. DISCLOSURE OF ACCRUED BENEFITS

Disclosure of accrued benefits to plan participants is addressed by both S. 1745 and S. 3017.

Section 4 of S. 1745 would require a detailed statement of benefits to be disclosed to each participant as part of the summary annual report. ERISA currently allows this information to be provided on a request basis. It should be noted that providing this information to all participants may entail significant administrative costs for many plans. Some plans routinely produce this information, but not all do. Post-ERISA experience has shown that only a small minority of participants ever request such statements in most plans.

Also paragraph (3)(B)(ii) of section 4 would introduce a new concept involving the projection of future benefits. This requirement is a marked departure from current requirements and goes far beyond the disclosure of accrued benefits. Such information is highly speculative for any particular individual, and creates expectations which will not be correct because of the varous uncertainties involved.

The best insight available to employees who wish to project future benefits is a thorough understanding of the benefit formula as it applies to their own particular situation.

The provisions of section 221 of S. 3017 seems to us to be preferable to section 4 of S. 1745. A question could be raised as to the necessity of providing such information to short service, high turnover participants. Although the information is obviously useful, is it worth the cost of providing it? The information is really not very significant until the participant approaches vesting. One compromise approach might be to provide such informaiton on a request basis to any participant within a few years, say 3 or 5, of the earliest vesting date.

Despite our reservations about section 4 of S. 1745, the Academy wishes to commend the report of the Commission on Federal Paperwork. This Commission has been very valuable in focusing attention on the administrative burdens created by ERISA.

B. OPINIONS OF ACTUARIES AND ACCOUNTANTS

Section 226 of S. 3017 would make some fundamental changes in the relative roles of actuaries and accountants, and the Academy strongly endorses this section of the bill. S. 3017 would change voluntary reliance to compulsory reliance in both directions, that is, reliance on actuaries by accountants, and conversely.

Section 103 of ERISA appears to create a division of responsibility between actuaries and accountants. The actuary's report is concerned with such items as the determination of plan liabilities for future benefits and the computations required to determine whether the plan complies with minimum funding standards. The accountant's report is concerned with a proper presentation of the financial status of the pension fund itself. Despite this apparently clear division of responsibility contemplated by ERISA, some differences of opinion have arisen between actuaries and accountants concerning their relative roles under the act. S. 3017 would help resolve these differences.

We also feel that some additional amendments should be made to further clarify the relative roles of the two professions. These amendments are consistent with the division of responsibility between the two professions which we believe was contemplated by ERISA. These amendments are submitted for the consideration of the subcommittees in appendix B.

C. JOINT AND SURVIVOR ANNUITIES

Section 238 of S. 2017 makes to significant changes to the joint and survivor annuity requirements of ERISA. First, the date of applicability is changed to the earliest age at which the vesting percentage is 50 percent or higher. Second, the benefit is no longer optional with the employer, but would be automatic.

Joint and survivor annuities may be socially desirable in protecting family members of a deceased plan participant. However, it is important to note that this provision would mandate additional benefit costs on any employer not already providing these benefits at employer expense. In many instances, the additional cost burden would be significant.

It is also important to remember that the additional benefits being provided are basically life insurance benefits. Many will question the logic of requiring death benefits under the pension plan and not recognizing similar death benefits provided by the plan sponsor under other programs, such as group life insurance plans. A question could be raised as to whether pension plans are the best vehicle to impose a requirement that additional death benefits be provided.

It might also be noted that this provision would place an extra burden on the generosity of those employers who have voluntarily provided more favorable vesting conditions than required by law.

D. FUNDING STANDARD ACCOUNT

Section 251 of S. 3017 would add a new provision concerning computations in the funding standard account. The academy believes that the language proposed in section 251 is confusing and that clarification is needed. We are uncertain as to the intent of this section.

One possible applicability of section 251 would be to a rather common type of 3-year negotiated contract in which the benefit formula contained step rate increases. Section 251 might be interpreted as requiring level dollar rather than step rate funding of these benefits over the 3-year period.

If the intent of section 251 is to require such level dollar, rather than step rate funding, then it would overturn IRS Revenue Ruling 77-2. This revenue ruling clearly sanctions a contribution schedule in step with benefit increases in this context.

We are also puzzled by the last sentence of section 251:

> A provision adopted but contingent on a future event shall be deemed not to be in effect as a provision of the plan prior to the occurrence of that event.

This provision is quite perplexing and seems to be at odds with the rest of the section.

Consider, for example, a plan with an automatic cost-of-living feature. Does this sentence prohibit the actuary from assuming a cost-of-living increase in future benefit projections? If it could be interpreted in that manner, the results would be most unfortunate. Imposing a restriction of this type, while simultaneously requiring the actuary to make his "best estimate," places the actuary in a very difficult position.

E. IMPACT OF INFLATION ON RETIREMENT BENEFITS

Section 273 of S. 3017 provides that the Secretary of Labor study the feasibility of requiring pension plans to provide cost-of-living adjustments.

The academy believes that a cost-of-living requirement involves major actuarial considerations and could result in major cost increases for many plans. Accordingly, if this study is conducted by the Department of Labor, the actuarial profession should be deeply involved in it.

F. PREEMPTION OF SECURITIES LAWS

Section 274 of S. 3017 provides for a preemption of various securities acts as they relate to private pension plans.

The academy has filed an amicus curiae brief with the Supreme Court on the *Daniel* case. This brief primarily addresses the issue of disclosure of the "actuarial probability" of receiving a benefit from a plan.

Secondarily, it also discusses the question of a "sale" of pension plan interests to covered employees. A number of severe actuarial problems would result in both areas, if the lower court decision in the case, as worded, is allowed to stand. These difficulties would be resolved by enactment of Section 274 of S. 3017, and, therefore, the academy strongly supports this section.

G. DEDUCTION FOR EMPLOYEE CONTRIBUTIONS

Section 303 of S. 3017 provides tax deductibility for employees of certain employee contributions to qualified retirement plans. The tax deductibility of employee contributions under qualified retirement plans is a public policy issue. Accordingly, the academy takes no position on this proposal.

However, if Congress decides to provide tax deductibility for employee contributions, the academy does endorse the simple approach of a straight percentage limitation. Other approaches have been suggested, for example, offsets of employer contributions against IRA limits. These other approaches would not only be much more complex to administer, but would also be of questionable validity in view of the contingent nature of benefits derived from employer contributions.

H. UNIFORM ACCOUNTING

The academy has previously submitted extensive testimony on S. 2992. Appendix F is the academy statement presented at the public hearing held on S. 2992 on June 14, 1978.

The following is an extract from this statement:

> In general, the academy supports what we believe is the intent of the bill. However, we believe that further clarification is needed to be sure that this intent is properly carried out. We also believe that to do so would require certain changes in other parts of ERISA and the Internal Revenue Code. We would add further that we believe that the apparent intent of the bill may, in fact, be accomplished without this specific legislation.

Action at the present time on S. 2992 may well be premature. The Department of Labor, together with the FASB, the AICPA and the American Academy of Actuaries have made substantial progress in resolving the issues in this area.

Section III of the written statement proposes two amendments designed to eliminate ambiguities and misconceptions to section 3042 of ERISA concerning enrolled actuaries. Time does not permit us to discuss these amendments today. However, we urge the subcommittees to give consideration to these proposals.

In closing, the academy commends the intention of the introducers of these various bills to resolve the difficulties created by ERISA. Many of the proposals in these bills are highly constructive in this regard. The comments presented in the academy statement are being offered in the same constructive spirit.

Representatives of the academy are available to meet with the subcommittees or staff at your convenience to discuss these, or other, proposals in more detail.

Mr. Bassett and I would be happy to answer any questions you may have.

Senator WILLIAMS. It is an excellent presentation, Mr. Kellison. Your full statement will be not only read, but studied, and will make a major contribution to our continuing deliberations in getting ready to refine our legislation.

Because of the numbers of witnesses, we would like to suggest to you that written questions may be presented for written response, if that would be all right.

Next we will hear from the American Society of Pension Actuaries, and their statement will be presented by Mr. William Cloer.

Mr. Johnson was listed as the witness, but Mr. Cloer is to present the testimony. We appreciate your appearance, gentlemen; please proceed.

Mr. CLOER. Thank you, sir.

We are pleased to be here to testify on these bills.

Generally we support the bill, S. 3017. We think it is well thought out, and the authors clearly understand many of the problems that have been brought about by ERISA.

Our comments contained in our prepared statements, and the ones that we will make at the table this morning will be confined only to those areas that we disagree with the bill, or where we believe amplification is needed.

Senator WILLIAMS. Will you give us the net position of favor and disfavor at some point briefly?

Mr. CLOER. Yes, we will.

We believe that while the idea of an "Employee Benefits Commission" is essentially a good one, and initially may help improve some lines of communication that we may have had at the start, we think right now that it might not be such a good idea at this present time.

We think that the staffs of Labor and PBGC are becoming highly competent and have developed lines of communication with practitioners. The Internal Revenue Service has long had a competent staff.

We think maybe the confusion that might be created by a new agency and loss of momentum at this time by the formation of a new commission might wipe out any advantage that the commission would have at the present time.

We also feel there should be an opportunity to assess reorganization that was presented by the administration on August 10, and division of responsibilities that was recommended by the President.

We emphatically support the elimination of the requirement of an annual distribution of the summary annual report in the bill.

We strongly support the provision of section 226 relating to the reliance by the enrolled actuary or accountant in the other's work product. This area of the law has resulted in undue expense to retirement plans.

Moreover, since there are some accounting firms that employ actuaries, there are documented cases where, unsolicited, actuaries who are members of accounting firms performing audits of retirement plans, reviewed the work of the enrolled actuary retained by the plan and questioned the methods and assumptions used by the plan's enrolled actuary. This review by the accounting firm's actuary creates a clear conflict of interest in addition to substantial unnecessary cost.

We support section 303, which would permit deduction of employee contributions up to certain limits, but feel the section needs modification as follows:

Because of the $1,000 limitation, we can see no reason for reducing the allowable deduction by 20 percent of adjusted gross income in excess of $30,000 per year.

There should be an automatic adjustment to the $1,000 limitation which would take inflation into account. For example, increases in the limitation could correspond to the increases allowed in defined contribution plans under IRC section 415.

We think it is inadvisable to make it mandatory that all qualified retirement plans accept employee contributions. Defined benefit with EE contributions would be two plans, with attendant administrative costs.

Tax credit for employers adopting new retirement plans is a good idea, which we support. However, we can see no reason that the tax credit should be limited to only small employers.

Moreover, we continue to be concerned about the reduction in new defined benefit plans being adopted. Reasons are plan termination insurance and requirement for actuarial certification. We would recommend additional incentives which would apply to defined benefit plans, only as follows: (1) An additional tax credit equal to 20 percent of the credit afforded by act section 304 for defined benefit plans; (2) a change in the plan termination insurance premium structure whereby each plan would pay a nominal flat annual charge and an additional premium that would bear a relationship to the amount by which the present value of vested benefits exceeds plan assets.

Defined benefit plans should be exempt from the requirements of revenue procedures 75–49 and 76–1, which impose 4–40 vesting requirements on plans where the "key employee" test or the "turnover" test cannot be met. The most objectionable element of these revenue procedures is the requirement that total years of service be counted for purposes of 4–40 vesting, rather than the employee's service following the adoption of the plan. This requirement to count years of preplan service can cause a defined benefit plan to have a significant unfunded vested liability on its effective date, and can act as a strong deterrent to the adoption of defined benefit plans.

We see no reason for legislation which would further increase the profusion of special master or prototype plans. We feel that current provisions for protype plans that are adopted by financial institutions—pattern plans which can be submitted to IRS for approval as to form by practitioners, and the so-called multiple-employer plans offer a wide range of plans that can be adopted by an employer.

While master or prototype plans may result in some savings to a participating plan sponsor, they encourage persons who are not qualified to advise sponsors on the long-term impact of retirement plan provisions. In our experience this has resulted in many plan sponsors adopting retirement plans which are inadvisable in relation to the sponsor's circumstances and making inappropriate investments as a result of the misconception that the savings associated with a "form" plan will outweigh the consequences of poor investment performance.

With the creation of the status of enrolled actuary in ERISA, Congress first recognized pension plan practitioners as professionals. Under ERISA, individuals who are able to pass certain tests and have a reasonable period of responsible pension actuarial experience are "licensed" by the Federal Government to certify to retirement plan costs.

Currently, there are approximately 2,800 actuaries who have been enrolled by the Joint Board for the Enrollment of Actuaries. Since this is the sole source of federally sanctioned "expertise" in the pension field, the public tends to regard enrolled actuaries as the only pension professionals qualified to give advice in retirement plan matters.

Actually, only a small percentage of qualified private retirement plans require the services of an enrolled actuary. According to the Internal Revenue Service (IR–1950), only 24 percent of the plans qualified during the period January to September 1977 were defined benefit plans, while the balance were defined contribution plans, which do not require the services of an enrolled actuary under ERISA.

The requirements of most defined contribution plans currently in effect are being met by professional pension plan consultants, who are neither recognized under ERISA, nor regulated, nor required to meet ethical or educational standards.

Consultants most frequently assist the employer in selecting the type of retirement plan, the design of the specific benefit formula, and the calculation of its effect. In addition, consultants work with attorneys in reducing the plan to writing and meeting qualification standards; preparing explanations and the summary plan description; administering the plan, including allocation of a participant's account balances under defined contribution plans and communication of accrued and vested benefit information to participants on an annual basis; completing reports required by governmental agencies; recommending the plan's funding method and providing assistance to the employer during audit.

Since many retirement plans retain the services of both a consultant and an actuary, most pension consulting firms employ both consultants and actuaries. In contrast to the 2,600 enrolled actuaries, there are approximately 10,000 to 15,000 pension consultants providing services to labor and industry, who are neither recognized by the law, nor required to meet uniform standards.

One solution to this problem is to create a form of legal status for qualified pension consultants:

1. Through legislation—Congress could set rules, similar to the rules for enrolled actuaries, which would provide a method for determining the qualification of pension consultants. ASPA would be pleased to offer specific recommendations for enrollment, methods to determine qualification, and rules of conduct.

2. By regulation—IRS could create a status such as the enrolled agent status, which would permit limited practice before the Treasury Department for qualified pension consultants.

The American Society of Pension Actuaries, which began its certified pension consultants program in 1976, and the International Foundation of Pension and Welfare Plans have already addressed the need to establish education criteria. Both organizations are sponsoring graduate level courses of instruction and an exhaustive examination program. During 1977, 535 students sat for ASPA's certified pension consultant exams. Techniques for testing the knowledge of consultants are continuing to be developed and could be accepted in lieu of governmental examinations as evidencing qualification to practice.

The substantial benefit and practical advantage of this aproach is clear. A professional body of pension plan practitioners, who are ethically bound to operate plans within the spirit as well as the letter of the law and who are subject to censure for wrongful acts, would be a most effective extension of ERISA. The pension community could then identify those professional practitioners who have met standards of character and knowledge imposed by an impartial authority. High standards of educational expertise, practical experience, and ethical behavior could be maintained and monitored. The public trust would be assured.

Finally, the majority of qualified retirement plans, which do not require the services of an enrolled actuary, could avail themselves more readily of the services of an individual who had demonstrated a high level of competence, and could engage that pension professional with greater confidence.

We urge, for the benefit of all, serious consideration be given to creating some legal status of providing some government recognition for the pension consulting profession.

We would caution against any legal requirement that private retirement plans automatically respond to increases in the cost of living.

The provision of automatic cost-of-living increases in private pension plans make two dangerous presumptions:

1. That the private sponsored retirement plan is a never-ending entity that will always have a source of contributions; and

2. That there is a relationship between the performance of the investments made by a retirement plan and the cost of living.

As a matter of fact, the retirement systems of private companies cannot be expected to continue indefinitely into the future, in view of industrial, technological, and economic changes in society; and a requirement that would place future unknown liabilities on private concerns would almost certainly act as a deterrent to the adoption of such plans. Experience of the last few years has demonstrated that the market value of equity investments, which are a primary investment of retirement plans, can be severely depressed at the same time that inflation is extreme. It is too soon to know whether inflation will be brought under control. Therefore, to mandate inflation adjustments in defined benefit pension plans would negate the effect of the tax incentives the bill provides for adopting new plans, and would be a serious deterrent.

We would like to offer the services of our society if the study regarding mandatory cost-of-living increase provisions in private retirement plans is undertaken.

We do agree with the Academy's statement on joint survivor annuity position, and also on uniform accounting.

I believe in their official statement we did agree to that.

We will be happy to answer any questions you may have.

Senator WILLIAMS. We may want to put some written questions to you, if that would be agreeable.

We appreciate very much your statement.

On your last point, on the cost-of-living factor, there is a study that is proposed here in the bill, and you have volunteered——

Mr. CLOER. To help in any way.

Senator WILLIAMS. Your attitude is clear, if the study should go forward by the Department, you are available to advise them.

Thank you very much.

Mr. CLOER. Thank you.

[The prepared statement of Mr. Cloer follows:]

STATEMENT
OF
J. WILLIAM CLOER, PRESIDENT,
WILLIAM W. HAND AND HOWARD J. JOHNSON,
CO-CHAIRMEN LEGISLATIVE AFFAIRS COMMITTEE
AMERICAN SOCIETY OF PENSION ACTUARIES
BEFORE THE
SUBCOMMITTEE ON LABOR OF THE SENATE
HUMAN RESOURCES COMMITTEE
AND THE
SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS
OF THE
SENATE FINANCE COMMITTEE
AUGUST 17, 1978

The American Society of Pension Actuaries is a national professional society consisting exclusively of pension plan actuaries and consultants. Our more than 1,500 members provide actuarial, consulting and administrative services to approximately 25% of the qualified retirement plans in the United States.

Our Society is pleased to be able to offer comments on S. 3017, a bill which we have already supported in our statement to the Subcommittee on Labor Standards, Committee on Education and Labor, U.S. House of Representatives on June 15, 1978.

In general, S. 3017 is a bill which if enacted will make significant improvements in the private pension system. The bill, however, is so extensive that we have limited our statement to those provisions relating to retirement plans which we feel require supplementation, or which should be added to the bill, or where we disagree with a provision of the bill.

We also wish to take this opportunity to offer the resources of our Society if the study regarding mandatory cost-of-living increase provisions in private retirement plans is undertaken.

CONSOLIDATION OF FEDERAL AGENCY
RESPONSIBILITIES FOR EMPLOYEE BENEFIT PLANS

While ultimately, the idea of an "Employee Benefits Commission" which would be a single agency charged with responsibility for administering the laws with respect to retirement plans may be a good one, we feel the formation of such an agency is premature. For many years, the Internal Revenue Service has done an outstanding job of administering the private pension system and has created a large team of highly trained specialist in the Employee Plans and Exempt Organizations branch. While neither the Labor Department nor the Pension Benefit Guaranty Corporation had such highly trained staffs at the time ERISA was enacted, in the almost four years since its passage, they, too, have developed personnel who are knowledgable with respect to the specific requirements of their areas of responsibility and the private pension system in general.

It is possible that a portion of this trained personnel would not be transferred to the Commission but rather would be reassigned to other positions within their current agency. Employers and their professional advisors, such as pension actuaries and consultants have developed a reasonably high degree of confidence and liason with the personnel of the various agencies and are just now beginning to work comfortably within the regulatory framework developed as a result of ERISA. The confusion and loss of momentum that would be caused by formation

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of a new agency at this time would, in our opinion, out-weigh its possible long-term advantages.

Furthermore, there should be an opportunity to assess the reorganization plan presented by the Administration on August 10, 1978. In fact under the reorganization plan the Administration has assumed the responsibility to evaluate the reorganization by 1980.

ELIMINATION OF SUMMARY ANNUAL REPORT

We emphatically support the proposal that would eliminate the requirement for distribution of copies of the summary annual report to each plan participant each year. Experience of practitioners has been that few employees who are participants in retirement plans are interested in the information contained in the summary annual report and that the expense of duplicating the form and distributing it to participants is almost totally unnecessary. The summary plan description could contain a notice describing the summary annual report, advising the plan participant of its availability from the administrator and of the charge for its reproduction.

OPINIONS OF ACTUARIES AND ACCOUNTANTS

Our Society strongly supports the provisions of Act Section 226 relating to the reliance by the enrolled actuary or accountant in the others work product. This area of the law has resulted in undue expense to retirement plans. Moreover, since there are some accounting firms that employ actuaries, there are documented cases where, unsolicited, actuaries who are members of accounting firms performing audits of retirement plans, reviewed the work of the enrolled actuary retained by the plan and questioned the methods and assumptions used by the plan's enrolled actuary. This review by the accounting firm's actuary creates a clear conflict of interest in addition to substantial unnecessary cost.

CERTAIN EMPLOYEE CONTRIBUTIONS

QUALIFIED RETIREMENT PLANS

The United States private pension system has been behind the systems of many other countries for many years because deductions of employee contributions to such plans have not been allowed. For this reason, we strongly support Act Section 303 which would permit deduction by the employee of certain contributions made to qualified plans. Our Society believes that such deduction would provide a strong incentive to establish and maintain tax qualified retirement plans. However, because of the maximum $1,000.00 limitation, we see no reason for reducing the allowable deduction by 20% of adjusted gross income in excess of $30,000.00 per year. Further, if inflation continues at its present rate, the $1,000.00 limit will be inadequate in relation to the retirement needs of American workers in the very near future. We would suggest inclusion of a proviso that would permit an increase in the $1,000.00 limit, perhaps to correspond with the "cost-of-living" increases prescribed in the Internal Revenue Code Section 415 limitations. Finally, the requirement that all qualified retirement plans accept employee contributions may add to the employer's administrative burdens and costs. Our Society recommends that this requirement be eliminated.

CREDIT FOR THE ESTABLISHMENT OF
QUALIFIED PLANS BY SMALL EMPLOYERS

Offering a tax credit for small employers adopting new retirement plans, or improving existing plans is a necessary first step in providing incentives that will help restore the momentum that was slowed by the enactment of ERISA for adoption of new plans.

Our Society, however, continues to be concerned over the alarming reduction in the number of new defined benefit retirement plans adopted since the enactment of ERISA. A number of factors have contributed to this reduction in defined benefit plans as a result of ERISA. Among the factors are the following: (a) required premium payments to the Pension Benefit Guaranty Corporation, (b) the contingent liability exposure of an employer who, because of business necessity, finds that it must terminate a plan, and (c) the expense attendant to certification of plan costs by an enrolled actuary.

Defined benefit plans are the only type of retirement plan under which it is possible to design a retirement benefit that bears a specific relationship to the employee's working compensation. While not all employees are best served by defined benefit plans, it is possible to create equity with a defined benefit plan whereas it is not always possible with a defined contribution plan. Perhaps some evidence of this is the fact that virtually all governmentally sponsored retirement plans are defined benefit plans.

With this in mind, there is a need for special incentives for employers to adopt defined benefit plans, that will help to offset the increased expenses of their operation. In this regard, we would recommend the following:

1. An additional tax credit equal to 20% of the credit provided under Act Section 304 could be extended to employers who adopt new defined benefit plans, as opposed to defined contribution plans;

2. Premiums paid to the Pension Benefit Guaranty Corporation could be structured in such a way that each plan pays a flat annual charge and an additional annual charge based on a percentage of the amount by which the present value of vested benefits exceed plan assets or, the plan's termination liability determined according to PBGC tables. This would cause those plans which have significant unfunded vested benefit liabilities to bear a greater and more equitable proportion of the insurance risk which in fact is created by such plans;

3. Defined benefit plans should be exempt from the requirements of IRS Revenue Procedures 75-49 and 76-1. Such plans should be permitted to qualify under the Internal Revenue

Code with the election of any of the three statutory vesting schedules contained in the Code and without being subjected to the "key employee test" or the "turnover test". The most objectionable element of these IRS revenue procedures is the apparent requirement that total years of service with the employer be counted for purposes of "4-40" vesting, rather than merely the employee's length of service following adoption of the plan. The requirement to count years of pre-plan service can cause a defined benefit plan to have a significant unfunded vested liability on its effective date and can act as a strong deterrent to the adoption of defined benefit plans.

SPECIAL MASTER OR PROTYPE PLANS

We can see no reason for legislation which would further increase the profusion of "special master or prototype plans". There are already provisions in the law and regulations for (a) prototype plans adopted by financial institutions, which can be joined by individuals and employers wishing to join them, (b) "pattern" plans which can be submitted to IRS offices by certain practitioners for approval as to form and, (c) so-called "multiple-employer plans" which can be joined by unaffiliated participating employers wishing to participate in the benefits offered by group participation in such plans. While such master or prototype plans may result in some savings to a participating plan sponsor, they encourage persons who are not qualified to advise sponsors on the long-term impact of retirement plan decisions. In our experience, this has resulted in many plan sponsors adopting retirement plans which are inadvisable in relation to the sponsor's circumstances and making inappropriate investments as a result of the misconception that the savings associated with a "form" plan will out-weigh the consequences of poor investment performance. The complexity of the private retirement plan system as a result of over fifty (50) years of law, the substantial number of options available to plan sponsors, actuarial considerations and ERISA, have created a situation where the greatest need is for a group of professional pension practitioners who are trained in the subject and ethically or legally required to act in conformance with governmental requirements and the public's best interests.

LEGAL STATUS FOR PENSION CONSULTANTS

With the creation of the status of enrolled actuary in ERISA, Congress first recognized pension plan practitioners as professionals. Under ERISA individuals who are able to pass certain tests and have a reasonable period of responsible pension actuarial experience are "licensed" by the federal government to certify to retirement plan costs.

Currently, there are approximately 2,800 actuaries who have been enrolled by the Joint Board for the Enrollment of Actuaries. Since this is the sole source of federally sanctioned "expertise" in the pension field, the public tends to regard enrolled actuaries as the only pension professionals qualified to give advice in retirement plan matters. Actually, only a small percentage of qualified private retirement plans require the services of an enrolled actuary. According to the Internal Revenue Service (IR-1950), only 24% of the plans qualified during the period January-September, 1977, were defined benefit plans while the balance were defined contribution plans, which do not require the services of an enrolled actuary under ERISA. The requirements of most defined contribution plans currently in effect are being met by professional pension plan consultants, who are neither recognized under ERISA, nor regulated, nor required to meet ethical or educational standards.

Consultants most frequently assist the employer in selecting the type of retirement plan, the design of the specific benefit formula and the calculation of its effect. In addition, consultants work with attorneys in reducing the plan to writing and meeting qualification standards, preparing explanations and the Summary Plan Description, administering the plan, including allocation of a participant's account balances under defined contribution plans and communication of accrued and vested benefit information to participants on an annual basis, completing reports required by governmental agencies, recommending the plan's funding method and providing assistance to the employer during audit. Since many retirement plans retain the services of both a consultant and an actuary, most pension consulting firms employ both consultants and actuaries. In contrast to the 2,600 enrolled actuaries, there are approximately 10,000 to 15,000 pension consultants providing services to labor and industry who are neither recognized by the law nor required to meet uniform standards.

Recommendation

One solution to this problem is to create a form of legal status for qualified pension consultants:

1. Through legislation - Congress could set rules, similar to the rules for enrolled actuaries which would provide a method for determining the qualification of pension consultants. ASPA would be pleased to offer specific recommendations for enrollment, methods to determine qualification and rules of conduct.

2. By regulation - IRS could create a status such as the enrolled agent status, which would permit limited practice before the Treasury Department for qualified pension consultants.

The American Society of Pension Actuaries, which began its Certified Pension Consultants program in 1976, and the International Foundation of Pension and Welfare Plans have already addressed the need to establish education criteria. Both organizations are sponsoring graduate level courses of instruction and an exhaustive examination program. During 1977, 535 students sat for ASPA's certified pension consultant exams. Techniques for testing the knowledge of consultants are continuing to be developed and could be accepted in lieu of governmental examinations as evidencing qualification to practice.

The substantial benefit and practical advantage of this approach is clear. A professional body of pension plan practitioners, who are ethically bound to operate plans within the spirit as well as the letter of the law and who are subject to censure for wrongful acts, would be most effective extension of ERISA. The pension community could then identify those professional practioners who have met standards of character and knowledge imposed by an impartial authority. High standards of educational expertise, practical experience and ethical behavior could be maintained and monitored. The public trust would be assured. Finally, the majority of qualified retirement plans, which do not require the services of an enrolled actuary, could avail themselves more readily of the services of an individual who had demonstrated a high level of competence and could engage that pension professional with greater confidence.

We urge for the benefit of all, serious consideration be given to creating some legal status of providing some government recognition for the pension consulting profession.

IMPACT OF INFLATION ON
RETIREMENT BENEFITS

We would caution against any legal requirement that private retirement plans automatically respond to increases in the cost of living. The provision of automatic cost-of-living increases in private pension plans make two dangerous presumptions:

1) That the private sponsored retirement plan is a never-ending entity that will always have a source of contributions; and

2) That there is a relationship between the performance of the investments made by a retirement plan and the cost of living.

As a matter of fact, the retirement systems of private companies cannot be expected to continue indefinitely into the future, in view of industrial, technological and economic changes in society and a requirement that would place future unknown liabilities on private concerns would almost certainly act as a deterrent to the adoption of such plans. Experience of the last few years has demonstrated that the market value of equity investments, which are a primary investment of retirement plans, can be severely depressed at the same time that inflation is extreme. It is still to soon to know whether inflation will be brought under control. Therefore, to mandate inflation adjustments in defined benefit pension plans would negate the effect of the tax incentives the bill provides for adopting new plans or improving plans because adopting and improving plans are voluntary employer decisions for the most part.

Senator WILLIAMS. Now we will hear from the American Institute of Certified Public Accounts.

Mr. Capelli is the spokesman.

Mr. CAPELLI. Good morning, Mr. Chairman.

My name is Andrew J. Capelli. Mr. Joseph E. Elmlirger is accompanying me. Both Mr. Elmlirger and I are members of the AICPA's Employee Benefit Plans and ERISA Committee and its Accounting for Pension Costs Task Force. In addition, I am a member of the Secretary of Labor's Advisory Council on Employee Benefit Plans.

The American Institute of Certified Public Accountants, AICPA, appreciates the opportunity to present this statement to you on Senate bills S. 3017 and S. 2992.

Our principal recommendations will relate to accounting and reporting provisions of the bills, and consider three matters.

First, the provisions of S. 3017 relating to the scope of the auditor's examination of plan financial statements.

Second, the provisions of S. 2992 that relate to the establishment of accounting standards for plan financial statements.

Third, the simplification of certain financial reporting requirements under ERISA.

Credit grantors, investors, and regulatory agencies such as the Securities and Exchange Commission have long recognized the need for independent audits of financial statements. Over the past 50 years, the accounting profession has developed standards for auditors to follow in making examinations of financial statements. Those standards are commonly referred to as generally accepted auditing standards. Users are provided assurance when the independent auditor is able through his examination, to determine that all important matters have been disclosed, that the financial statements are presented in conformity with generally accepted accounting principles, and that those principles have been followed consistently.

The adoption of S. 3017 would remove a significant part of a plan's financial statements from the scope of the auditor's examination. The investments and acturarial information of an employee benefit plan ordinarily are the predominant items in a plan's financial statements. S. 3017 would preclude the plan administrator from including those items in the scope of the auditor's examination. However, the work of other professions, such as bank examiners, trustees, and acturaries does not include an independent audit of those items.

A certification by a bank or an insurance carrier on the accuracy of a plan's investment assets or a certification by an enrolled actuary on the overall reasonableness of the actuarial information of the plan is not, by itself, sufficient audit evidence. The auditor's opinion must be based on evidence the auditor has obtained; that is, matters within his knowledge.

An unrestricted scope audit ordinarily will not require the plan auditor to visit the bank or insurance carrier holding the plan's assets. We agree with the apparent view of Congress that the cost of many plan auditors visiting banks and insurance carriers may exceed the related benefits. The plan auditor could use what has become known in the auditing profession as the single auditor approach. Under that approach, the plan auditor would obtain from the auditor of the bank or insurance carrier, a report that provides assurance that the necessary procedures and review of internal control of the appropriate bank or insurance carrier operations were performed.

That assurance, when coupled with auditing procedures on information regarding plan transactions prepared by the investment trustee and forwarded to the plan administrator, can enable the plan auditor to express an unqualified opinion on the plan's financial statements. Alternatively, it also may be possible under certain circumstances to obtain a confirmation from the bank or an insurance carrier which, when coupled with other auditing procedures, would satisfy generally accepted auditing standards; however, the auditor must be free to make that decision based on the circumstances.

It is important to recognize that although some banks and insurance carriers are subject to periodic examination by State or Federal authorities, those authorities and the thrust of their examination procedures are concerned with the solvency of the institutions and not with whether the institution's financial statements are presented fairly in conformity with generally accepted accounting principles or with whether or not the institutions internal controls are sufficient to produce accurate plan information.

With respect to the actuarial values and other information concerning the plan, the independent auditor needs to use the work of an actuary in making his audit. However, using the work of an actuary differs from relying on that work. Generally accepted auditing standards require the independent auditor to satisfy himself concerning the professional qualifications and reputation of the actuary, make reasonable inquiries of the actuary, and test the census data that that was provided to the actuary.

Ordinarily, the independent auditor would accept the work of an actuary unless his auditing procedures lead him to believe that the actuary's report is unreasonable in the circumstances.

However, the independent auditor must be able to make reasonable inquiries of the actuary for several reasons. First of all, actuaries ordinarily do not test the validity of the census data that is provided to them by the plan administrator. Consequently, the independent auditor must determine that the actuary used the same census data that the auditor tested during his audit. In addition, the auditor must be able to inquire of the actuary about actuarial assumptions included in the actuary's report if the auditor believes that one or more of them may be unreasonable in the circumstances based on the auditor's knowledge of the plan. For example, if the actuary used an employee turnover assumption of 5 percent and the independent auditor is aware that the experience of the plan is 50 percent, the independent auditor should be free to discuss with the actuary the actuary's basis for the employee turnover assumption.

If the independent auditor is precluded from applying to the finanancial statements that the auditing procedures that he considers necessary in the circumstances, which would happen if certain provisions of S. 3017 were adopted, generally accepted auditing standards would require the independent auditor to disclaim an opinion on a plan's financial statements because of the significant restriction on the scope of his examination.

The AICPA believes that plan participants are not being provided the assurance contemplated by ERISA if the independent auditor disclaims an opinion on plan financial statements. Furthermore, the AICPA believes that only unrestricted audits of plan financial statements by independent auditors would satisfy the regulatory needs and meet the congressional mandate set forth in ERISA.

I would now like to introduce my associate, Mr. Joseph Elmlinger, who will comment on other pending ERISA bills.

Mr. ELMLINGER. The AICPA believes that the passage of S. 2992, which would require the Secretary of the Treasury to promulgate uniform standards for calculating and reporting the assets and liabilities of pension plans, would disrupt the progress being made by the Financial Accounting Standards Board, FASB, in developing financial accounting and reporting standards for employee benefit plans. We are in complete agreement with the objectives of the bill. However, after careful consideration of its provisions and our knowledge of progress being made in the development of accounting and reporting standards, we have concluded that the proposed legislation is unnecessary. Presently, ERISA requires the financial statements of an employee benefit plan to be prepared in conformity with generally accepted accounting principles. The FASB has been working closely with the AICP, the Department of Labor, and the actuarial profession in an effort to develop uniform standards for accounting and reporting by employee benefit plans by the end of 1978.

We believe that completion of the board's proposed statement on accounting and reporting by defined benefit pension plans will resolve the concern which resulted in the introduction of S. 2992. Accordingly, we recommend that you permit the present progress to continue without further legislation at this time. In addition, we strongly support the principle that the setting of financial accounting and reporting standards should remain in the private sector.

Senate bill S. 901 would authorize the Secretary of Labor to prescribe regulations requiring employee benefits plans to file such annual reports as are necessary to achieve the objectives of ERISA. In addition, it would delete the provisions of ERISA that prescribe financial statements and schedules to be included in the annual reports of employee benefit plans. Adoption of that provision would not necessarily simplify the reporting and disclosure requirements, but rather may deprive participants of otherwise meaningful and necessary financial information. We recommend that the specific financial schedule requirements set forth in section 103 of ERISA be eliminated. Instead, the Secretary of Labor should be empowered to require only those schedules he deems necessary to accomplish the reporting and disclosure objectives of ERISA. It is the financial schedule requirements of section 103 of ERISA that are in some cases duplicative, and in other cases burdensome. Specifically, the most burdensome schedule is that of reportable transactions which is required by subsection 103(b)(3)(E). In summary, that schedule requires the reporting of transactions or series of transactions in excess of 3 percent of plan assets.

With regard to Senate bill S. 3193, we support the proposal for consolidating the EBS–1 plan description form with the filing requirements for initial qualification of a plan. Section 4 of Senate bill S. 3193 would require plans to file full annual reports every 5 years on a staggered basis, and simplified reports in other years. We believe that our recommendations for reduced financial schedule requirements, when coupled with the annual report changes adopted this year by the Department of Labor, will significantly reduce the ERISA paperwork problem. Instead of the S. 3193 annual report proposal, we recommend the abbreviated reporting program I have described, and a more effective compliance effort by the regulatory authorities.

In the interest of saving time this morning, we have no other specific comments with respect to provisions of the other ERISA bills being considered at this hearing.

For your convenience we are submitting for the record our detailed recommendations for ERISA amendments, and a separate comment letter on Senate bill S. 2992.

We thank you for the opportunity to present our statement.

The AICPA supports your efforts to improve ERISA.

We would appreciate the opportunity to assist you or your staff in developing ERISA amendments. For your convenience we are attaching our "recommendations for ERISA amendment," and a separate comment letter on Senate bill S. 2992. We would be happy to respond to any questions you may have.

Thank you.

Senator WILLIAMS. Thank you very much, Mr. Elmlinger. We thank all of you.

[The prepared statement of Mr. Capelli and the information referred to by Mr. Elmlinger follow:]

AICPA

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ERISA HEARINGS

SUMMARY STATEMENT OF THE
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

TO

THE SENATE HUMAN RESOURCES SUBCOMMITTEE ON LABOR

AND

THE SENATE FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS

S.3017, S.2992, AND OTHER ERISA BILLS

August 17, 1978

ERISA HEARINGS

SUMMARY STATEMENT OF THE
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S.3017, S.2992, AND OTHER ERISA BILLS

August 17, 1978

The American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to present this statement to you on Senate bills S.3017, S.2992, and other ERISA bills. My name is Andrew J. Capelli. Mr. Joseph E. Elmlinger is accompanying me. Both Mr. Elmlinger and I are members of the AICPA's Employee Benefit Plans and ERISA Committee, and its Accounting for Pension Costs Task Force. In addition, I am a member of the Secretary of Labor's Advisory Council on Employee Benefit Plans. Our principal recommendations concern three matters.

1. The provisions of S.3017 relating to the scope of the auditor's examination of plan financial statements.
2. The provisions of S.2992 that relate to the establishment of accounting standards for plan financial statements.

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3. The simplification of certain financial reporting requirements under ERISA.

Credit grantors, investors, and regulatory agencies such as the Securities and Exchange Commission have long recognized the need for independent audits of financial statements. Over the past fifty years, the accounting profession has developed standards for auditors to follow in making examinations of financial statements. Those standards are commonly referred to as generally accepted auditing standards. Users are provided assurance when the independent auditor is able through his examination, to determine that all important matters have been disclosed, that the financial statements are presented in conformity with generally accepted accounting principles, and that those principles have been followed consistently. The adoption of S.3017 would remove a significant part of a plan's financial statements from the scope of the auditor's examination. The investments and actuarial information of an employee benefit plan ordinarily are the predominant items in a plan's financial statements. S.3017 would preclude the plan administrator from including those items in the scope of the auditor's examination. However, the work of other professionals, such as bank examiners, trustees, and actuaries does not include an independent audit of those items.

A certification by a bank or an insurance carrier on the accuracy of a plan's investment assets or a certification by an enrolled actuary on the overall reasonableness of the actuarial information of the plan is not, by itself, sufficient audit evidence. The auditor's opinion must be based on evidence the auditor has obtained; that is, matters within his knowledge.

An unrestricted scope audit ordinarily will not require the plan auditor to visit the bank or insurance carrier holding the plan's assets. We agree with the apparent view of Congress that the cost of many plan auditors visiting banks and insurance carriers may exceed the related benefits. The plan auditor could use what has become known in the auditing profession as the "single auditor approach." Under that approach, the plan auditor would obtain from the auditor of the bank or insurance carrier, a report that provides assurance that the necessary procedures and review of internal control of the appropriate bank or insurance carrier operations were performed. That assurance, when coupled with auditing procedures on information regarding plan transactions prepared by the investment trustee and forwarded to the plan administrator, can enable the plan auditor to express an unqualified opinion on the plan's financial statements. Alternatively, it also may be possible under certain circumstances to obtain a confirmation from the bank or an insurance carrier which, when coupled with other auditing procedures, would satisfy generally accepted auditing standards; however, the auditor must be free to make that decision based on the circumstances.

It is important to recognize that although banks and insurance carriers are subject to periodic examination by state or Federal authorities, those authorities and the thrust of their examination procedures are concerned with the solvency of the institutions and not with whether the institution's financial statements are presented fairly in conformity with generally accepted accounting principles.

With respect to the actuarial values and other information concerning the plan, the independent auditor needs to use the work of an actuary in making his audit. However, using the work of an actuary differs from relying on that work. Generally accepted auditing standards require the independent auditor to satisfy himself concerning the professional qualifications and reputation of the actuary, make reasonable inquiries of the actuary, and test the census data that was provided to the actuary. Ordinarily, the independent auditor would accept the work of an actuary unless his auditing procedures lead him to believe that the actuary's report is unreasonable in the circumstances.

However, the independent auditor must be able to make reasonable inquiries of the actuary for several reasons. First of all, actuaries ordinarily do not test the validity of the census data that is provided to them by the plan administrator. Consequently, the independent auditor must determine that the actuary used the same census data that the auditor tested during his audit. In addition, the auditor must be able to inquire of the actuary about actuarial assumptions included in the actuary's report if the auditor believes that one or more of them may be unreasonable in the circumstances based on the auditor's knowledge of the plan. For example, if the actuary used an employee turnover assumption of 5% and the independent auditor is aware that the experience of the plan is 50%, the independent auditor should be free to discuss with the actuary the actuary's basis for the employee turnover assumption.

If the independent auditor is precluded from applying to the financial statements the auditing procedures that he considers necessary in the circumstances, which would happen if S.3017 were adopted, generally accepted auditing standards would require the independent auditor to disclaim an opinion on a plan's financial statements because of the significant restriction on the scope of his examination. The AICPA believes that plan participants are not being provided the assurance contemplated by ERISA if the independent auditor disclaims an opinion on plan financial statements. Furthermore, the AICPA believes that only unrestricted audits of plan financial statements by independent auditors would satisfy the regulatory needs and meet the Congressional mandate set forth in ERISA.

I would now like to introduce my associate Mr. Joseph Elmlinger who will comment on other pending ERISA bills.

The AICPA believes that the passage of S.2992, which would require the Secretary of the Treasury to promulgate uniform standards for calculating and reporting the assets and liabilities of pension plans, would disrupt the progress being made by the Financial Accounting Standards Board (FASB) in developing financial accounting and reporting standards for employee benefit plans. We are in complete agreement with the objectives of the bill. However, after careful consideration of its provisions and our knowledge of progress being made in the development of accounting and reporting standards, we have concluded that the proposed legislation is unnecessary. Presently, ERISA requires the financial statements of an employee benefit plan to be prepared in conformity with generally accepted accounting principles. The FASB has been working closely with the AICPA, the Department of Labor, and the actuarial profession in an effort to develop uniform standards for accounting and reporting by employee benefit plans by the end of 1978. We believe that completion of the Board's proposed statement on Accounting and Reporting by Defined Benefit Pension Plans will resolve the concern which resulted in the introduction of S.2992. Accordingly, we recommend that you permit the present progress to continue without further legislation. In addition, we strongly support the principle that the setting of financial accounting and reporting standards should remain in the private sector.

Senate bill S.901 would authorize the Secretary of Labor to prescribe regulations requiring employee benefit plans to file such annual reports as are necessary to achieve the objectives of ERISA. In addition, it would delete the provisions of ERISA that prescribe financial statements and schedules to be included in the annual reports of employee benefit plans. Adoption of that provision would not necessarily simplify the reporting and disclosure requirements, but rather may deprive participants of otherwise meaningful and necessary financial information. We recommend that the specific financial schedule

<u>requirements</u> set forth in section 103 of ERISA be eliminated. Instead, the Secretary of Labor should be empowered to require only those schedules he deems necessary to accomplish the reporting and disclosure objectives of ERISA. It is the financial schedule requirements of section 103 of ERISA that are in some cases duplicative and in other cases burdensome. Specifically, the most burdensome schedule is that of reportable transactions which is required by subsection 103(b)(3)(E). In summary, that schedule requires the reporting of transactions or series of transactions in excess of 3% of plan assets.

With regard to Senate bill S.3193, we support the proposal for consolidating the EBS-1 plan description form with the filing requirements for initial qualification of a plan. Section 4 of Senate bill S.3193 would require plans to file full annual reports every five years on a staggered basis and simplified reports in other years. We believe that our recommendations for reduced financial schedule requirements, when coupled with the annual report changes adopted this year by the Department of Labor, will significantly reduce the ERISA paperwork problem. Instead of the S.3193 annual report proposal, we recommend the abbreviated reporting program I have described and a more effective compliance effort by the regulatory authorities.

We have no other specific comments with respect to provisions of the other ERISA bills being considered at this hearing.

We wish to thank you for the opportunity to present this statement. The AICPA supports your efforts to improve ERISA and we would appreciate the opportunity to assist you or your staff in developing ERISA amendments. For your convenience, we are attaching our "Recommendations for ERISA Amendments," and a separate comment letter on Senate bill S. 2992.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

EMPLOYEE BENEFIT PLANS AND ERISA COMMITTEE

Recommendations for ERISA Amendments

1. EXAMINATION OF PLAN ASSETS

Legislative Recommendation

Revise subsection 103(a)(3)(A) of ERISA to read as follows:

> The administrator of an employee benefit plan shall engage, on behalf of all plan participants, an independent public accountant who shall conduct an examination of the financial statements of the plan and express an opinion as to whether the financial statements taken as a whole required to be included in the annual report of subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a consistent basis. Such examination shall be conducted in accordance with generally accepted auditing standards and, accordingly, shall include such tests of the accounting records and such other auditing procedures as the independent public accountant considers necessary in the circumstances. The independent public accountant shall also express an opinion as to whether the separate schedules specified in subsection (b)(3) of this section present fairly in all material respects the information contained therein when considered in conjunction with the financial statements taken as a whole. The opinion of the independent public accountant shall be made a part of the annual report. In a case where a plan is not required to file an annual report, the requirements of this paragraph shall not apply. In a case where by reason of section 104(a)(2) a plan is required only to file a simplified annual report, the Secretary may waive the requirements of this paragraph.

Reasons for Legislative Recommendation

Subsection 103(a)(3)(A) of ERISA requires the administrator of an employee benefit plan to engage an independent accountant to make an examination of the financial statements of the plan in accordance with generally accepted auditing standards and to express an opinion on whether the financial statements required to be included in the plan's annual report are presented fairly in conformity with generally accepted accounting principles. However, subsection 103(a)(3)(A) also refers to subsection 103(a)(3)(C), which provides that the independent accountant is not required to express an opinion on statements of a common or collective trust or a separate trust maintained by a bank or a separate account maintained by an insurance carrier. Those statements are required by subsection 103(b)(3)(G) to be included in the annual report under the schedule requirements. The foregoing subsections are reproduced as Exhibit 1.

In its final annual reporting regulations, the Department of Labor adopted a very broad interpretation of the statutory language and provided that "the examination and report of an independent qualified public accountant need not extend to any statement or information prepared and certified by a bank or similar institution or insurance carrier" (reg. sec. 2520.103-8(a)). The regulations do not, however, eliminate the requirement that plans subject to audit requirements (that is, by regulation, plans with 100 or more participants) engage an independent accountant regardless of whether all or part of the plan's assets are held by a bank or with an insurance carrier. However, generally accepted auditing standards, as promulgated by the American Institute of Certified Public Accountants (AICPA), do not permit independent accountants to divide responsibility for their opinions by expressing reliance on the work or certification of other parties who are not licensed to practice as certified public accountants.

A certification by a bank on the accuracy of the statement of a separate trust is not, by itself, sufficient audit evidence to enable an independent accountant to express an opinion on plan financial statements, where the plan has a material amount of its assets in a bank or with an insurance carrier. As a result, if the independent accountant is precluded from applying to those assets the auditing procedures that he considers necessary in the circumstances, the scope of the accountant's examination has been restricted. Generally accepted auditing standards require an independent accountant to disclaim an opinion on financial statements if the scope of his examination is significantly restricted.

The AICPA believes that plan participants are not being provided the assurance contemplated by ERISA if the independent accountant's examination is restricted to exclude assets held in a bank or with an insurance carrier as permitted by subsection 103(a)(3)(C) of ERISA. It is important to recognize that examinations of plans' financial statements in accordance with generally accepted auditing standards do not result in each plan auditor visiting banks and insurance carriers holding plans' assets. We agree with the apparent view of Congress that the cost of many plan auditors visiting banks and insurance carriers may exceed the related benefits. But an audit of a plan conducted in accordance with generally accepted auditing standards could involve what has become known in the auditing profession as the "single auditor approach." Under that approach, each plan auditor simply obtains from the auditor of the plan's bank or insurance carrier a report which provides assurance that the necessary auditing procedures were performed. When coupled with procedures performed at the plan, the plan auditor can express an opinion that the examination of the plan's financial statements was conducted in accordance with generally accepted auditing standards. Under certain circumstances, obtaining a confirmation from a bank or insurance carrier would, when coupled with other auditing procedures, satisfy generally accepted auditing standards. In addition, it is important to note that although banks and insurance carriers are subject to periodic examination by state or Federal authorities, those authorities are primarily interested in the solvency of those institutions and not whether the institutions' financial statements are presented fairly in conformity with generally accepted accounting principles.

We believe that examinations of plan financial statements conducted in accordance with generally accepted auditing standards would provide an element of assurance to plan participants as well as auxiliary benefits to all interested parties. Senate Bill S. 3017, which was introduced by Senators Williams and Javits, would provide that the accountant's examination and opinion shall not include plan assets held in a bank or with an insurance carrier. Presently, a plan administrator may decide but is not required to restrict the scope of the independent accountant's examination. If that provision is adopted, it would magnify the problems discussed above by precluding a plan administrator from engaging an independent accountant to examine and express an opinion on a plan's financial statements taken as a whole in accordance with generally accepted auditing standards. As discussed above, we believe that the independent accountant's examination should not be so restricted.

As background information, we would like to briefly discuss the benefits of an independent audit of financial statements.

An "audit" is an examination of financial statements made in accordance with generally accepted auditing standards by accountants who are independent of the preparation of the financial statements and indeed independent of the client.

In their capacity as independent accountants, certified public accountants have one important objective; namely, to perform an examination that will enable them to express an opinion on whether the representations contained in the client's financial statements present fairly financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles applied on a consistent basis.

The audit must be conducted in accordance with professional standards. Professional standards for auditing are promulgated by the AICPA. Accounting standards, which establish generally accepted accounting principles, are promulgated by the Financial Accounting Standards Board (FASB).

In performing an examination, the independent accountant seeks to determine, among other things, that all important matters have been disclosed, that his client's financial statements are in accordance with generally accepted accounting principles, and that those principles have been followed consistently. The independent accountant's examination includes only those auditing procedures that, in his judgment, are necessary to enable him to express an opinion on the client's financial statements. That means that the auditor has examined the financial statements in accordance with the standards of the profession and is willing to be held responsible for his opinion. It implies an orderly process of reasoning from particular facts to a specific conclusion about a course of action, a process that has to be both practical and logical.

The independent accountant is not an originator of either the financial statements nor the data from which the financial statements are prepared. The financial statements and the systems, procedures, policies, and decisions that support them are primarily the responsibility of management because management alone can control the systems and the people, make the decisions for the plan, and directly know the bases for and consequences of those decisions. Professional standards preclude the independent accountant from creating financial data and permit him only to express an opinion on the fairness of its presentation. Furthermore, the accountant must be independent; that is, "he must be without bias with respect to the client under audit, since otherwise he would lack the impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be" (section 220.02 of Statement on Auditing Standards No. 1).

To fulfill his responsibilities, the independent accountant must be in a position to challenge all aspects of the financial statements including amounts determined by the client and those determined by specialists that the client uses.

The primary benefit of an independent audit is the accountant's independence, objectivity, and opinion on the financial statements. An accountant's independence and objectivity must be visible and explicit because parties other than his client also benefit from his work. Those parties include stockholders, plan beneficiaries, lenders, regulatory agencies, and other interested parties.

Clearly, the opinion of an independent accountant has little value unless it rests unquestionably on the integrity, independence, and objectivity of the accountant. The independent accountant's role is unique; only he is in a position to perform an audit and express an independent opinion on the financial statements taken as a whole, thus lending credibility to management's representations.

2. EXAMINATION OF ACTUARIAL INFORMATION

Legislative Recommendation

Delete subsection 103(a)(3)(B) of ERISA.

Reasons for Legislative Recommendation

Section 103(a)(3)(B) of ERISA provides that in expressing an opinion on plan financial statements, "the accountant may rely on the correctness of any actuarial matter certified by an enrolled actuary, if he so states his reliance."

Actuarial information has a major impact on financial statements presented in conformity with generally accepted accounting principles of a defined benefit pension plan. The April 14, 1977 FASB exposure draft, Accounting and Reporting for Defined Benefit Pension Plans, would increase that impact by requiring a statement of accumulated benefits and a statement of changes in those benefits.

Because of the current and expected future impact of actuarial information on plan financial statements, independent accountants need to use the work of actuaries in making their examinations of plan financial statements. However, using the work of an actuary differs from relying on that work. The independent accountant's responsibility in using the work of another professional is set forth in Statement on Auditing Standards No. 11, Using the Work of a Specialist.* (A copy of the Statement is enclosed.)

The basic premise of SAS No. 11 is that the independent accountant is not qualified to do the work of a specialist. The independent accountant, however, "may encounter matters potentially material to the fair presentation of financial statements in conformity with generally accepted accounting principles that require special knowledge and that in his judgment require using the work of a specialist" (paragraph 2 of SAS No. 11). The SAS specifically identifies actuaries as persons possessing special skill or knowledge in a field other than accounting and auditing.

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* Statements on Auditing Standards are issued by the Auditing Standards Executive Committee, the senior technical committee of the AICPA designated to issue pronouncements on auditing matters. Rule 202 of the Institute's Code of Professional Ethics requires adherence to the applicable generally accepted auditing standards promulgated by the Institute. It recognizes Statements on Auditing Standards as interpretations of generally accepted auditing standards and requires that members be prepared to justify departures from those Statements.

SAS No. 11 requires that the independent accountant satisfy himself concerning the professional qualifications and the reputation of the specialist by inquiry or other procedures as appropriate. In addition, paragraph 8 of SAS No. 11 states: "Although the appropriateness and reasonableness of methods or assumptions used and their application are the responsibility of the specialist, the auditor should obtain an understanding of the methods or assumptions used by the specialist to determine whether the findings are suitable for corroborating the representations in the financial statements. The auditor should consider whether the specialist's findings support the related representations in the financial statements and make appropriate tests of accounting data provided by the client to the specialist." Thus, many (if not most) independent accountants believe that if plan administrators include information that is based on the work of a specialist, such as the results of actuarial valuations, in the financial statements of an employee benefit plan, independent accountants should make reasonable inquiries concerning that information. (Some independent accountants believe that even if actuarial information on benefit obligations is not presented in a plan's financial statements, the work of an actuary would be used as an auditing procedure for the actuarial aspects of contributions received and receivable and benefits paid and payable.)

Paragraph 8 of SAS No. 11 continues: "Ordinarily, the auditor would use the work of the specialist unless his procedures lead him to believe that the findings are unreasonable in the circumstances." Please note the emphasis on the word "use." The SAS does not include the term "rely" because responsibility for the independent accountant's opinion on the financial statements is not divided between the independent accountant and the specialist.

An independent accountant follows the guidance in SAS No. 11 in using the work of many specialists, including actuaries. For example, an independent accountant may need to use the work of a geologist or petroleum reservoir engineer in an examination of the financial statements of a company in the oil and gas industry, may test revenue recognition on a construction project using estimates of the stage of completion prepared by an engineer, or may satisfy himself as to the carrying basis of real estate investments using the work of an appraiser. The independent accountant's report on the examination of the financial statements ordinarily does not contain a reference to the work that those specialists performed. Neither does the independent accountant's report on the financial statements of an employee benefit plan refer to the work of an actuary.

Paragraph 11 of SAS No. 11 specifically states that "the auditor should not refer to the work or findings of the specialist. Such a reference in an unqualified opinion might be misunderstood to be a qualification of the auditor's opinion or a division of responsibility, neither of which is intended. Further, there may be an inference that the auditor making such reference performed a more thorough audit than an auditor not making such reference." For those reasons, SAS No. 11 prohibits an independent accountant from referring to the specialist in his report unless the independent accountant decides to modify his opinion as a result of the report or findings of the specialist.

Some actuaries argue that if the independent accountant is unwilling to accept and rely on actuarial matters certified to by an enrolled actuary, then the independent accountant has usurped his function and position. However, section 103 of ERISA requires that the independent accountant make an examination of the financial statements of the plan and express an opinion on whether those financial statements taken as a whole are presented fairly in conformity with generally accepted accounting principles. To fulfill his responsibilities under ERISA and under generally accepted auditing standards, the independent accountant must make reasonable inquiries about all aspects of the financial statements of the plan, including amounts determined by the plan's actuary.

The following are types of auditing procedures that many independent accountants might apply to actuarial information that is disclosed in the financial statements of a plan:

a. Obtain a copy of the latest actuarial report on the plan.

b. Inquiry about the professional qualifications and reputation of the actuary.

c. Compare the actuarial cost methods and assumptions used with those used in the preceding period.

d. Compare the actuarial information disclosed in the plan's financial statements with related information in the actuarial report.

e. Make appropriate tests of the census data that the plan administrator provided to the actuary.

f. If necessary, make reasonable inquiries of the actuary concerning (a) whether the actuary used the same census data that the independent accountant tested in step e and (b) the basis for certain actuarial assumptions if the independent accountant, based on his knowledge of the plan, believes that an assumption is unreasonable in the circumstances. (For example, if the plan actuary used an employee turnover assumption of 5 per year and the independent accountant is aware that the experience of the plan is 50 per year, the independent accountant would inquire of the plan's actuary regarding the basis for the employee turnover assumption.) Ordinarily, the independent accountant would use the work of the plan's actuary unless the independent accountant's procedures lead him to believe that the actuarial information is unreasonable in the circumstances.

The above procedures do not duplicate the work of the plan's actuary. The purpose of the procedures are to enable the independent accountant to evaluate whether the actuary's report corroborates the representations of the plan administrator that are in the financial statements of the plan.

Senate Bill S.3017 would require the independent accountant to rely on the correctness of any actuarial matter certified to by an enrolled actuary. As explained on page 12 of our recommendations, the independent accountant must make reasonable inquiries about all aspects of the financial statements of the plan, including amounts determined by the plan's actuary, to fulfill his responsibilities under ERISA and under generally accepted auditing standards. If that provision of S.3017 is adopted, generally accepted auditing standards would require the independent accountant to disclaim an opinion on a plan's financial statements because the scope of his examination with respect to actuarially determined information of the plan would be significantly restricted. We recommend that Sec. 226, "Opinions of Actuaries and Accountants," of S.3017 not be adopted so that independent accountants can continue to apply those procedures that in their judgment are necessary in the circumstances.

3. FINANCIAL STATEMENT REQUIREMENTS

<u>Legislative Recommendation</u>

Delete subsections 103(b)(1) and(2) and references to them effective on the issuance by the Financial Accounting Standards

Board (FASB) of a Statement of Financial Accounting Standards on Accounting and Reporting for Employee Benefit Plans. In addition, do not permit the Internal Revenue Service or the Department of Labor to (a) promulgate accounting principles for employee benefit plans or (b) provide exceptions to generally accepted accounting principles.

Reasons for Legislative Recommendation

Subsection 103 (a)(3)(A) requires that the financial statements of an employee benefit plan be presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Accounting standards, which establish generally accepted accounting principles, are promulgated by the Financial Accounting Standards Board (FASB).* The FASB is currently studying accounting and reporting for employee benefit plans with the intention of issuing a Statement that would establish generally accepted accounting principles for those plans. The FASB has issued a discussion memorandum and issued an exposure draft of a Statement entitled, "Accounting and Reporting by Defined Benefit Pension Plans."

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* The FASB is an independent organization charged with setting generally accepted accounting principles. Its pronouncements are binding on members of the AICPA and are considered to be authoritative by the Securities and Exchange Commission.

Subsections 103 (b)(1) and (2) prescribe the financial statement and related disclosure requirements for employee welfare benefit plans and employee pension benefit plans, respectively. Many believe that those subsections have defined, for purposes of complying with ERISA, what is required by generally accepted accounting principles; however, as stated above, those principles are presently being established by the FASB.

Senate Bill S.2992, which was introduced by Senator Bentsen, would require that the Secretary of the Treasury "promulgate uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions used in such calculations." We recommend that S.2992 not be adopted because we believe that generally accepted accounting principles for employee benefit plans should be established by the FASB.

4. SCHEDULE REQUIREMENTS

Legislative Recommendation

Delete subsection 103 (b)(3) of ERISA and insert in its place:

> (3) With respect to all employee benefit plans, the statement required under paragraph (1) or (2) shall have attached to it those schedules that the Secretary of Labor deems necessary to accomplish the reporting and disclosure objectives of ERISA.

Reasons for Legislative Recommendation

Subsection 103 (b)(3) prescribes the schedules required to be filed as part of the annual report. Those schedules requirements are in some cases duplicative, in other cases burdensome, and the reasons for requiring the information are unclear. Specifically, the most burdensome schedule is that of reportable transactions which is required by subsection 103 (b)(3)(E). In summary, the schedule requires reporting of transactions or series of transactions in securities or with a person in excess of 3% of plan assets.

EXHIBIT 1 - EXCERPTS FROM ERISA SECTION 103

<u>103(a)(3)(A)</u>

"Except as provided in subparagraph (C), the administrator of an employee benefit plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual report by subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards, and shall involve such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant..."

<u>103(a)(3)(C)</u>

"The opinion required by subparagraph (A) need not be expressed as to any statements required by subsection (b)(3)(G) prepared by a bank or similar institution or insurance carrier regulated and supervised and subject to periodic examination by a State or Federal agency if such statements are certified by the bank, similar institutions, or insurance carrier as accurate and are made a part of the annual report."

<u>103(b)(3)(G)</u>

"...if some or all of the assets of a plan or plans are held in a common or collective trust maintained by a bank or similar institution or in a separate account maintained by an insurance carrier or a separate trust maintained by a bank as trustee, the report shall include the most recent annual statement of assets and liabilities of such common or collective trust, and in the case of a separate account or a separate trust, such other information as is required by the administrator in order to comply with this subsection...."

AICPA

American Institute of Certified Public Accountants
1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

July 24, 1978

The Honorable Lloyd M. Bentsen
Chairman
Subcommittee on Private Pension
Plans & Employee Fringe Benefits
240 Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The American Institute of Certified Public Accountants wishes to express its views on the recently introduced Bill S. 2992 which deals with financial and other disclosure requirements in connection with the Employment Retirement Income Security Act (88 Stat. 829).

It has always been the policy of the AICPA to support and promote full and fair disclosure and the pension fund area is no exception. We are in complete agreement with the objectives of the Bill. However, after careful consideration of its provisions, the views expressed in statements submitted by interested parties and our knowledge of progress being made in the development of accounting and reporting standards, we have concluded that the proposed legislation is unnecessary. We believe that there is a substantial record of substantive progress being made to resolve the problems relating to financial reporting by pension funds through the cooperative effort of the Financial Accounting Standards Board (FASB), the accounting and actuarial professions, and the responsible government agencies (Department of Labor, Treasury Department, and the Securities and Exchange Commission).

As you know, the FASB was created to set financial accounting and reporting standards. This activity is under the close scrutiny of the Securities and Exchange Commission and has been operating satisfactorily for many years.

The FASB has been working closely with the Department of Labor (DOL) in an effort to develop uniform standards for accounting and reporting by defined benefit pension plans. We agree with the expression of the FASB that finalization of the Board's statement on "Accounting and Reporting by Defined Benefit Pension Plans" will resolve the concern which resulted in the

The Honorable Lloyd M. Bentsen
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introduction of S. 2992. We have no reason to doubt the FASB's prediction that its deliberations will be completed in time for a final statement to be applicable to the preparation of pension plan financial statements for 1979 and we have been working closely with it to achieve that objective.

A requirement that the Secretary of Treasury be directed to set accounting standards for pension plan financial statements would therefore disrupt the progress being made without evidence that such a change would accelerate the issuance of uniform standards or enhance the quality of such standards. In addition, we strongly support the principle that the setting of financial accounting and reporting standards should remain in the private sector.

We recommend that the Subcommittee permit the present progress to continue without further legislation. We are confident that the issues addressed by the Bill will be satisfactorily resolved by the actions already underway.

Thank you for the opportunity to comment on this matter.

Sincerely yours,

Wallace E. Olson

Wallace E Olson
President

Statement on Auditing Standards

December 1975

CPA

Using the Work of a Specialist

1. The purpose of this Statement is to provide guidance to the auditor who uses the work of a specialist in performing an examination of financial statements in accordance with generally accepted auditing standards.[1] For purposes of this Statement, a specialist is a person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing. Examples of such specialists include actuaries, appraisers, attorneys, engineers, and geologists.[2]

Decision to Use the Work of a Specialist

2. The auditor's education and experience enable him to be knowledgeable about business matters in general, but he is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation. During his examination, however, an auditor may encounter matters potentially material to the fair presentation of financial statements in conformity with generally accepted accounting principles that require special knowledge and that in his judgment require using the work of a specialist.

[1] This Statement does not apply to using the work of a specialist who is a member of the auditor's staff, or to the form or content of letters of audit inquiry concerning litigation, claims, or assessments and lawyers' responses thereto.

[2] For purposes of this Statement, a person whose special skill or knowledge relates to the internal affairs or business practices of the client, such as a credit or plant manager, is not considered a specialist.

3. Examples of the types of matters that the auditor may decide require him to consider using the work of a specialist include, but are not limited to, the following:

a. Valuation (e.g., works of art, special drugs, and restricted securities).
b. Determination of physical characteristics relating to quantity on hand or condition (e.g., mineral reserves or materials stored in piles above ground).
c. Determination of amounts derived by using specialized techniques or methods (e.g., certain actuarial determinations).
d. Interpretation of technical requirements, regulations, or agreements (e.g., the potential significance of contracts or other legal documents, or legal title to property).

4. In performing an examination of financial statements in accordance with generally accepted auditing standards, the auditor may use the work of a specialist as an audit procedure to obtain competent evidential matter. The circumstances surrounding the use of a specialist differ. Although the familiarity of individual auditors with the work performed by certain types of specialists may differ, the auditing procedures necessary to comply with generally accepted auditing standards need not vary as a result of the extent of the auditor's knowledge.

Selecting a Specialist

5. The auditor should satisfy himself concerning the professional qualifications and reputation of the specialist by inquiry or other procedures, as appropriate. The auditor should consider the following:

a. The professional certification, license, or other recognition of the competence of the specialist in his field, as appropriate.
b. The reputation and standing of the specialist in the views of his peers and others familiar with his capability or performance.
c. The relationship, if any, of the specialist to the client.

6. Ordinarily, the auditor should attempt to obtain a specialist who is unrelated to the client. However, when the circumstances so warrant, work of a specialist having a relationship to the client may be

acceptable (see paragraph 8). Work of a specialist unrelated to the client will usually provide the auditor with greater assurance of reliability because of the absence of a relationship that might impair objectivity.

7. An understanding should exist among the auditor, the client, and the specialist as to the nature of the work to be performed by the specialist. Preferably, the understanding should be documented and should cover the following:

a. The objectives and scope of the specialist's work.
b. The specialist's representations as to his relationship, if any, to the client.
c. The methods or assumptions to be used.
d. A comparison of the methods or assumptions to be used with those used in the preceding period.
e. The specialist's understanding of the auditor's corroborative use of the specialist's findings in relation to the representations in the financial statements.
f. The form and content of the specialist's report that would enable the auditor to make the evaluation described in paragraph 8.

Using the Findings of the Specialist

8. Although the appropriateness and reasonableness of methods or assumptions used and their application are the responsibility of the specialist, the auditor should obtain an understanding of the methods or assumptions used by the specialist to determine whether the findings are suitable for corroborating the representations in the financial statements. The auditor should consider whether the specialist's findings support the related representations in the financial statements and make appropriate tests of accounting data provided by the client to the specialist. Ordinarily, the auditor would use the work of the specialist unless his procedures lead him to believe that the findings are unreasonable in the circumstances. If the specialist is related to the client (see paragraph 6), the auditor should consider performing additional procedures with respect to some or all of the related specialist's assumptions, methods, or findings to determine that the findings are not unreasonable or engage an outside specialist for that purpose.

Effect of the Specialist's Work on the Auditor's Report

9. If the auditor determines that the specialist's findings support the related representations in the financial statements, he may reasonably conclude that he has obtained sufficient competent evidential matter. If there is a material difference between the specialist's findings and the representations in the financial statements, or if the auditor believes that the determinations made by the specialist are unreasonable, he should apply additional procedures. If after applying any additional procedures that might be appropriate he is unable to resolve the matter, the auditor should obtain the opinion of another specialist, unless it appears to the auditor that the matter cannot be resolved. A matter that has not been resolved will ordinarily cause the auditor to conclude that he should qualify his opinion or disclaim an opinion because the inability to obtain sufficient competent evidential matter as to an assertion of material significance in the financial statements constitutes a scope limitation (see SAS No. 2, paragraphs 10 and 11).

10. The auditor may conclude after performing additional procedures, including possibly obtaining the opinion of another specialist, that the representations in the financial statements are not in conformity with generally accepted accounting principles. In that event, he should express a qualified or adverse opinion (see SAS No. 2, paragraphs 15-17).

Reference to the Specialist in the Auditor's Report

11. When expressing an unqualified opinion, the auditor should not refer to the work or findings of the specialist. Such a reference in an unqualified opinion might be misunderstood to be a qualification of the auditor's opinion or a division of responsibility, neither of which is intended. Further, there may be an inference that the auditor making such reference performed a more thorough audit than an auditor not making such reference.

12. If the auditor decides to modify his opinion (see paragraphs 9 and 10) as a result of the report or findings of the specialist, reference to and identification of the specialist may be made in the auditor's report if the auditor believes such reference will facilitate an understanding of the reason for the modification.

The Statement entitled "Using the Work of a Specialist" was adopted unanimously by the twenty-one members of the Committee, of whom three, Messrs. Badecker, Lisk and Nelson, assented with qualifications.

Messrs. Badecker and Lisk approve issuance of this Statement but qualify their assent because they disagree with paragraph 11, which prohibits reference to the specialist in the auditor's unqualified report. They believe there may be circumstances when such reference will serve to better inform the reader as to the nature and character of an examination made in accordance with generally accepted auditing standards and the extent of the auditor's responsibility. They believe that the auditor should be held only to a standard of reasonableness and due care in the selection of the specialist and that silence with respect to the work of the specialist and the auditor's reliance on that work may imply the possession of skills by the auditor in an area in which he lacks qualification.

Mr. Nelson approves issuance of this Statement but qualifies his assent because he believes that the Statement may necessitate changing arrangements previously made with clients and specialists. Consequently, an effective date should be specified to allow for an orderly implementation of the provisions promulgated in the Statement.

Auditing Standards Executive Committee (1974-1975)

Note: *Statements on Auditing Standards are issued by the Auditing Standards Executive Committee, the senior technical committee of the Institute designated to issue pronouncements on auditing matters. Rule 202 of the Institute's Code of Professional Ethics requires adherence to the applicable generally accepted auditing standards promulgated by the Institute. It recognizes Statements on Auditing Standards as interpretations of generally accepted auditing standards, and requires that members be prepared to justify departures from such Statements.*

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Senator WILLIAMS. I may want to present written questions after further study of your full statements that have been presented for our record.

It has been excellent, excellent opening prsentation of your ideas.

We want to study them, and study your prepared statements in full.

Senator Javits, any questions?

Senator JAVITS. Thank you, Mr. Chairman.

I join the Chair in thanking you for your testimony. The juxtaposition of it is critical to us, as it would be to a court.

I would ask one further thing, Mr. Chairman, if the Chair will allow me. That is, as you hear about and read about developments, do not feel that your testimony is static. If you feel you wish to present something to us, or send something to the chairman—hopefully you will send me a copy as ranking member—we will see that it is considered.

Your professionalism is critical to the final result.

Thank you.

Senator WILLIAMS. Thank you. Thank you all.

Mr. CAPELLI. Thank you.

Senator WILLIAMS. We will now turn to the panel of financial institutions: The American Council of Life Insurance, William T. Gibb, chief counsel, Federal taxes and pensions; Investment Company Institute, Matthew P. Fink, general counsel; and American Bankers Association, Bernard F. Curry, vice president-elect, trust division.

We welcome all your presentations and your thoughtful analyses. We have the American Council of Life Insurance listed first. Shall we proceed with you?

STATEMENT OF WILLIAM T. GIBB, CHIEF COUNSEL, FEDERAL TAXES AND PENSIONS, AMERICAN COUNCIL OF LIFE INSURANCE, ACCOMPANIED BY PAUL J. MASON, STAFF MEMBER; MATTHEW P. FINK, GENERAL COUNSEL, INVESTMENT COMPANY INSTITUTE; AND BERNARD F. CURRY, VICE PRESIDENT-ELECT, TRUST DIVISION, AMERICAN BANKERS ASSOCIATION, A PANEL

Mr. GIBB. Thank you very much.

I am here today on behalf of the American Council of Life Insurance, whose members hold about 92 percent of the assets of insured pension plans. Also, insofar as my statement relates to welfare benefit plans, I am also appearing on behalf of the Health Insurance Association, whose members have collectively in force over 90 percent of health and accident policies written in the United States.

I am accompanied by Paul J. Mason, who is also on the staff of the American Council of Life Insurance.

Our complete statement is available for the record; I will summarize by touching on the highlights.

Senator WILLIAMS. We will put the complete statement in the record.

Mr. GIBB. Let me start out by making clear that we support and continue to support the basic objectives of ERISA; that is, to strenthen the private employee benefit plan system and also to encourage the growth of this system so as to cover additional employees and improve benefits under existing plans.

However, now that ERISA has been in place for almost 4 years, two facts have become apparent:

First, to a significant extent, ERISA has been counterproductive. It has impeded the establishment of new plans and even let to the loss of coverage which existed before its enactment. This undesirable result is attributable in large degree to overregulation, particularly in terms of additional paperwork and other administrative burdens. Moreover, the design of the preemption clause is giving an incentive to welfare benefit plans to drop valuable insurance coverage in favor of uninsured arrangements.

Second, the affirmative steps taken in ERISA to encourage expansion of employee benefit plan coverage have proved to be inadequate.

We strongly believe that the time has arrived for Congress to deal with these unintended fallouts from ERISA. Thus, we applaud the efforts that led to the introduction of the various bills covered by this hearing and urge that your subcommittees report meaningful legislation as soon as practicable.

I will new briefly summarize our comments on several of the proposals in the seven bills under consideration.

Reduction of burdens on small pension plans: It would be redundant to dwell on the problems—in terms of paperwork, other administrative burdens, and increased levels of administrative expenses—that ERISA has presented to plans of small employers.

Moreover, in developing solutions, it is not enough to merely shift paperwork and other administrative workloads from the plans to the insurance companies, banks, et cetera, who may be servicing them. The burdens will still be there and the plans will continue to bear their cost. Thus, substantive, and not solely procedural, changes are necessary. This is not to say, however, that significant streamlining and consolidation cannot also be achieved by assigning some of the reporting and disclosure requirements to insurance companies and other master plan sponsors, as would be done under the special master plan program proposed in title IV of S. 3017. But, standing alone, this would not be a complete solution.

Within this context, a positive program should be adopted for alleviating the burdens and complexities imposed by ERISA on employee benefit plans of small employers. It should, at a minimum, contain the following specific components:

(1) Elimination of the summary annual report.

(2) Simplification of the plan description form. Since most of the information in the plan description must also be in the summary plan description, the plan description information should, in the case of small plans, be very much simplified—even in the consolidated form proposed by the administration—in order to remove the present overlap.

(3) ERISA should be amended to permit small pension plans to provide a 1-year eligibility period—as another way of minimizing administrative work and cost—without having to forfeit the convenience and cost savings of a single annual entry date. In this regard, S. 3017 would achieve this needed reform, but with a condition that would offset most, if not all, of the administrative advantages. We urge that this condition be eliminated.

In addition to the specific items described above, we endorse the other proposed amendments in the various bills that would streamline the reporting and disclosure requirements of ERISA.

Moreover, as I indicated, we support the basic concept of the "special master program" in S. 3017. However, we believe certain modifications are essential for the program to operate efficiently from the standpoint of both the employer and the sponsor. These are detailed in my prepared statement.

Tax incentives: Maximum encouragement should be given to the vigorous growth of private retirement plans and savings in a manner that is flexible and equitable among workers at all income levels.

Rather than attempting to discuss specific proposals that have been made, I would like to set forth basic principles which the council believes should be followed in designing such a tax incentive program:

(1) Employee contributions to retirement savings plans should be deductible for tax purposes. And we urge that the following features be adopted in the design of such a tax deduction package:

Maximum flexibility as to savings vehicles should be provided. Thus, employee contributions to a qualified retirement plan should be tax deductible. However, in view of the serious recordkeeping and other administrative problems involved in integrating voluntary employee contributions into many types of pension plans, plans should be given the option of accepting such contributions, but should not be required to do so.

Therefore, contributions to individual retirement accounts should also be deductible, without regard to the fact that the employee is also participating in a retirement plan sponsored by his employer.

The tax deductions should not be phased out at a specified income level or completely denied to a specified group, such as stockholders. Such a phaseout or other limitation would impact hardest on middle-income employees; a group that should clearly be encouraged to provide for their retirement.

The dollar and percentage limitations on the employee tax deductions should be as uniform as possible as among various types of arrangements—for example, IRA's, contributions to qualified plans, et cetera. Moreover, we do not believe that the tax deduction should be used as a "carrot" to impose limits on other aspects of a plan; for example, on the maximum employer contribution.

(2) S. 3017 would provide a package of tax incentives intended to encourage employers to establish and improve retirement plans. We believe these proposals raise important tax policy isuess that need careful study. They are spelled out in detail in my prepared statement.

Our comments on the question of preemption fall into two categories: (1) Comments on section 274 of S. 3017, which deals with the relationship of ERISA to the Federal securities laws; and (2) a recommendation that the ERISA preemption provisions be revised so as to specifically cover certain State mandated group insurance coverages.

(1) We concur with the proposed amendments in section 274. In enacting ERISA, Congress intended to establish a single regulatory scheme for employee benefit plans. Application of Federal and State securities laws to such plans and to separate account and bank collective trust vehicles used to fund them frustrates that intention. The regu-

latory schemes created under ERISA is clearly capable of adequately protecting participants' interests without unnecessary and duplicative regulations under the securities laws.

Moreover, we urge that the proposed preemption be expanded to also include general account contracts of insurers used to fund employee plans. Such a change is consistent with, and necessary to, the concept that a single regulatory scheme should be applicable to vehicles funding employee benefit plans covered by ERISA.

While we often welcome the Securities and Exchange Commission's efforts to provide administrative relief, we are of the view that the best solution is for the Congress to decide what is basically an issue of legislative policy, and that the solution proposed by the pending bill is a sound one.

(2) State mandated group insurance coverage. We believe that the preemption provisions of ERISA, as particularly applied to employee welfare benefit plans and as currently interpreted by the courts, have permitted extraordinary burdens to be placed upon insured plans and further, have encouraged such plans to become uninsured.

The problem can be illustrated by a recent Federal court of appeals case which holds that a State mandated insurance benefit—in this case, a New Hampshire insurance law mandating the inclusion of mental health coverage in all group insurance policies issued in that State—was not preempted. On the other hand, however, the court makes it clear that "a State may not regulate an employee benefit plan simply because the plan serves as self-insurer on all of its benefits."

The net result of the decision is to preempt State mandate benefit laws from applying to uninsured plans but not to preempt such laws from applying to insured plans.

These State laws present two serious problems for insured plans:

They differ, State by State, and are often conflicting as between States, thereby causing serious compliance problems, and, as a result, they encourage employers to turn to uninsured arrangements to avoid their impact.

Our associations have made it clear in previous testimony before Congress that we support State regulation of the life and health insurance business. It has proven in almost every area to be responsive to the needs of both the public and the insurance business. We therefore seek to preserve that system of regulation and believe that our proposed solution is consistent with that objective.

We urge Congress to resolve the problems discussed above by specifically preempting State laws mandating benefits and classes of individuals to be covered by insurance policies purchased by welfare benefit plans. This would leave undisturbed the States' mechanism which regulates the insurance business—that is, regulation of solvency, policy forms, agents' licensing, unfair trade practices, unfair claim practices, et cetera.

Again, thank you for giving me the opportunity to present the views of the Council and the HIAA on the important issues involved in these hearings.

Mr. Mason and I would be very happy to attempt to answer any questions you may have.

Senator WILLIAMS. Thank you very much.

You mentioned the *New Hampshire* case. You did not mention the *District Court* case that came out of the Hawaii situation, the health plan, the mandate health plan there.

Did you deal with that?

Mr. GIBB. No, sir. That is a somewhat different problem. It has half the problems we have. That is, I understand that case applies to insured and uninsured plans. That says any employer or all employers in Hawaii have got to establish a health plan and have to provide certain benefits whether it is done through insurance or not. The law has the problems that if it is allowed to stand, it can result in 51 States having 51 different laws. It does not have the second problem that we are concerned with in our particular area, and that is, it does no differentiate between insured plans and noninsured plans. But, nevertheless, we think the preemption clause should stand with regard to the Hawaii plan as well.

Senator WILLIAMS. Perhaps you could supplement your statement with an analysis of that. It would be helpful.

Mr. GIBB. OK.

[The prepared statement of Mr. Gibb and the supplement analysis referred to follows:]

Statement by Mr. William T. Gibb
On Behalf of the American Council of Life Insurance and
The Health Insurance Association of America
On Bills Relating to ERISA
Before the Senate Human Resources Subcommittee on
Labor and the Senate Finance Subcommittee on Private
Pension Plans and Employee Fringe Benefits

August 17, 1978

My name is William T. Gibb, Chief Counsel of the American Council of Life Insurance. I am appearing here today on behalf of the Council and, insofar as my statement relates to welfare benefit plans, on behalf of the Health Insurance Association of America. The Council has a membership of 479 life insurance companies which, in the aggregate, have 92 percent of the life insurance in force in the United States and hold 99 percent of the assets of insured pension plans. The HIAA has 320 members which, collectively, have in force over 90 percent of health and accident policies in the United States. Most of the members of the Council are also in the business of health and accident insurance.

I am pleased to have the opportunity to comment on the important issues addressed in the seven bills which are the subject of this hearing. However, before presenting the views of our two associations on specific proposals, I would like to comment generally on the question of amending ERISA.

General Comments

We supported, and continue to support, the basic objectives of ERISA. That is, to strengthen the private employee benefit plan system so that it may better fulfill the role of providing for the retirement and other financial security of American workers and their families and to encourage the growth of this system to cover additional employees and improve benefits under existing plans.

However, now that ERISA has been in place for almost four years, two facts have become apparent:

-- First, to a significant extent, ERISA has been counterproductive. It has impeded the establishment of new plans and even led to the loss of coverage which existed before its enactment. This undesirable result is attributable in large degree to over-regulation, particularly in terms of additional paperwork and other administrative burdens. Moreover, the design of the preemption clause is giving an incentive to welfare benefit plans to drop valuable insurance coverage in favor of uninsured arrangements.

-- Second, the affirmative steps taken in ERISA to encourage expansion of employee benefit plan coverage have proved to be inadequate. In this regard, much of the positive incentives have been negated by the burden of additional regulation.

We strongly believe that the time has arrived for Congress to deal with these unintended fallouts from ERISA. Thus, we applaud the efforts that led to the introduction of the various bills covered by this hearing and urge that your Subcommittees report meaningful legislation as soon as practicable.

Specific Comments

I would now like to comment specifically on various of the proposals included in the seven bills. In some cases, I will be proposing additional provisions which we think should be included in any amendments to a particular section of ERISA.

Reduction of Burdens on Small Pension Plans

It would be redundant to dwell on the problems--in terms of paperwork, other administrative burdens, and increased levels of administrative expenses--that ERISA has presented to plans of small employers. Others have documented the fact of small plan terminations and the slowdown in growth of new plans. All we can do is reinforce these findings--they are true. And the consequences are in terms of less retirement security for American workers and their families.

Moreover, in evaluating the impact of ERISA, it is important to look both at the burdens placed directly on employee benefit plans and at the burdens placed on those who sell and service these plans, such as insurance companies. For, in both situations, the ultimate cost falls on the plan. Likewise, in devising solutions, it is not enough to merely shift paperwork and other administrative workloads from the plans to the insurance companies, banks, etc., who may be servicing them. The burdens will still be there and the plans will continue to bear their cost. Thus, substantive, and not solely procedural, changes are necessary. This is not to say, however, that significant streamlining and consolidation cannot also be achieved by assigning some of the reporting and disclosure requirements to insurance companies and other master plan sponsors, as would be done under the special master plan program proposed in Title IV of S. 3017, as discussed below. But, standing alone, this would not be a complete solution.

Minimum Program. Within this context. a positive program should be adopted for alleviating the burdens and complexities imposed by ERISA on employee benefit plans of small employers. It should, at a minimum, contain the following specific components:

(1) Elimination of the Summary Annual Report--ERISA requires a plan administrator to furnish to each participant and beneficiary receiving benefits under an employee benefit plan, a summary of the annual report required to be filed by the plan with the Department of Labor. This requirement as to a summary is burdensome and costly while the detailed financial information called for is of little interest to plan participants. Thus, we strongly endorse the proposals in the pending bills to repeal this disclosure item.

In this regard, it should be noted that ERISA requires that a copy of the full annual report be made available, on request, to plan participants and beneficiaries. Moreover, this right must be spelled out in the plan's summary plan description. The availability of the financial information, in this manner, would seem clearly sufficient to protect the interests of plan participants.

(2) Replacement of Plan Description with a One-Page Registration Statement for Small Plans--On establishment of an employee benefit plan, and periodically thereafter, ERISA generally requires the plan administrator to file both a plan description and a summary plan description with the Department of Labor and to furnish the summary plan description to plan participants and beneficiaries. Since most of the information in the plan description is also in the summary plan description, it is proposed that, for small plans (fewer than 100 participants), the plan description be replaced with a one-page registration statement in order to remove the present overlap with the summary plan

description. It should be noted, as a precedent, that the Department of Labor has already exempted fully insured and unfunded welfare benefit plans with fewer than 100 participants from having to file a plan description.

(3) Utilization of Age 25 and One Year of Service with a Single Entry Date for Small Plans--In order to minimize administrative work and cost, for both the employer and insurance company, plans which use individual insurance contracts as a funding media find it helpful to deal with the mechanics of the plan as of one day each year, i.e., the plan's anniversary date. However, because of ERISA's participation provisions, in order to utilize such a single entry date,*/ many pension plans are able to establish only a six month eligibility period, in lieu of the one-year period generally available. This results in added expense to the plan of having to temporarily cover short-term employees who will leave before qualifying for benefits. Therefore, ERISA should be amended to permit small pension plans to qualify for the generally applicable one-year eligibility period without having to forfeit the convenience of a single annual entry date.

In this regard, section 232 of S. 3017 would achieve this needed reform, but with a condition that would offset most, if not all, of the administrative advantage. Specifically, in order to utilize a one-year eligibility period in conjunction with a single annual entry date, the plan would be required to measure

*/ See section 202(a)(4) of ERISA which provides that, once having met the statutory one-year eligibility period, an employee must be brought into the plan within six months. Thus, a pension plan cannot utilize the full one-year eligibility period in tandem with a provision that the employee will be covered on the next following anniversary date.

benefit accruals and vesting from the date of employment. Thus, each participant would have a different calendar period, dependent on his date of hire, and individualized vesting and benefit accrual computations would have to be made for each participant, instead of computations based on a uniform period (such as the plan year) as is generally permitted under ERISA. We urge that this condition be dropped and that the general rules for vesting and benefit accruals apply under the amendment in section 232. As so revised, we would strongly endorse this provision.

In addition to the specific items described above, we endorse the other proposed amendments in the various bills that would streamline the reporting and disclosure requirements of ERISA.

Finally, we currently have pending various issues with the Department of Labor and IRS which, if not satisfactorily resolved at that level, should be dealt with legislatively. We will report to you as to the status of these matters in the future. However, one of them represents a new concept and, for this reason, we believe it should be reported to you at this time:

(4) Exemption from Actuarial Certification Requirements for Small Plans--Currently, the ERISA requirement (section 103(d)) for annual actuarial certifications by enrolled actuaries is causing a significant burden in the small pension plan area. There are several aspects to this burden:

(a) Financial - in small plans, the cost of the actuarial certification for defined benefit plans can be a very significant percentage of the total plan contribution. For example, in a ten life plan, the annual contribution might be from $10,000 to $15,000 and the cost of actuarial certification could range up to $2,000, depending on the vendor of the services.

(b) Additional complexity - most small plan sponsors are not knowledgeable in the employee benefits plan area and do not have an in-house staff of employee benefit experts. Therefore, they would like to keep plan administration as simple as possible. The requirement for an annual actuarial certification for defined benefit plans by an enrolled actuary is a significant complicating factor.

(c) Enrolled actuary - the Joint Board has only enrolled a few thousand actuaries, and only a small percentage of these actuaries work in the small plan area. Therefore, the enrolled actuaries working in the small plan area must certify hundreds of plans each year. This forces them to take shortcuts and/or miss filing dates. In effect, these enrolled actuaries are forced to provide actuarial certification on a mass production basis when actuarial certification is not the type of task that lends itself to mass production techniques.

Proposal. We have proposed, as a solution to this problem, that small pension plans be exempted from the ERISA actuarial certification requirements provided that certain conditions are met. These conditions are patterned after those applicable to so-called "insurance contract plans" (defined in section 301(b) of ERISA), which presently are exempted from, among other things, the actuarial certification requirements. We believe there is authority to grant this exemption by regulation.

Specifically, we have proposed that defined benefit plans with fewer than 100 participants be exempt from the ERISA actuarial certification requirements for a year if:

(i) The plan is funded exclusively by assets which are guaranteed by an insurance company, a bank, a savings and loan association, or a similar institution, against market fluctuations.

(ii) The contributions to the plan are based upon the individual level premium funding method (without supplemental liability) using a reserve basis specified by IRS regulations.

(iii) The value of retirement benefits provided by the plan at normal retirement age is equal to the reserves at normal retirement age. All ancillary benefits in excess of the reserve for an individual (e.g., pre-retirement death benefits) are insured by an insurance company.

(iv) All contributions necessary to meet the reserve requirements have been made during the plan year.

(v) No rights under any plan assets have been subject to a security interest at any time during the plan year.

(vi) There are no policy loans outstanding against any plan assets at any time during the year.

With the above-outlined conditions, the calculations would be so simple as to obviate the need for the expertise of an enrolled actuary.

The proposed exemption described above would be applicable to plans which are funded by individual insurance contracts, group insurance contracts or to plans without any insurance as a funding vehicle.

In addition, small plans underwritten by group deferred annuity contracts which satisfy these proposed conditions, except for the individual level premium funding method (condition (ii)), should also be exempted from the actuarial certification requirements.

Special Master or Prototype Plans

Title IV of S. 3017 would establish a "special master plan" program to ease the paperwork and other burdens of adopting and operating pension plans, particularly by small employers. The core of the proposal is to shift many of the statutory responsibilities arising out of the plan from the employer to the sponsor of the plan, in our situation, a life insurance company.

As I have indicated, we wholeheartedly endorse the idea of simplifying the administration of employee benefit plans. Within this context, we support the basic concept of the "special master plan" program.

However, we urge that such a program constitute only one facet of an attack on the complexities and burdens of ERISA--for it must be recognized that shifting the responsibility to perform certain functions does not eliminate the burdens they create; it merely puts the burdens on someone else. Thus, it is extremely important that emphasis also be placed on eliminating or streamlining the various requirements themselves. As we have noted above, several of the bills would make significant strides in this direction in terms of amendments to the disclosure requirements. In addition, we have suggested another step that can be taken with regard to the actuarial certification requirements. Adoption of the "special master program" in no way reduces the need for action on these items.

As I indicated, we support the basic concept of the "special master program". However, we believe certain modifications in the provisions of

S. 3017 are essential for the program to operate efficiently from the standpoint of both the employer and the sponsor.

(1) Responsibilities assigned to the sponsor. We believe that the responsibilities shifted to the sponsor should be limited to reporting and disclosure and maintaining individual accounts for participants. By denominating the sponsor as "administrator" and "named fiduciary", S. 3017 would apparently also make the sponsor responsible for the day-to-day operations of the plan. We do not believe this is feasible or desirable, since the sponsor is not on the premises and, in fact, may be located in another part of the country. Moreover, S. 3017 would make the sponsor the "investment manager" for the plan. We do not understand how this would operate in the case of an insured plan; but certainly the sponsor should not be required to recommend the products of a competing life insurance company or other funding media. It should continue to be the responsibility of the employer to pick the particular insurance company or other sponsoring organization from which to purchase a "master plan".

Thus, we strongly recommend that Title IV of S. 3017 be revised as follows:

(a) The law should set out the specific responsibilities that are to be shifted to the sponsor. We believe these should be limited to reporting and disclosure and maintaining participant accounts. In this regard, however, it should be made clear that while the sponsor is responsible for preparing summary plan descriptions, etc., and furnishing them to the employer, the employer will remain responsible for distribution of summary plan descriptions and other documents that are required to be made to plan participants.

(b) The sponsor should not be labeled with any of the statutory terms, such as "plan administrator", "named fiduciary", or, unless otherwise agreed to, "investment manager". These labels carry correlative responsibilities and consequences which should not automatically be placed on the sponsor. For example, a fiduciary is automatically subject to the co-fiduciary rules; a plan administrator or investment manager cannot qualify for Prohibited Transaction Exemption 77-9, etc. Thus, the duties of the sponsor should be set forth specifically; not by use of general labels.

(c) Correspondingly, it should be made clear that the labels put on various plan officials do not make them accountable for the duties assigned by the law to the sponsor.

(2) Defined Benefit Plans. The "special master plan" program should be made immediately available to defined benefit plans, as well as defined contribution plans. There are many very desirable aspects to a defined benefit plan, particularly in being able to adapt to rises in the cost of living. We see no particular obstacles to making them immediately eligible for the "special master plan" program.

Tax Incentives

Private retirement plans, individual savings, and Social Security, together, have the job of providing retirement income security for American workers and their families. It is important that there be a proper balance among the three mechanisms. In this regard, Social Security should be designed to provide retired workers with a basic level of economic protection in their retirement. The provision of retirement income above this level is, and should be, the responsibility of individual workers and their employers--with appropriate encouragement being provided by the Government--through the use of various private savings media, including insurance company products. Unlike Social Security, these private arrangements provide flexibility so that the retirement programs can be designed to suit the needs of particular groups of employees in different firms, industries, unions and geographical locations. Moreover, private retirement savings are an important source of capital so necessary if our economy is to continue to grow.

To this end, maximum encouragement should be given to the vigorous growth of private retirement plans and savings in a manner that is flexible and equitable among workers at all income levels. Rather than attempting to discuss specific proposals that have been made, I would like to set forth several principles which the Council believes should be followed in designing a tax incentive program:

(1) Employee contributions to retirement savings should be deductible for tax purposes. We realize that limitations on such deductions are inevitable in view of the revenue loss potential, but we urge that the limitations be set as high as possible, consistent with these constraints. Moreover, we urge that the following features be adopted in the design of a tax deduction package:

-- Maximum flexibility as to savings vehicles should be provided. Thus, employee contributions to a qualified retirement plan should be tax deductible, whether they are mandatory or voluntary contributions. This would encourage employees to share in the costs of their employers' retirement plans and, thus, would help employers set up such plans and improve benefits in situations where the employers would, themselves, be unable to pay the full cost of the plan or the benefit improvement.

However, in view of the serious recordkeeping and other administrative problems involved in integrating voluntary employee contributions into many types of pension plans, plans should be given the option of accepting such contributions, but should not be required to do so. Therefore:

-- Employee contributions to Individual Retirement Accounts should also be deductible, without regard to the fact that the employees are also participating in a retirement plan sponsored by their employer.

-- The tax deductions should not be phased out at a specified income level or completely denied to a specified group, such as stockholders. Such a phase-out or other limitation would impact hardest on middle income employees; a group that should clearly be encouraged to provide for their retirement. Moreover, if the decision to establish a plan is in the hands of an individual who would be affected by the phase-out, he would be discouraged from even establishing a plan. Limitations on the tax deductions based on a percentage of compensation, with a dollar cap, are sufficient to prevent any abuse by upper income employees.

-- The dollar and percentage limitations on the employee tax deductions should be as uniform as possible as among various types of arrangements (e.g., IRA's, contributions to qualified plans, etc.). The present tax law is complicated enough in drawing distinctions between corporate plans, H.R. 10 plans, IRA's, Subchapter S corporation plans and plans of tax-exempt organizations. Further complexity should be avoided. Moreover, we do not believe that the tax deduction should be used as a "carrot" to impose limits on other aspects of a plan; for example, on the maximum employer contribution.

(2) Tax incentives for employers should be carefully studied. S. 3017 would provide a package of tax incentives intended to encourage employers to establish and improve retirement plans. We believe these proposals raise important tax policy issues that need careful study.

More specifically:

-- A tax incentive to establish a retirement plan carries the danger that some employers may establish a plan solely in response to the extra tax savings and without any real appreciation of the long-term commitment that is involved. We question whether it is wise policy to encourage such a development.

-- A tax incentive to improve an existing plan would undoubtedly lead to the strengthening of plans and, in this respect, would be desirable. However, employers who have voluntarily improved their plans in the past might feel that a new tax incentive is unfair.

In conclusion, we fully support measures to encourage the growth of private retirement savings and applaud those who have provided for them in proposed legislation. However, as discussed above, we believe that certain principles should be followed in designing a package to achieve this objective.

Preemption

Our comments on the question of preemption fall into two categories: (1) comments on section 274 of S. 3017, which deals with the relationship of ERISA to the Federal Securities laws; and (2) a recommendation that the ERISA preemption provisions be revised so as to specifically cover certain state mandated group insurance coverages. Our positions and recommendations are set forth in detail below.

(l) Section 274 of S. 3017

This amendment would revise Section 514 of the Employee Retirement Income Security Act of 1974 to clarify the applicability of Federal and State securities laws to plans which are subject to ERISA. This amendment provides that ERISA supersedes Federal and State securities laws to the extent that such laws might be applied to the interest of an employee in an employee benefit plan described in Section 4(a) and not exempt under Section 4(b) of ERISA or to certain insurance company and bank vehicles commonly used to fund such plans. Proposed new paragraph (2) to be added to Section 514(d) by Section 274 is intended to make it clear that the interest of an employee in an employee benefit plan subject to ERISA shall not be subject to the Federal or State securities laws unless such plan is an eligible individual account plan in which participation is voluntary. Proposed new paragraph (3) to be added to Section 514(d) makes it clear that the interest or participation of an employee benefit plan subject to ERISA either in a single or collective trust maintained by a bank or in a separate account maintained by an insurance company also shall not be subject to the Federal or State securities laws. Further, such single or collective trusts and separate accounts are not to be considered investment companies for purposes of Federal and State laws.

We concur with these proposed amendments of Section 514(d). In enacting ERISA Congress intended to establish a single regulatory scheme for employee benefit plans. Application of Federal and State securities laws to such plans frustrates that intention. The regulatory scheme created under ERISA is clearly capable of adequately protecting participants' interests in employee benefit plans without unnecessary and duplicative regulation under the securities laws.

The Congress has consistently encouraged the creation of private retirement plans. These have now grown to the point where they cover over 30 million people. The administration of qualified pension and profit sharing plans is a highly technical and complex area, utilizing the services of actuaries, accountants and lawyers. Any added complication that impedes or discourages the operations of the plan or its funding agencies or anything that causes delay or additional burden, constitutes a serious disincentive. Although amendments have been enacted to the Federal securities laws which provide some relief in this area, pension plan sponsors and administrators are still subject to a large variety of securities law provisions which we believe are unnecessary and, in contrast to the provisions of ERISA, are not directly relevant to the regulation of employee benefit plans.

While we often welcome the Securities and Exchange Commission's efforts to provide administrative relief, we are of the view that the best solution is for the Congress to decide what is basically an issue of legislative policy, and that the solution proposed by the pending bill is a sound one.

The following discussion is intended to amplify our position with respect to Section 274. We also have specific modifying language to recommend which would be consistent, in our view, with the objectives of S. 3017.

Interests in Employee Benefit Plans (Proposed Paragraph 2)

We concur with proposed Paragraph 2 which would preempt the application of Federal and State securities laws to interests in employee benefit plans subject to ERISA. In this connection we believe that the Seventh Circuit in Daniel v. International Brotherhood of Teamsters was in error when it affirmed a lower court decision which held, for the first time, that an interest in a pension plan is an investment contract and that a plan participant may maintain a cause of action under the anti-fraud provisions of the Federal securities laws. Three other district courts recently have held that the securities laws do not apply to interests in such plans.[1/]

1/ Robinson v. UMH Health & Retirement Fund, 435 F. Supp. 245 (D.D.C. 1977); Wiens v. International Bd. of Teamsters, [Current] FED. SEC. L. REP. (CCH) ¶ 96,005 (C.D. Cal. 1977); Hurn v. Retirement Fund Trust of Plumbing, Heating & Piping Indus., 424 F. Supp. 80 (C.D. Cal. 1976).

It is apparent that the Seventh Circuit neglected evidence in the legislative history and text of ERISA that strongly indicated that Congress in 1974 did not recognize that the securities laws had played, or would play, any significant role in the pension regulatory scheme. The legislative reports concerning ERISA and pension reform generally failed to mention the securities laws in their exhaustive listings of other federal legislation which had some relationship to pension plans. There is no indication that Congress intended to have these different regulatory schemes meshed. The general absence of mention of the applicability of the securities laws in either the text or legislative history of ERISA clearly militates against any conclusion that the Congress in 1974 understood that the securities laws applied to the regulation of pension plans. The provisions of ERISA have been described as "an elaborate interweaving of jurisdiction" between the Labor Department and the Treasury Department. 2/ The precision with which Congress specified the roles of those departments clearly indicates the type and extent of regulation that Congress intended for pension plans. The absence of mention of the securities laws and the SEC is conspicuous.

The Justice Department in its Motion for Leave to File Amicus Curiae and Brief filed in the Supreme Court on August 4 appears to generally concur in this view:

2/ See Lee, "The Elaborate Interweaving of Jurisdiction": Labor and Tax Administration and Enforcement of ERISA and Beyond, 10 University of Richmond Law Review 463, 503 note 209 (1976).

> "Any judicial delineation of the contours of a cause of action should take into account that Congress has, in ERISA, enacted a comprehensive statute to establish and protect workers' pension rights. Any interpretation of the securities laws that would engraft onto ERISA remedies under those laws enacted 40 years earlier and never before applied to pension plans should be adopted with caution lest the carefully designed scheme of Congress be disrupted.
>
> "Where, as here, Congress has provided specific directions on what information must be disclosed to the employee, such directions should be deemed to embody, for Securities Acts purposes, everything that is material. If there has been compliance with ERISA's disclosure provisions there should be no liability under the Securities Acts for failure to disclose additional information."

We further believe that proposed paragraph (2) of Section 514(d) is a sensible measure regardless of whether or not the particular pension plan in Daniel or any other type of plan technically falls within the Federal securities laws' definition of a security. The purpose of this new provision is not to rewrite the Federal securities laws but to preclude their application in an area in which Congress has established a single regulatory scheme which obviates the need for the application of those laws.

Certain Vehicles Funding Employee Benefit Plans (Proposed Paragraph (3))

We also concur in proposed paragraph (3) which would preempt the applicability of the Federal securities laws to interests in bank trusts and insurers' separate accounts issued to employee benefit plans covered by

ERISA. For the reasons discussed below, we further propose that paragraph (3) be modified to include general account contracts of insurers. We believe that Congress intended a single regulatory scheme to apply to interests in such plans. We also believe that it is appropriate for a single regulatory scheme to be applicable to vehicles funding such plans when the sponsors of such vehicles are subject to regulation of a sufficient and extensive nature.

General Account Contracts

When the Federal securities laws were originally adopted, the Congress decided to make these laws inapplicable to the administration of qualified retirement plans. The applicability of the securities laws was not affected by an employer's choice of funding agency. Regardless of whether a bank or insurance company was chosen, there were statutory or administrative exemptions that relieved both funding agencies from the necessity of compliance with those laws.

Prior to 1960, banks had the advantage of being able to invest accumulated plan contributions under a trusteed plan either in fixed-income securities or in equity securities, in whatever proportion the employer preferred. Life insurance companies, however, could offer only investments primarily in fixed-income securities. In consequence, although other factors may also have contributed, an increasing percentage of this business was placed with the banks.

In the early 1960's however, life insurance companies in order to compete more effectively sought and obtained authorization under state law to include facilities for investing the assets of retirement plans in common stocks or other equity securities and for allocating the investment results directly to those plans. This is accomplished through what are known as "separate accounts." These separate accounts, which have now been expressly authorized by the legislatures of almost all of the states, are the life insurance company counterpart of the collective pension trusts of the banks.

Life insurance company separate accounts, however, which were not in existence or even contemplated when the securities laws were adopted, were not given the express statutory exemptions enjoyed by qualified pension and profit-sharing trusts. It was only by reason of the accident of time that the securities laws contained exemptions for the common stock investment services provided by banks in this area while they did not contain exemptions for comparable common stock investment services offered by life insurance companies. This accidental difference was removed in large measure by the Investment Company Amendments Act of 1970. Generally, the amendments made by the 1970 Act to the 1940 Act provide exemption from the provisions of that Act to separate accounts which hold assets attributable to certain pension and profit-sharing plans qualifying under either Section 401 or Section 404(a)(2) of the Internal Revenue Code. The 1970 Act also amended the 1933 Act to provide, essentially, an exemption from the prospectus requirements of that Act for such plans. The 1970 Act further provides an exemption from certain provisions of the 1934 Act for certain qualified plans funded by separate accounts. Thus, to a large extent Section 274 merely reaffirms a policy adopted by Congress in the 1970 Act amendments.

The 1970 exemptive amendments to the 1933 and 1934 Acts applicable to insurance company funding of qualified plans specifically covered only separate accounts and made no reference to interests in general accounts. This was because the contracts which provided for the allocation of contributions to general accounts were universally regarded as insurance policies or annuity contracts and therefore exempted from registration under the 1933 Act either because they were not regarded as "securities" at all or because they were exempted by Section 3(a)(8) of that Act.

Recently, however, questions have arisen with respect to the applicability of the registration requirements of the 1933 Act to the offer and sale by life insurance companies of certain contracts to the trustees of pension or profit-sharing plans that meet the requirements of Section 401 of the Internal Revenue Code or to corporate employers establishing such plans.

While the investment of qualified plan assets by banks is accomplished entirely through the use of trusts, the major part of the qualified plan assets managed by life insurance companies was not held in separate accounts in 1970, and this continues to be the case today. The Investment Company Amendments Act of 1970 actually affected a relatively small part of the qualified plan funding activities of life insurance companies. Most of these assets are held, under individual and group annuity contracts, and life insurance policies, as part of the general accounts of insurance companies. Employers who wish assets of their plans to be invested primarily in common stocks or in real property, and who choose insurance companies to administer and invest such funds, enter into contracts which provide for the allocation of plan contributions to separate accounts. Employers who wish to have assets of the plans invested primarily on a fixed-income basis, and who also choose insurance companies to administer and invest such funds, generally enter into contracts which do not so provide, and, accordingly, the plan contributions, when made, simply become part of the general assets of the insurance company.

Proposed paragraph (3) of Section 514(d) insofar as it deals with insurers relates to separate accounts only. For the reasons indicated above, we feel that proposed paragraph (3) of Section 514(d) must be modified to include general account contracts of insurers issued to fund employee benefit plans covered by ERISA. (Our specific recommended language appears on page 25)

Plans Other Than Corporate Qualified Plans

The proposed statutory pattern of Section 274 differs from the 1970 Act amendments with respect to the activities of banks and insurance companies in connection with the administration of qualified plans established by self-employed persons, commonly called H. R. 10 or Keogh or Keogh-Smathers

Plans. As a result of the 1970 Act, the 1940 Act was made inapplicable to such plans but no exemption from the registration requirements of the Securities Act of 1933 or from the Securities Exchange Act of 1934 was provided. In contrast, proposed paragraph (3) of Section 514(d) does not draw distinctions between corporate plans and other employee benefit plans such as H. R. 10 plans in addressing the applicability of the Federal securities laws to interests of employee benefit plans in bank trusts and insured separate accounts. We concur with this aspect of the legislation. Any distinction based on the nature of the employer (i. e., whether the sponsor of the employee benefit plan is a corporation or a partnership) is not uniformly relevant to the issue of whether or not the application of the Federal securities laws is necessary or appropriate where ERISA applies.

We believe that the requirements of ERISA subject the insurer to the highest standards of duty and responsibility. State regulation of insurers similarly imposes relevant regulation which serves to make the applicability of the anti-fraud provisions of the Federal securities laws duplicative and unnecessarily burdensome. There are limitations under State laws which ultimately serve to provide similar types of protections and safeguards which are the concern of the SEC in applying the anti-fraud provisions of the Securities laws. Therefore, no regulatory "gap" will be created if the anti-fraud provisions are made inapplicable to these funding vehicles.

Recommended Modifications to Section 274

We urge the following proposed amendments to Section 274:

1. The new subparagraph 514(3)(A) refers only to interests in separate accounts. Since there have now been questions raised over whether certain general account contracts constitute "securities," there is no reason to exclude separate account funding and not do the same for general account funding.

This would be most simply accomplished by striking the words "separate account maintained" in line 6 of page 46 and replacing them with the words "contract issued."

2. Because the insurance contract is issued to the plan trustee or employer rather than to the plan itself, the introductory phrases of subparagraph (B) in line 8 on page 46 should be amended to read "issued for the purpose of funding an employee benefit plan . . ."

We believe that such a revision of the law is consistent with the original Congressional intent in enacting ERISA and with the basic approach of this legislation.

3. The term "eligible individual account plan," which is used both in Section 271 and Section 274 of the Act, appears to have been intended to refer to what Senator Williams referred to in his introductory statement as a plan in which participation is wholly voluntary and which is designed and permitted to invest heavily in securities issued by the employer who maintains the plan.

The traditional position of the Securities and Exchange Commission has been that registration of the interests in a plan is not required except where the plan is in fact invested in securities of the employer to an extent in excess of the employer contributions, so that employee contributions will necessarily have been used for the purchase of employer securities. A thrift or profit-sharing plan, which is one of the types of plans covered by the term "eligible individual account plan," is often designed so as to invest in other than employer securities, and as Sections 271 and 274 are now drafted there would be a strong implication that the securities laws should apply to the interests in such plans and possibly even that those interests should be registered under Section 5 of the 1933 Act, something that is not the current practice.

We believe it would be preferable if the following modifying language were added to both Section 271 (at line 22 on page 42) and Section 274 (at line 2 on page 46):

> "and under which an amount in excess of the employer's contribution is allocated to the purchase of any employer security."

This language is taken substantially from Section 3(a)(2) of the 1933 Act, the only change being to simplify it through the use of the term "employer security" which is a defined term in ERISA.

(2) State Mandated Group Insurance Coverage

Background. Section 514 of ERISA attempts to set forth the basic areas of regulatory responsibility--as between the states and the federal government--respecting employee pension and welfare benefit plans. The American Council of Life Insurance and the Health Insurance Association of America believe that the provisions of this section, as particularly applied to employee welfare benefit plans and as currently interpreted by the courts, have permitted extraordinary burdens to be placed upon insured employee welfare benefit plans and further have encouraged such employee welfare benefit plans to become uninsured. We do not believe either result was intended by Congress or is in the best interest of sound regulation in this area.

The statutory language of Section 514 is well known to the members of these Subcommittees and will therefore not be repeated in this statement. It has been briefed and argued on numerous occasions to require an interpretation, on the one extreme, that it broadly preempts all state laws relating to employee benefit plans and, on the other extreme, that it preempts only those state laws which are duplicative of the provisions of ERISA. The result has been confusion and, in some cases, conclusions which we do not believe were intended by Congress.

For example, Dawson v. Whaland, 562 F2d 70, decided by the United States Court of Appeals for the First Circuit on September 1, 1977, with certiorari denied by the United States Supreme Court on April 18, 1978, holds that a state mandated benefit (a New Hampshire insurance law mandating the inclusion of mental health coverage in all group insurance policies issued in that state) was not preempted. The court concluded "that ERISA does not preempt application of state law to group insurance policies when such policies are purchased by employee benefit plans." On the contrary, however, the court makes it clear that "a state may not regulate an employee benefit plan simply because the plan serves as self-insurer on all of its benefits." The net result of the decision in Dawson is to preempt state mandated benefit laws from applying to uninsured (self-insured) plans but not to preempt such laws from applying to insured plans. In response to the argument that insured plans would be detrimentally affected and might face bankruptcy or extinction, the court responded: "Assuming such detrimental consequences exist, we note that Congress fully intended to appraise the implementation of the Act and to provide remedial legislation where necessary."

Necessity for Remedial Legislation. We believe it is extremely important for Congress to clarify this situation in the interest of sound regulation of insurance and the protection of the benefits provided by the employers under employee welfare benefit plans. In the first place, we support sound state regulation of insurance, yet we do not believe that a scheme where states mandate the coverages contained in group insurance policies in a non-uniform and often conflicting manner is sound state regulation of insurance. In the second place, we believe that the present effect of ERISA is to encourage plans to become uninsured and thereby lose the protection of important state regulatory controls.

(a) "Mandated Coverage" Problem--The problem for insured plans when states are permitted to mandate coverages in group insurance policies can be easily discerned from an examination of the proliferation of non-uniform state laws and regulations.

Eighteen states have passed laws relating to health insurance benefits for alcoholism treatment. Some mandate benefits for inpatient care, but not for outpatient; some require the reverse. Each law has different limitations of coverage; some require coverage only in certain treatment facilities.

Eight states have passed laws relating to health insurance benefits for drug addiction treatment. Some set minimum benefits, some set maximum benefits. All eight laws are different in their approaches to inpatient and outpatient treatment.

Eighteen states have passed laws relating to insurance benefits for treatment of mental illness. Some require the coverage for inpatient treatment; others require it for outpatient treatment. The outside limits required range from $500 to $10,000. Coinsurance limits range from 25% to 90%.

Forty-eight states have passed laws relative to coverage for newborn children. While the American Academy of Pediatrics developed a Model Newborn Children Act with the cooperation of the HIAA, many states saw fit to change the Model, thereby creating many substantive and compliance problems for both group insurers and multistate employer operations.

While we could continue to cite examples of non-uniform state laws and regulations affecting insured employee benefit plans, it should be clear that the situation is chaotic for insurers and their customers, the employers. Both the insurers and the employers must keep track of the types and variations of mandated coverages in each state in which they operate. These laws are constantly changing making the mechanics of compliance increasingly burdensome.

The situation is frequently complicated by union bargaining agreements which cover employees in more than one state.

The employer ultimately is the party that bears the additional burden of costs associated with the mechanics of handling the aberrations. These additional and unwanted costs are naturally resisted by the employer and often it is forced to reduce desired benefits in order to keep costs reasonable or to seek to become uninsured to avoid these laws.

Furthermore, several of the states have applied their laws mandating coverages to group policies issued outside their state which cover residents of their state. The tendency for this to occur with greater frequency is most alarming. Thus, an employer may negotiate or determine benefits for his employees in the state where it is headquartered in accordance with that state's law and find that such benefits when purchased under an insurance policy issued in that state are not in accordance with a neighboring state's law, or the neighboring state may require an additional benefit or benefits for employees in its state. This not only removes the freedom of selecting among the benefits most desired by the employer and employees but impossibly complicates the benefit structure for employers with multistate operations. Moreover, providing a benefit mandated for a few employees located in a state other than the principal state of the employer may increase costs such that the majority of the employees lose valuable coverage more widely desired by them.

It should be apparent that the increasing number of non-uniform state laws mandating coverages in group insurance policies has made it increasingly more burdensome for insurers to provide insured coverage to employee welfare benefit plans. Moreover, these laws make it difficult and costly for the employer to provide the kind of benefits and the benefit mix most desired by the employees through an insured plan.

(b) "Movement To Become Uninsured" Problem--The combination of the effect of the preemption provisions of ERISA and the increasing tendency of the states to mandate coverages as described above has not surprisingly led many employers to become uninsured and numerous more to consider such a move. Under ERISA, as currently interpreted, group life and health insurance sold to employee welfare benefit plans are not protected from the hodgepodge of state mandated coverages, while employers which choose to be uninsured are free to provide coverages without regard to state laws. We view this as alarming both from the standpoint of placing insurers in an untenable competitive disadvantage with uninsured plans and from the standpoint of eroding the protection afforded employees by the traditional state regulatory controls that protect their coverages.

Many large as well as most small employers desire the protection that group insurance provides for their employees. However, when the various states where their employees are located dictate the coverages that must be included in group insurance, the providers of such insurance find it difficult to compete with the incentive to become uninsured in order to avoid the problem of mandated coverages. Insurers clearly should be afforded the opportunity to provide insured protection to the employee benefit market in parity with uninsured plans, a result currently precluded by ERISA.

In addition, a very important fact is that uninsured plans are neither subject to state regulation over the financial stability or management of the provider nor subject to the many other state controls placed upon insurance companies to protect the insureds. While some large employers may be able to provide benefits to their employees without insurance, the recent experience of the uninsured multiple employer trusts indicates, for example, that other employers cannot.

In short, we do not believe Congress intended by the preemption language of ERISA to motivate employers to drop insured plans in favor of uninsured plans.

Proposed Legislative Solutions. Our associations have made it clear in previous testimony before Congress that we support state regulation of the life and health insurance business. It has proven in almost every area to be responsive to the needs of both the public and the insurance business that serves the public. We therefore seek to preserve that system of regulation and believe that our proposed solution is consistent with that objective.

We urge Congress to resolve the problems created by state mandated group insurance coverages and the consequent movement to uninsured plans, and to do so by clarifying the preemption language of ERISA. We suggest an amendment to the preemption provision whereby it is specifically stated that state laws mandating benefits and classes of individuals to be covered are preempted with respect to policies purchased by welfare benefit plans.*/ (We would be pleased to assist the staff of your Subcommittees in drafting such an amendment.) This would leave undisturbed the states' mechanism which regulates the insurance business, i.e., regulation of solvency, policy forms, agents' licensing, unfair trade practices, unfair claim practices, etc., but remove the chaotic result which we have witnessed when 51 jurisdictions pass numerous non-uniform laws mandating group insurance coverages that must be part of insured employee welfare benefit plans. Such a limited preemption would, in our opinion, remove serious obstacles to employers desiring insured protection and thereby remove much of the incentive presently attributed to the language of ERISA for employers to become uninsured. Employers would be free to negotiate coverages without the interference of mandated coverage restraints and yet the employers and employees could retain the protection afforded by insurance and the vast majority of state regulation that works effectively in this area.

Joint and Survivor Annuities

Section 238 of S. 3017 would significantly revise the requirements for "early survivor annuities", as enacted by ERISA. Basically, ERISA provides that each participant in a pension plan must be given the right to elect a survivor

*/ Under our approach, group conversion requirements would not be preempted.

annuity for his spouse in the event he dies after early retirement age (or, if later, age 55). S. 3017 would make two substantial changes in this provision:

(1) The provision of a survivor annuity (payable to the spouse) would be made mandatory for all pension plans; and

(2) The survivor annuity benefit would have to be provided to every participant once he becomes 50 percent vested under the plan.

We believe that these changes would operate against the best interests of many participants and plans and, thus, we oppose them. Our specific reasons are as follows:

(1) The additional coverage would be minimal in many cases. The amount of a survivor annuity that could be provided by the value of the accrued benefit for a relatively young employee who is 50 percent vested would, in many cases, be very small. Thus, the expanded provision could involve significant administrative and recordkeeping costs in order to provide minimal benefits at best. The provision in existing law which confines the requirement to employees who die after early retirement age protects against this problem to a considerable degree.

(2) The new requirement will often conflict with existing group life insurance plans. Many employers presently have group life insurance plans for their employees in order to provide protection for dependents in case the employee dies during his working years. This is the very same protection as is sought by the proposed expansion of the survivor benefit provisions in a pension plan. To have both would, in many cases, be duplicative. Thus,

enactment of the proposal in S. 3017 would require many employers to move their group life insurance plans into their pension plans--at a tax disadvantage to the employees since they would lose the tax exclusion provided by section 79 of the Internal Revenue Code for the first $50,000 of coverage. Thus, we seriously question the need for the expansion of the early survivor annuity as proposed in S. 3017; particularly in the mandatory form suggested.

(3) The impact of the proposal would fall most heavily on plans with liberal vesting. We believe it is extremely important to encourage sound vesting in pension plans--and, to do this, disincentives should not be introduced into the law. The proposed early survivor annuity requirement--which would apply once 50 percent vesting is achieved--would be such a disincentive since it would bring with it burdensome administrative costs in providing for what will probably be minimal benefits.

For all these reasons, we oppose expansion of the early survivor benefit requirements.

However, whatever the decision on this proposal, we urge the enactment of the following three important clarifications in the operation of the joint and survivor annuity provisions.

(a) Profit-Sharing and Money Purchase Plans

The Treasury Department regulations indicate that a defined contribution plan which offered a life annuity option, but which provided another benefit form, usually a lump-sum payment, as the automatic form of benefit payment, must (in order to conform to ERISA) be revised to make a joint and survivor annuity the automatic benefit form and the lump-sum payment an elective form. (See paragraph (a) of §1.401(a)-(11)).*/ The particular fact situations involved are the thousands of profit-sharing (including thrift) plans which provided for a lump-sum payment of the participant's accumulated account value as the automatic benefit form, but which also offered the participant the option to elect to receive part or all of his account in the form of annuity payments. Under the final Treasury rules, these plans have had to be fundamentally restructured to provide an annuity as the basic benefit form or (as is more likely) drop the opportunity for a participant to elect an annuity benefit form in order to avoid making the joint and survivor annuity the automatic benefit form. Moreover, a new defined contribution plan cannot be designed to provide a lump-sum as the automatic benefit form, if it desires to provide an annuity option.

We believe this result is in conflict with sound tax policy and strongly urge that the law be clarified to indicate that, in the case of a defined contribution plan, the joint and survivor annuity requirements will be satisfied in a case where a non-annuity type payment is the automatic benefit form, so long as a qualified joint and survivor annuity is available as an option of the same rank as any other annuity option.

We believe such a revision of the law is consistent with the original Congressional intent in enacting ERISA. If Congress had intended to mandate annuity distributions, as compared to lump-sum distributions, it would have

*/ We strenuously opposed this provision during the development of the regulations and again after their issuance, but were unsuccessful.

clearly stated this in the law. But it did not. Moreover, the plans involved have been purposely designed to provide for lump-sum payments as the automatic benefit form and such a benefit form may be desirable from most participants' point of view. The annuity option is generally included as a convenience for employees who desire it. In their present form, the Treasury regulations encourage employers to drop this option which would seem clearly to run counter to the interests of plan participants.

(b) Lump-Sum Payments of Early Survivor Annuity

We urge that the early survivor annuity provisions be revised to provide that the survivor payments may be in the form of a lump-sum. Both S. 3017 and, with a limited exception, present law provide that such payments must be made in annuity form--an inflexibility which is inconsistent with the usual options given to plans and participants. The availability of a "lump-sum" alternative is particularly important where the amount involved is small and does not justify the expense of administering an annuity payout formula.

In the same vein, we urge that the law be amended to make clear that a plan does not have to establish the elaborate election procedures for the early survivor annuity, where it provides a pre-retirement death benefit at least equal in value to the required early survivor annuity. The Treasury Department regulations presently provide that the election procedures do not have to be applied in a defined contribution plan which meets this condition; but such a provision is not extended to defined benefit plans, although there are many such plans which contain a pre-retirement death benefit which, by definition, exceeds in value the minimum early survivor annuity specified in the law. To require this type of plan to offer and explain an early survivor annuity option creates unnecessary expense and confusion.

(c) Beneficiary

Finally, we urge that the law be clarified to provide that a plan may permit a participant to elect to have the pre-retirement survivor annuity paid to a person other than his or her spouse. There are various reasons, many times related to estate planning, why a plan participant may desire to have survivor payments made to a person other than the spouse. The law should not be inflexible in this regard. On the other hand, a plan should not be required to provide a survivor benefit other than to the spouse.

Fiduciary Provisions

S. 3017 and S. 1745 would make a number of changes in the fiduciary provisions of ERISA. While they would alleviate some specific problem areas, we strongly believe that a much more thorough re-examination and reworking of ERISA's fiduciary rules--particularly, the prohibited transaction section--is necessary if the law is to work efficiently and without unnecessarily disrupting business practices and transactions. Your staff has indicated interest in seeking a broader solution and, to this end, we are in the process of trying to develop a specific recommendation for consideration by your Subcommittees at a later time.

In this regard, I am sure you have been bombarded with examples of situations where the current fiduciary provisions are producing unintended hardships and problems. I would like to give you one more example of particular applicability to the life insurance business. Ever since the enactment of ERISA, we have been urging the Labor and Treasury Departments to make clear, in their regulations defining "investment advice", that such term does not include recommendations made by an insurance agent or broker as part of a selling effort in those situations where the agent or broker has made clear to the plan sponsor the sales capacity in which he is acting. (Rendering "investment advice" for a fee is a fiduciary activity under ERISA.) To date, we have been unsuccessful.

This is the type of issue that should be considered in any revision of the fiduciary provisions. Where an insurance agent or broker, in a sales capacity, recommends that a plan sponsor buy a product which he sells--and, in so doing, suggests various possible options--it is just not realistic to categorize him as a plan fiduciary on the ground that he is acting as an investment advisor to the plan. It would seem far more logical to classify the giving of such recommendations as a fiduciary activity only in those situations where the agent or broker holds himself out as an impartial advisor.

<u>Status of general asset account.</u> Section 261 of S. 3017 deals with the status under ERISA of the assets in a life insurance company's general account. We urge adoption of such an amendment, modified as described below.

The Labor and Treasury Departments have interpreted the pertinent sections of ERISA to provide that, where an employee benefit plan purchases a contract based on the general asset account of an insurance company, the underlying assets of the company are <u>not</u> "plan assets" of that plan for purposes of applying ERISA's fiduciary provisions. A contrary result would place impossible restrictions on an insurance company's investment activities in its general account by reason of the broad range of possible technical violations that could occur through dealing with "parties-in-interest".

Section 261 of S. 3017 is aimed at codifying this result in the law itself. We strongly support this objective, but suggest certain clarifying amendments to section 261. More specifically, a plan may be funded through the use of contracts issued by an insurance company on its general account, but provide for benefit payments other than in the form of a life annuity insured by that company. We can see no reason why the form of the benefit payment should affect the issue of whether the insurance company's general account assets are "plan assets." For example, if an unallocated contract is held by a trust, the trustee may, on the retirement of an employee, direct the insurance company to pay an amount over to the trust from which it will, in turn, pay the benefits directly. Or it may instruct the insurance company to provide a guaranteed annuity or merely to make specified payments as long as funds are available. There is no reason why the form of the benefit payment should affect the issue of whether the insurance company's general account assets are "plan assets". Thus, we urge that references to "benefits which are insured" be deleted from section 261. To this end, lines 6 through 10 on page 38 of S. 3017 should be revised to read:

> "(2) In the case of a plan which is funded in whole or in part by a contract issued by an insurance company, the assets of the plan shall include the contract but shall not, solely by

reason of the issuance of such contract, include the assets of the insurer issuing the contract except to the ex-* * *."

Retroactive Disqualification of Plans

We support section 307 of S. 3017 which would prohibit the retroactive disqualification of a plan unless it is determined that the past failure to meet the qualification standards was a result of intentional failure or willful neglect. Such protection has become increasingly important by virtue of the complexity of many of ERISA's provisions and the implementing regulations; thereby substantially increasing the chance for inadvertent non-compliance.

Elimination of Overlapping Jurisdiction

We fully support the idea of streamlining the administration of ERISA through the elimination of overlapping jurisdiction by two or more government agencies with regard to the enforcement of specific provisions of the law. Several ways have been suggested for achieving this objective, running the spectrum of consolidating all ERISA related activities in a new agency to retaining the jurisdiction of various agencies, but assigning each such agency with enforcement of specific provisions to the exclusion of any other agency. Since the decision as to what approach to take will obviously involve many factors, including political considerations, beyond our expertise or even knowledge, we will confine ourselves to merely supporting the concept.

Reduction In Disability Benefits

Section 237 of S. 3017 would prohibit an employee welfare benefit plan from reducing a participant's disability benefit by reason of any increase in the disability benefit levels payable under the Social Security Act. A similar result is sought under S. 250, but would be accomplished through a tax disincentive to the employer.

Almost all private disability plans integrate with Social Security. No one disputes that a plan which does not offset Social Security increases is superior to a plan which permits such offsets. Since the vast majority of the disability benefits being provided by employee welfare benefit plans are funded through insurance contracts, insurers have, over the past few years, made this point repeatedly and many have taken extraordinary measures to convince such plans to purchase the more comprehensive contract.

The ability of an insurer to deduct Social Security increases impacts the amount of benefit which will be paid by the insurer and the likelihood of such increases is a factor included in establishing the premium to be charged the plan. Although insurers cannot know for certain the number and amount of future increases that will take effect, they do make actuarial assumptions as to what the increases are likely to be, based on statistically demonstrable past trends plus present legislative enactments (e.g., automatic adjustments), and these assumptions are reflected in their premium rates. Substantially less premium is charged for contracts which do not contain a Social Security "freeze" (i.e., increases are deducted) than for those contracts which contain such a "freeze" (i.e., increases are not deducted). Because of the differential in premium rates, plans frequently prefer to purchase the less expensive "no freeze" contract.

While the Council and HIAA vigorously endorse the public policy behind a legislatively mandated Social Security "freeze", we feel equally strongly that such a mandate can only be applied prospectively. To do otherwise would be an unreasonable impairment of the contractual rights of parties.

As noted, there currently exist a number of employee welfare benefit plans which do not include the Social Security "freeze" (i.e., Social Security increases reduce benefits). Under such plans, there now exist a multitude of disabled persons to whom the insurance company presently is obligated to make disability payments, but against which future Social Security increases may be offset. A legislatively imposed "freeze" on these current claims would force the insurer to bear the additional cost which the plans originally decided not to bear and would leave the insurer no practical recourse to recoup the additional premium to pay the higher benefits. Under the terms of most contracts, insurers cannot retroactively obtain the increase in premium from the plans. Any attempt to recoup the additional cost through higher future premiums or lower future dividends would lead the plan to change carriers. Indeed, many contracts have long since terminated, though the liability to disabled persons incurred while the contract was in force remains.

For these important reasons, and also to allow sufficient time for the necessary policy changes, we urge that any legislation on the subject permit existing employee welfare benefit plans which do not include a Social Security "freeze" on the effective date of the Act to add such a "freeze" on the first plan anniversary date which is more than 60 days after such effective date. Moreover, any such "freeze" should only be required to be applied to those persons becoming disabled after inclusion of the contractual provision.

Multiple Employer Trusts

Section 266 of S. 3017 requires that every "uninsured welfare plan", as defined therein, be subject to solvency and reserve standards as the Secretary shall require by regulation. This would appear to be an attempt to regulate at the federal level certain uninsured multiple employer trusts (METs).

We believe this section is confusing in context with other provisions of the Act and recent court decisions holding that uninsured METs are subject to regulation by the states. To the extent there is continuing concern with regulating this area, we would like to explore with your staff the nature of the problem area and the appropriate solution.

Conclusion

Again, thank you for giving me the opportunity to present the views of the Council and the HIAA on the important issues involved in these hearings. As I indicated at the outset, we believe that the experience under ERISA to date has clearly established the need for certain corrective amendments if the law is to fulfill its laudatory objective of strengthening and extending the vital financial protections provided by employee pension and welfare benefit programs. I would be happy to attempt to answer any questions you may have and to attempt to furnish any additional information which the Subcommittees might think helpful.

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September 11, 1978

The Honorable Harrison A. Williams, Jr.
Chairman, Subcommittee on Labor
Senate Committee on Human Resources
The United States Senate
Washington, D. C. 20510

The Honorable Lloyd Bentsen
Chairman, Subcommittee on Private Pension
Plans and Employee Fringe Benefits
Senate Committee on Finance
The United States Senate
Washington, D. C. 20510

Gentlemen:

This letter will supplement my statement and remarks on behalf of the American Council of Life Insurance and the Health Insurance Association of America on bills relating to ERISA before your two Subcommittees at the joint hearing on August 17, 1978. Specifically, Senator Williams requested our two associations to address the United States District Court, Northern District of California, decision in Standard Oil Company of California vs. Joshua C. Agsalud, et al. and, in particular, S. 1383 which would amend ERISA to clarify the status of the Hawaiian Prepaid Health Care law under title I and title IV of such Act.

In the Standard Oil case, Standard Oil Company of California (Standard) sought declaratory and injunctive relief when defendants sought to enforce the Hawaii Prepaid Health Care Act (Hawaii Act) against it. In 1974 the Hawaii legislature enacted a prepaid health care plan requiring employers to establish health care plans conforming to the Act. This Act was amended in 1976 to require that the plans cover diagnosis and treatment of alcohol and drug abuse. Standard was a Delaware corporation conducting business in interstate commerce with employees in many states including Hawaii. Standard's self-funded health plan did not provide certain benefits required by the Hawaii Act, including the coverage for alcohol and drug abuse. The District Court concluded that the Hawaii Act was preempted by ERISA and the case is now on appeal.

S. 1383, introduced by Senators Inouye and Matsunaga, would amend ERISA, specifically paragraph (3) of section 4(b), so as to exempt from title I of ERISA any employee benefit plan which "is maintained solely for the purpose of complying with. . .disability or health insurance laws." This amendment would circumvent the District Court's holding that the Hawaii Act was not included in the phrase "disability insurance laws" by simply expanding that phrase to include "or health insurance" laws. The effect would be to exempt from the provisions of ERISA, including reporting, disclosure, fiduciary and preemption provisions, any employee benefit plan which was maintained to comply with a state's health insurance laws. This would presumably include any act such as the Hawaii Act and, possibly, other state health insurance mandated benefits.

Our testimony presented to you on August 17, 1978, directed your attention to essentially two concerns with regard to group life and health insurance coverages under ERISA section 514. First, we pointed out the increasing tendency for the individual states to pass non-uniform laws mandating coverages in group insurance policies purchased by welfare benefit plans and to apply such laws to group policies issued outside their state which cover residents of their state. Secondly, we pointed out that such increasing tendency of the states coupled with the effect of the preemption provisions of ERISA, whereby state mandated benefit laws are preempted from applying to uninsured plans but not from applying to insured plans (citing Dawson), have led many employers to become uninsured and numerous more to consider such a move. In order to correct these concerns, we proposed an amendment to the ERISA preemption provision whereby it is specifically stated that state laws mandating benefits and classes of individuals to be covered are preempted with respect to group policies purchased by welfare benefit plans.

While S. 1383 does not specifically address section 514 of ERISA, its effect is the continued permissability of, and encouragement for, states to pass non-uniform laws mandating health coverages for employee benefit plans and to apply such laws to out-of-state employers. In other words, an employer would continue to have a myriad of non-uniform and often conflicting state laws apply to its coverage. As the Court in the Standard Oil case stated: "Although this social experiment of Hawaii may pose no 'risk to the rest of the country,' it does impose a burden on interstate commerce which Congress has the power to remove."

We therefore oppose S. 1383 as it permits one of the very things we seek to prohibit, that is the proliferation of non-uniform laws mandating coverages in insured employee welfare benefit plans. While it places employers which seek to become uninsured in the same position as employers which purchase insurance, a situation which we would normally support, it nevertheless imposes extraordinary burdens upon employee welfare benefit plans that we do not believe Congress intends.

We will be pleased to discuss our opposition to S. 1383 with either of you, your Subcommittees, or staff. Moreover, we appreciate this opportunity to present our views.

Very truly yours,

William T. Gibb

William T. Gibb
Chief Counsel
Federal Taxes and Pensions
American Council of Life Insurance

WTG/jsg

Senator WILLIAMS. Thank you very much.

Mr. Mason, did you have anything to add?

Mr. MASON. No.

Senator WILLIAMS. Next we will hear from the Investment Company Institute, Matthew P. Fink, general counsel.

Mr. FINK. I am accompanied by Ramsay D. Potts, the institute's outside counsel.

I am general counsel of the Investment Company Institute, which is the national association of the mutual fund industry.

I have a lengthy written statement and ask that it be included in the record.

Senator WILLIAMS. It will be.

STATEMENT OF MATTHEW P. FINK, GENERAL COUNSEL, INVESTMENT COMPANY INSTITUTE, ACCOMPANIED BY RAMSAY D. POTTS, OUTSIDE COUNSEL TO THE INSTITUTE

Mr. FINK. The institute strongly supported pension reform legislation from the time the very first bills were introduced in Congress in 1971. On June 21, 1972, we testified before the Senate Committee on Labor in support of S. 3598, the Williams Javits bill, which formed a major basis for ERISA.

We applauded the enactment of ERISA as a long overdue reform measure needed to protect the rights of millions of American workers. We do not share the views of those who claim that ERISA has gone too far in seeking to protect the rights of participants in employee benefit plans. At the same time, we realize that further legislative fine-tuning may be needed.

We had hoped that our testimony at these hearings could have concentrated on these matters, including the administration of ERISA, the problems of small plans, the reduction of paperwork and the new special master and prototype plan concept—which we strongly endorse. However, because of one provision in S. 3017, we find ourselves obliged to devote our testimony to a matter extraneous of ERISA, and which actually relates to the Federal banking laws and the Federal securities laws.

Section 274 of S. 3017 would add two unrelated provisions to ERISA. The first provision provides that an employee's interest in a plan is not a security. This would reverse the decision in the *Daniel* case. We believe there is logic to the position that an employee's rights and remedies with respect to his plan should be determined as a matter of the law of labor relations and should fall under ERISA rather than the securities laws. ERISA does seek to protect an employee in a plan, for example, by requiring that he receive a summary plan description and an annual plan report.

However, the second provision of section 274, which is unrelated to the problems created by the *Daniel* case, provides that shares of a pooled investment fund operated by a bank or insurance company and sold to an employee benefit plan are not securities. This is not a matter of labor relations, but has long been perceived as a matter of securities and banking regulation.

The enactment of this second provision of section 274 would have a dramatic impact on the Federal securities and banking laws—by declaring that interests in pooled investment funds sold to employee benefit plans are not securities.

If the second provision of section 274 is enacted, employee benefit plans will lose protections afforded by the Federal securities laws—protections which are not provided by ERISA.

First, sponsors of pooled investment funds will be free to run advertisement aimed at employee benefit Keogh plans and individual retirement accounts, with no restraints whatever imposed by ERISA. We ask the members of these subcommittees to review the advertisements attached to our testimony, ads which banks presently can only direct at corporate plans. If the provision is enacted, Keogh plans and IRA's will be told by United Jersey Bank that "We're No. 1 nationally in investment performance"; by Hibernia National Bank that it is "No. 1"; and by the Fifth Third Bank of Cincinnati that it is "Entering our second decade of outperforming the Dow Jones." Banks will be free to select the time periods used in their ads so that they can choose the periods of their best performance. And they will be free to select the particular stock market index which best suits their needs. In contrast, every single one of the ads attached to our testimony is prohibited in the case of a pooled fund subject to the Securities Act of 1933.

Second, if the provision is enacted, sponsors of pooled investment funds will not be required to provide employee benefit Keogh plans and IRA's with prospectuses, but will be free to use any type of sales material they desire. In order to demonstrate what will occur, we obtained the sales materials used by 17 banks for their pooled investment funds for Keogh plans which take advantage of present exemptions from the securities laws—by reason of only selling to plans in one State. Our examination of these documents was to determine whether Keogh plans investing in these funds are being provided with the most basic kind of information deemed essential under the Federal securities laws. The lack of such disclosures is startling. None of the 17 banks describe the fund's investment restrictions; none provide relevant information describing the bank operating and advising the fund; none give background information regarding the bank's officers and directors; none disclose the total fees paid to the bank in each of the last 3 years; none describe the fund's policy with respect to buying or selling portfolio securities; none disclose amounts of brokerage commissions paid by the fund or to whom; and over half do not contain the fund's current financial statements or the fund's current portfolio. In contrast, every mutual fund subject to the Federal securities laws must provide all of this information to all investors. including employee benefit plans.

Third, if the provision is enacted, all employee benefit plans will lose the right to bring actions under the Federal securities laws in connection with their purchases of shares of pooled investment funds. And ERISA does not seek to provide employee benefit plans with an equivalent right of action.

The enactment of the second provision of section 274 also would have the effect of repealing one of the fundamental reform measures enacted in the thirties, the Glass-Steagall Act of 1933. In the twenties, commercial banks formed securities affiliates and mass-merchandised their shares of the public. The abuses that this produced are summarized in our written statement. By the early thirties there was a national consensus that bank entry into the securities business in the twenties had been a major contributor to the Great Crash. Therefore, Congress enacted the Glass-Steagall Act which bars banks from engaging in the securities business.

The wisdom of Glass-Steagall was underscored in the early seventies when commercial banks sponsored real estate investment trusts. As set forth on our written statement, bank sponsorship of REIT's involved abuses strikingly similar to those of the twenties, and led to the greatest strains on our financial system since the Great Crash.

In our view, the mass-merchandising by banks of shares of pooled investment funds to employee benefit plans constitutes a violation of the Glass-Steagall Act. Indeed, the existing evidence indicates that these funds are embarking on the same road as prior pooled investment vehicles sponsored by banks. An early indication are the aggressive advertisements attached to our statement. Then there are studies cited in our written statement which present instances of abuses by banks with respect to their pooled funds. It is unclear whether ERISA has curbed these abuses.

We submit that, at a minimum, what is needed is a full-scale congressional study of activities which violate the letter and spirit of the Glass-Steagall Act, including bank sponsorship of real estate investment trusts and bank sponsorship of pooled investment funds for employee benefit plans.

Yet the enactment of section 274 would implicitly repeal the Glass-Steagall Act in this important area, by declaring that interests in these pooled funds are not securities.

In conclusion, the Senate Securities Subcommittee currently is studying the issues of bank entry into the securities business and the application of the Federal securities laws to these activities. Moreover, this study is specifically studying bank sponsorship of pooled investment funds for employee benefit plans. We respectfully suggest that if Congress determines to take legislative action in this area, it should do so only after careful consideration of this study and after hearings which would give these most important issues the undivided attention they deserve.

I was not here yesterday, Mr. Chariman, but I understand that former Chairman Hills of the SEC testified to the same effect concerning this provision of section 274.

Thank you.

[The prepared statement of Mr. Fink follows:]

STATEMENT OF THE

INVESTMENT COMPANY INSTITUTE

ON S. 3017

BEFORE THE

SUBCOMMITTEE ON LABOR OF THE SENATE COMMITTEE

ON HUMAN RESOURCES AND THE SUBCOMMITTEE

ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE

BENEFITS OF THE SENATE FINANCE COMMITTEE

August 17, 1978

My name is Matthew P. Fink. I am General Counsel of the Investment Company Institute. With me today is Ramsay D. Potts, outside counsel to the Institute.

The Investment Company Institute is the national association of the American mutual fund industry. Its membership includes 460 open-end investment companies ("mutual funds"), their investment advisers and principal underwriters. Its mutual fund members account for over 90% of industry assets and have approximately seven million shareholders, including thousands of employee benefit plans.

The Institute is vitally concerned with legislation affecting employee benefit plans. Mutual funds serve as an important funding vehicle for all types of plans, particularly those of smaller employers. For example, at the end of 1977, there were 343, 665 individual Keogh plan accounts invested in mutual fund shares valued at more than $1.9 billion, representing over 30% of all Keogh plan assets.

The Institute strongly supported pension reform legislation from the time the very first bills were introduced in Congress. For example, on June 21, 1972, we testified before the Senate Committee on Labor in support of S. 3598, the Williams-Javits bill, which helped form a major basis for ERISA.

We applauded the enactment of ERISA as a long over-due reform measure needed to protect the rights of millions of American workers. We do not share the views of those who claim that ERISA has gone too far in seeking to protect participants in employee benefit plans and in imposing fiduciary duties on those who manage such plans. At the same time we realize that any major piece of reform legislation will contain imperfections and legislative fine-tuning may be needed. Since the enactment of ERISA we have testified before various Congressional committees with respect to possible curative legislation. Indeed, on March 27th of this year we met with staff members of the Senate Committee on Human Resources to discuss these matters, and by letter dated April 13, 1978, we submitted our detailed suggestions to them.

We had hoped that our testimony at these hearings today could have concentrated on these matters, particularly the questions of administration of ERISA, the problems of small plans, the reduction of paperwork, and the new Special Master and Prototype Plan concept which we strongly endorse. We believe that the mutual fund industry's expertise, particularly in the area of small plans and master and prototype programs, would enable us to offer real assistance in these important areas. However, because of one provision in S. 3017 we find it necessary to devote our statement today to a matter extraneous to ERISA and which actually relates to the federal banking laws and the federal and state securities laws. I am referring to the second provision of Section 274 of the bill.

Section 274 would add two unrelated provisions to Section 514 of ERISA. The first provision provides that an employee's interest in a pension plan is not a security. This would reverse the decision in the Daniel case which presently is pending before the Supreme Court. There is logic to the position that an employee's rights and remedies with respect to his pension plan should be determined as a matter of the law of labor relations and should fall under ERISA rather than the securities laws. ERISA does seek to protect an employee in a plan, for example by requiring that he receive a summary plan description and an annual plan report.

However, the second provision of Section 274, which is unrelated to the problems created by the Daniel case, provides that shares of a pooled investment fund operated by a bank or insurance company and sold to an employee benefit plan are not securities. This is not a matter of labor relations but has long been perceived as a matter of securities and banking regulation. *

The second provision of Section 274 would repeal two of the basic reform measures enacted by Congress in the 1930's. First, it would authorize massive bank

* In its recent brief to the Supreme Court in the Daniel case, the Department of Justice argued that an employee's interest in a pension plan is not a security, but also stated that this result "will in no way impair the effectiveness of the securities laws to police securities transactions that pension plans make in the capital markets." (Brief of the United States as Amicus Curiae, note 9 at p. 19 (August 1978) (emphasis added).

It should also be noted that the application of the federal securities and banking laws to pooled investment funds is not a recent surprise pulled out of a judicial hat. The application of these laws to pooled funds has been carefully worked out by legislation, as well as in a number of administrative and judicial proceedings including three Supreme Court cases stretching back 20 years.

entry into the securities business, activity which for over 40 years has been barred by the Glass-Steagall Act of 1933. Second, it would permit the nation's largest financial institutions to mass-merchandise securities to millions of small investors without regulation under the federal securities laws which for almost 50 years have provided the cornerstone of investor protections. Thus, enactment of this provision would deprive employee benefit plans of essential disclosure and fraud protections afforded by the securities laws -- protections which are not provided by ERISA.

We would also point out that the very issues of bank activities in the securities business and the application of the federal securities laws to such activities currently are being considered in a study being conducted by the Securities Subcommittee of the Senate Committee on Banking, Housing and Urban Affairs. Moreover, this study is specifically considering bank sponsorship of pooled investment funds for employee benefit plans.* The Subcommittee has sent detailed questionnaires to some 2,500 commercial banks in order to generate information about their securities activities, particularly their sponsorship of pooled investment funds for employee benefit plans. We believe that if Congress determines to take legislative action in this area, it should do so only after careful consideration of the findings of this study and after hearings which would give this issue the undivided attention it deserves, and not as part of a most worthwhile bill, such as S. 3017, designed to improve the administration of the 1974 pension reform law.

* See Section V of the Study Outline of the Senate Securities Subcommittee on "The Securities Activities of Commercial Banks," 94th Cong., 1st Sess. (1975).

However, since this issue is raised in the bill, we will demonstrate in our testimony the impact which the enactment of the second provision of Section 274 would have: First, on the nation's banking laws which are designed to protect our nation's financial system by prohibiting banks from engaging in the securities business; and Second, on the federal securities laws which are designed to protect all investors, including large and small employee benefit plans, against fraud and over-reaching. It is these twin effects which should be thoroughly aired at hearings wholly devoted to this subject.

I. THE FEDERAL BANKING LAWS

A. The Pre-1933 Experience

For over 100 years, the federal banking laws have sought to prevent commercial banks from engaging in the securities business. This long-standing position has been based on Congress' concern that bank involvement in the securities business inevitably will result in disaster for banks engaging in these activities, and hence cause severe problems for the entire American economic system. For example, the National Banking Act of 1864, which granted national banks certain limited powers, totally prohibited banks from underwriting or dealing in non-Government securities.* However, in the 1920's, the Comptroller of the Currency lobbied on behalf of the commercial banking industry to completely break down the historic separation of commercial banking and

* Department of the Treasury Issues Paper, "Public Policy Aspects of Bank Securities Activities" Appendix, at 2 (1975).

the securities business.* The Comptroller's efforts on behalf of the banking industry resulted in the passage of the McFadden Act in 1927 which permitted national banks to underwrite securities as authorized by the Comptroller.**

Time does not permit us to fully describe the myriad abuses which resulted from commercial bank entry into the securities business in the 1920's, other than to note that they included: causing bank securities affiliates to make investments considered too "risky" for the bank itself; dumping bad bank loans and investments into securities affiliates' portfolios; the purchase by banks and controlled trust accounts of unsuccessful issues underwritten by securities affiliates; imprudent and excessive bank loans to prevent the collapse of securities affiliates; bank loans to purchasers of securities underwritten by affiliates; bank loans to corporations using securities affiliates as underwriters; abuses of relationships with correspondent banks to help distribute securities affiliates' underwritings; and personal self-dealing by bank officers and

* "...[T]he Comptroller did not enforce the existing restrictions on the powers of national banks and suggested greater leniency in the national banking laws. From 1923 to 1927 the Office of the Comptroller was the driving force behind the legislation which conferred on national banks the power to engage in a modified securities business." Peach, The Security Affiliates of National Banks, at 150 (1941). (Footnote omitted).

** Following passage of the McFadden Act, "Commercial banks became increasingly more active in the securities markets; their market share of new bond issue participations was boosted from 37 per cent in 1927 to 61 per cent in 1930.... By the end of the decade commercial banks and their affiliates had become the dominant force in the investment banking field." Perkins, "The Divorce of Commercial and Investment Banking: A History", 88 Banking Law Journal, 483, at 495 (1971). (Footnote omitted).

directors in the operation of securities affiliates. *

As we shall demonstrate, similar abuses occurred again in the early 1970's with respect to bank-sponsored real estate investment trusts, and are occurring today in connection with bank-sponsored pooled investment funds for employee benefit plans.

B. The Glass-Steagall Act of 1933 and the Camp Case

By the early 1930's there was a national consensus that commercial bank entry into the securities business had been a major contributor to the Great Crash and the ensuing depression. ** As a result, Congress enacted the Banking Act of 1933 (the Glass-Steagall Act) which restored the historic separation between commercial banking and the general securities business. ***

The banking industry's first major attempt to circumvent the Glass-Steagall Act occurred in the 1960's, when banks attempted to sponsor commingled agency accounts -- in reality mutual funds -- and to mass-merchandise their shares to the public. The banks' attempt to reenter the general securities business on a wholesale

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* Hearings Before a Subcommittee of the Senate Committee on Banking and Currency, 71st Congress, 3d Session, Part 7, at 1063-64 (1931).

** "...Members of the Glass Committee and the general public believed at the time that the securities activities of banks contributed to and accentuated the economic collapse. They believed that the banking community, as the depository of individual savings and the institution which created credit, bore higher standards of responsibility as a result of its crucial position of influence over the state of the economy." Treasury Issues Paper Appendix, supra, at 17.

*** For example, Section 16 of the Glass-Steagall Act provided that a national bank "shall not underwrite any issue of securities or stock" and shall not purchase "for its own account...any shares of stock of any corporation", and Section 21 prohibited a national bank from engaging in "the business of issuing, underwriting, selling or distributing, at wholesale or retail, or through syndicate participation, bonds, debentures, notes or other securities...."

basis was struck down by the United States Supreme Court in 1971 in its landmark decision in Investment Company Institute v. Camp.* The Court did not base its decision on a technical reading of the Glass-Steagall Act, but found that "the potential hazards and abuses that flow from a bank's entry into the mutual investment business are the same basic hazards and abuses that Congress intended to eliminate about forty years ago...." The Court identified at least eleven specific dangers:

- "the bank and the [securities] affiliate are closely associated in the public mind, and should the affiliate fare badly, public confidence in the bank might be impaired";

- "since public confidence is essential to the solvency of a bank, there might exist a natural temptation to shore up the affiliate through unsound loans or other aid";

- "the bank would make its credit facilities more freely available to those companies in whose stock or securities the affiliate has invested";

- "banks might even go so far as to make unsound loans to such companies";

- "bank depositors might suffer losses on investments that they had purchased in reliance on the relationship between the bank and its [securities] affiliate. This loss of customer good will might 'become an important handicap to a bank during a major period of security market deflation'";

- "banks...might be tempted to make loans to customers with the expectation that the loan would facilitate the purchase of stocks and securities";

- "security affiliates might be driven to unload excessive holdings through the trust department of the sponsor bank";

- "the bank would have a salesman's stake in the performance of the fund, for if the fund were less successful than the competition the bank would lose business and the resulting fees";

- "the bank might exploit its confidential relationship with its commercial and industrial creditors for the benefit of the fund";

* 401 U. S. 617 (1971).

- "the bank might undertake, directly or indirectly, to make its credit facilities availalle to the fund or to render other aid to the fund inconsistent with the best interests of the bank's depositors";

- "the bank might divert talent and resources from its commercial banking operation to the promotion of the fund."

As we shall demonstrate below, most of the dangers enumerated by the Supreme Court actually occurred in connection with bank sponsorship of REITs in the early 1970's, and are occurring today in connection with bank-sponsorship of pooled investment funds for employee benefit plans.

Today, the banking industry urges the repeal of the Glass-Steagall Act,arguing that while the Act may have been relevant in the years of the Great Depression, it is totally irrelevant in the modern world of the 1970's. For example, the Senior Vice President and General Counsel of Citibank, the nation's second largest commercial bank, stated last year:

> "The basic needs in 1933 were to strengthen the commercial banking system and restore depositors' confidence so that banks could resume their intermediary function of helping to convert the nation's savings into productive investments for economic growth. The Glass-Steagall Act was remarkably successful in meeting those public needs.
>
> "Today, however, the commercial banking system has shaken off a series of economic and financial crises and has emerged stronger and more capable than ever. Depositors feel no loss of confidence."*

* Angermueller and Taylor, "Commercial vs. Investment Bankers", September-October 1977 Harvard Business Review, 132 at 137.

Thus, the banking industry would have Congress believe that the Glass-Steagall Act was an exercise in public relations which has outlived its usefulness.

However, the nation's recent experience with bank-sponsored real estate investment trusts emphasizes as clearly as possible the continued need to prohibit banks from engaging in the securities business. *

B. Bank REITs

Time does not permit us to detail the full history of bank-sponsored REITs. ** Suffice it to say that the bank REIT debacle of the early 1970's led to the greatest strains on our financial system since the Great Crash. Although we cannot distinguish between bank-sponsored REITs and others, at least seven REITs have gone into bankruptcy; another 11 have failed to pay interest on their subordinated debt, much of which was sold to public investors; over 40 REITs have nominal or negative net worth and another 19 apparently have been kept afloat by interest rate concessions from their banks. The "deeply troubled" REITs owe over $8.8 billion, $7 billion of it to the banks. ***

* The banking industry maintains that the Glass-Steagall Act only bars banks from selling REIT securities and not from "sponsoring" REITs. See Response of the American Bankers Association to "The Securities Activities of Commercial Banks Study Outline" of the Senate Subcommittee on Securities, May 1976, at 55.

** We discussed this matter in detail in our testimony of June 16, 1978, before the Senate Committee on Banking, Housing and Urban Affairs on S. 72, A Bill to Amend the Bank Holding Company Act and The Bank Merger Act.

*** Kenneth D. Campbell, "Background of the REIT Industry", Practicing Law Institute, REIT Restructuring, at pp. 11, 15 (May-June 1977); Glatt and Miller, "The Real Estate Debtor or REIT and the Bankruptcy Act," id. at pp. 99, 147-152; and "Rise in Property Aiding Recovery of Real Estate Investment Trusts", New York Times, January 23, 1978, at pp. D1, D3.

The point, however, is not to chronicle bad investment luck or judgment on the part of banks. The importance of the REIT debacle is that bank involvement in the securities business led to a disaster for the banking system and hence for the nation. At least two banks failed as a result of the REIT debacle.* Chase Manhattan Bank was placed on the Comptroller's secret list of problem banks, largely due to loans to its REIT.** The holding company for Chemical Bank was forced to call off a proposed public offering of its securities due to investor concern over the bank's loans to REITs.*** Investment bankers warned investors against purchasing bank stocks generally as a result of the REIT problem.**** The Federal Reserve Board ultimately was forced to pressure banks to "bail out" their REITs out of fear that REIT failures would lead to a "financial

* Schotland, "Bank Holding Companies and Public Policy Today", Compendium of Papers Prepared for the FINE Study, 94th Cong., 2d Sess., 233 at 273 (1976).

** "[O]ne of the largest loans classified by examiners early last year at Chase was $140 million to Chase Mortgage and Realty Trust." "Citibank, Chase Manhattan on U. S. 'Problem' List", Washington Post, January 11, 1976, p. 1, col. 1.

*** "Chemical Bank Parent Cancels Debt Sale Due to Investor Concern Over REIT Loans", Wall Street Journal, March 31, 1975, p. 3, col. 2.

**** See, e.g., "Bank Loans to REITs: Problems and Prospects", Drexel Burnham & Co. (1975) at p. 1: "Accordingly, we maintain our very cautious approach to bank stock investing. We would, likewise, refrain from purchasing any bank stocks until the threat from the REIT situation appears to be dissipating; and further, if heavily invested in the bank group, we would advise lightening positions."

panic"* and would endanger "the stability of the financial system."** The disastrous economic consequences of bank REITs fully bear out the premise of Glass-Steagall that confidence in banks may be impaired by imprudent or speculative investment activity and banks would be forced to indulge in unsound banking practices to keep their securities affiliates afloat.

The fact is, however, that economic disaster was not the sole problem with bank-sponsored REITs, but that they involved the same sorry tale and abuses that occurred in connection with bank securities affiliates in the 1920's and which the Supreme Court warned against in the Camp case.

First, banks engaged in questionable promotional activities. Typically, the bank and its REIT had the same employees and facilities,*** and in promoting shares

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* "Another reason the banks helped out the REITs is that they were told to do so by the government. Former member of the Federal Reserve Board Andrew Brimmer testified to this fact in February. He told the House Banking Committee that the Fed asked banks to lend money to the REITs last summer. Brimmer said that he and other Fed members felt that was a necessary action. At the time, the real estate investment trusts were in a great deal of trouble. The Fed's directors thought a series of REIT failures might start a financial panic, and to prevent that from happening, they engineered a rescue of the REITs. Now the banks are stuck with the consequences." "Bad Investments", New Republic, April 19, 1975, at 8.

** Statement of Former Federal Reserve Board Chairman Arthur F. Burns, quoted in Robertson, "How the Bankers Got Trapped in the REIT Disaster", Fortune, March 1975, 113.

*** "The REITs sponsored by banks were usually merely a transfer of the bank's real estate people and activities to a separate corporate entity, which proceeded with common officers, often common facilities, and often common clientele and ventures." Schotland, supra, at 271.

of their REITs to the public banks stressed the expertise of the bank itself.* Thus it is hardly surprising that investors purchased REIT securities in misplaced reliance on the bank.**

Second, banks used their ability to manipulate the financial affairs of the REIT for the bank's own advantage. Since the advisory fee received by the bank was based on the amount of the REIT's assets, banks sought to swell the size of their REITs by causing them to borrow excessively and to make loans without adequate

* "Becoming an advisor to Chase Manhattan Mortgage and Realty Trust was the logical extension of our current activities. Chase is the largest national originator of construction and development loans and has considerable experience in making equity real estate investments." Stephen R. Downes, Assistant Treasurer, The Chase Manhattan Bank, N. A., "Why Chase Manhattan Sponsored a Real Estate Investment Trust", Trust and Estates (1970) p. 1026 at p. 1027.

** "Stockholder reaction at the meeting was typified by the observation of a Milwaukee attorney who invested in the trust's stock when all signs pointed up. 'I got in,' he said 'because this was being run by First Wisconsin and I felt they were a good, orderly investor-minded organization.'" "Banks are Declared Key to Relief for 'Very Sick' First Wisconsin REIT", American Banker, April 22, 1975, p. 1, col. 2.

"And justified or not, the feeling may also exist that if a REIT runs into difficulties, the bank will stand behind it, rather than jeopardizing the bank's name." Schulein, "Recent Developments in the REIT Industry", Federal Reserve Board Bank of Boston, New England Economic Review, September-October 1972, at 10.

review.* At least one major bank's failure to make adequate reserve provisions for write-downs and losses was allegedly due to its desire not to lower the advisory fee paid by its REIT.**

* "With fees based on the gross amount of money loaned, advisers had every incentive to encourage trusts to leverage their assets by borrowing." Robertson, supra, at 168.

"During this period of rapid growth, most trust advisers were compensated according to the asset size of their REIT. The greater the level of mortgage investments, the greater the fee." G. N. Buffington, Executive Vice President and General Counsel of the National Association of Real Estate Investment Trusts, address to the Association of Reserve City Bankers, March 20, 1975.

"But in its haste to grow, sources at First Wisconsin say, an inexperienced staff often made loans with only cursory examination of such things as developers' financial status and project plans.
'The trust would throw some kid into the room with a big-time developer like (Walter J.) Kassuba, who knew exactly what he wanted, and the kid would be overwhelmed,' one source says." "Too Much Too Soon: How 2 Realty Trusts Gave Backers Big Gains - And Then Big Losses", Wall Street Journal, March 14, 1975, p. 1, col. 6.

** "Falling Out: Real Estate Trusts Feud With Advisers Over Their Obligations", Wall Street Journal, March 13, 1975, p. 1, col. 6.

Third, there were major conflicts between the business interests of the banks and that of their REITs. Loans that were too risky for a bank were simply passed on to its captive REIT.* Similarly, loans which the bank itself could not lawfully make were passed on to the REIT, thereby complementing the bank's own real estate activities by not refusing a loan to a good bank customer.**

There also were more subtle conflicts of interest. Banks profited from the use of the "float" created by the REITs' loans to developers.*** In addition, banks earned commissions on the placement of REIT loans and received fees as the REITs' transfer

* "The problem was aggravated when bankers connected with REITs received loan requests from developers. 'You come in with a loan, and where is it going to go?' says Joseph W. Barr, former chairman of American Security. 'If it's a good loan, it goes to the bank. If it's not, it goes to the trust.'" "Bankers Gain from Insider Deals", Washington Post, February 15, 1976, p. 1, col. 1.

"Bankers, who might have injected an element of prudence along the way, didn't. Indirectly, through the REIT mechanism, they made loans for projects they would never have financed directly...." Robertson, supra, at p. 113.

** "Last year was real evidence of things to come regarding the future, when without curtailing any of our Real Estate and Mortgage Loan Department lending activities, we had to turn down over one billion dollars in prime construction and development loan opportunities because the funds were not available." Downes, supra, at p. 1027.

"Sponsoring a REIT enables a commercial bank to bypass indirectly a number of restrictions which may hamper its acquisition and lending of funds. For example, during the past tight money period a REIT could sell commercial paper without an interest-rate ceiling, while banks were subject to ceilings. Thus, a bank may want to sponsor a REIT in order to assure its customers of a source of real estate funds." Schulein, supra, at 10.

***"For example, if a trust was lending $20 million to a contractor, and a check was issued by the adviser's bank on Friday, the check mightn't clear until the following Wednesday, giving the bank six days of interest on the check's 'float'". "Falling Out: Real Estate Trusts Feud With Advisers Over Their Obligations", Wall Street Journal, March 13, 1975, p. 1, col. 6.

agents, registrars and dividend agents. Banks also lent immense sums to their captive REITs, which had the triple effect of producing interest income for the bank, creating compensating deposits in the bank, and expanding the REIT asset base used to calculate the bank's advisory fee. When banks reached their own lending limits, additional money was lent by the parent holding company, a practice apparently permitted under banking law.* In some cases banks made preferential loans to REITs controlled by the banks' own officers and directors; the REITs in turn gave fees and loans to the insiders, and postponed payments on their delinquent loans.**

When their REITs began to founder, banks attempted rescue missions. And, as the Supreme Court warned in the Camp case, "If imprudent management should place the fund in distress, a bank might find itself under pressure to rescue the fund through measures inconsistent with sound banking." At least two bank holding companies failed

* "Bank Loans to REITs: How Serious the Problem?", Keefe, Bruyette & Woods, Inc. (1975) at 65.

** "Riggs National Bank and Madison National Bank have loaned more than $9 million often at preferential interest rates, to a real estate investment company controlled by the two banks' key officers and directors.

"The money from the banks has been used in part by the Riggs and Madison officers and directors to give themselves millions of dollars in fees and loans from the real estate investment firm, Mortgage Investors of Washington.

"Some of the loans have not been repaid on time and, rather than foreclosing on themselves, the Riggs and Madison officers and directors have postponed dates when the loan payments are due. In some instances, they have reduced the interest charges on the loans." "Bankers Gain from Insider Deals", Washington Post, February 16, 1976, p. 1, col. 1.

when they sought to rescue their REITs.* In an attempt to save its REIT from bankruptcy, Chase Bank purchased from its REIT $160 million of loans, which "nobody else would buy on the terms the Chase Bank gave."** The holding company and affiliated subsidiaries of First Wisconsin National Bank entered into similar transactions with its REIT.***

The bank REIT debacle led Federal Reserve Board Governor Henry R. Wallich to conclude that: the "experience in many cases was sufficiently adverse to justify the conclusion that the banks were fortunate not to have been burdened, at the same time, with securities affiliates. In 1974, Glass-Steagall stood the banks in good stead".****

Yet, the enactment of the second provision of Section 274 of S. 3017 would repeal the historic barrier which the Glass-Steagall Act restored between banking and the securities business. And it would do this in perhaps the largest and most rapidly

* "[A] small BHC in Florida and a major one in Tennessee failed during that period as a result of exposure to bad real estate loans which had been held originally by mortgage banking affiliates but which at the end, in unsuccessful 'work-out' efforts, were loaded into the affiliated banks." Schotland, supra, at 247.

** Ibid, at 272.

*** "The holding company and two of its subsidiaries agreed to purchase $18.8 million in loans from the REIT at face value, despite the belief that these loans included principle losses of as much as $4.5-million. In addition, the corporate group agreed to reimburse the REIT, up to $5.5-million, for all principle losses above $7-million." "First Wisconsin's Gloomy Outlook", Business Week, August 3, 1974, at 43.

**** Wallich and Harvey, "Reflections on Glass-Steagall", Bankers Magazine, March-April 1975, at p. 9.

expanding area of the securities business -- the merchandising of securities to employee benefit plans. *

D. Bank Pooled Funds for Employee Benefit Plans

The operation of bank pooled funds for employee benefit plans is of fairly recent origin. Although banks were permitted to create pooled funds for personal trusts and estates over 30 years ago, ** they were not authorized by the Federal Reserve Board to operate pooled funds for employee benefit plans until 1955. ***

The purpose of bank pooled investment funds for employee benefits is -- in the words of the Comptroller of the Currency (the present regulator for such funds) -- to allow "sharing of administration expenses among the funds so pooled, thus reducing the service and management fees charged by the bank to each individual fund, and also... [to allow] the diversification of assets required for a sound investment program." ****

* The tremendous growth of private pension plans in recent years has been startling. In 1950 they had assets and reserves of $12.1 billion; by 1966 this figure had grown to $86.5 billion; and at year end 1976 they had assets and reserves of $248.8 billion. "Pension Facts 1977", American Council of Life Insurance, at 23. Pooled investment funds for employee benefit plans sponsored by banks participated in this boom. In 1967, they had assets of only $607 million. By the end of 1975, the top 115 banks alone had pooled investment funds for employee benefit plans with assets of $21.5 billion. See Bank Administered Pooled Equity Funds For Employee Benefit Plans, Michigan State University, 1967 at 7; and SEC Final Report on Bank Securities Activities, at 154 (1977).

** Fed. Res. Bd. Reg. F. §17, 2 Fed. Reg. 2976 (1937). The Federal Reserve Board's regulations required that common trust funds be operated in furtherance of "bona fide fiduciary purpose" and not solely as vehicles for investment purposes. The Board repeatedly warned banks against using common trust funds as investment vehicles, presumably to avoid violations of the Glass-Steagall Act. See, e.g., 26 Fed. Reserve Bull. 390, at 393 (1940). Since 1962 common trust funds for personal trusts and estates have been administered by the Comptroller of the Currency whose regulations follow those of the Federal Reserve Board. See 12 C.F.R. §9.18(a)(1)(1977).

*** 30 Fed. Reg. 3305 (1955).

**** Brief of the Comptroller of Currency in Opposition to a Petition for a Writ of Certiorari, in Investment Company Institute v. Camp, at p. 3 (December 1969). (Footnotes omitted).

However, our testimony today will demonstrate that banks are not simply utilizing their pooled investment funds for employee benefit plans for these purposes, but are mass-merchandising interests in these funds -- interests which clearly are securities -- to hundreds of thousands of employee benefit plans. We also will demonstrate that abuses are occurring with respect to these pooled investment funds which bear an uncanny resemblance to the pattern of bank securities affiliates in the 1920's and bank REITs in the 1970's, and to the dangers which the Supreme Court pointed to in the Camp case with respect to bank-sponsored mutual funds.

Bank securities affiliates in the 1920's and bank REITs in the 1970's were built on aggressive merchandising. In the Camp case the Supreme Court warned that "[p]romotional incentives might also be created by the circumstance that the bank's mutual fund would be in direct competition with mutual funds.... The bank would want to be in a position to show to the prospective customer that its fund was more attractive than the mutual funds offered by others." We have with us today copies of advertisements currently being published by banks in newspapers and magazines which reach hundreds of thousands of employee benefit plans. These ads do little more than trumpet the collective funds' investment performance, and make practically no mention whatsoever of the banks' fiduciary expertise. United Jersey Bank's headline is "We're #1 Nationally in Investment Performance". The Fifth Third Bank of Cincinnati's headline is "Entering Our Second Decade of Outperforming the Dow Jones." Hibernia National Bank's headline states that it is "#1". What is more, the banks have carefully selected the time periods used in their ads, presumably so that they can select the periods of their best performance. The Fifth Third Bank of Cincinnati uses one year and unabashedly speaks of "our consistency of performance". The National City Bank of Cleveland uses 1, 2 and 3 years.

Marine Midland uses 1, 3 and 5 years. The First National Bank of Birmingham uses 1 and 5 years. The First National Bank of Allentown uses 3 and 3/4 years. Hibernia and Continental use 5 years. The First National Bank & Trust Company of Tulsa uses 7 years, and the National Bank of Detroit uses 10 years. On top of all this, the banks have selected the particular market index which best suits their needs. For example, in the equity fund area: the First National Bank of Detroit and the First National Bank & Trust Company of Tulsa use Becker; Marine Midland uses Pensions and Investments and Standard & Poor's; and United Jersey Bank uses Merrill Lynch.

Moreover, under the present federal securities laws banks can only run such ads for pooled investment funds for corporate plans. The enactment of the second provision of Section 274 of S. 3017 would permit banks to run ads for pooled investment funds for all employee benefit plans, including Keogh plans and Individual Retirement Accounts -- plans which tend to be far smaller and less sophisticated than corporate plans.*

There also is evidence that similar abuses are occurring with respect to bank pooled investment funds for employee benefit plans as occurred with respect to bank securities affiliates in the 1920's and bank REITs in the 1970's, and to which the Supreme Court pointed in the Camp case with respect to bank-sponsored mutual funds.

* The average mutual fund Keogh plan has only $8,106 in assets and 1.4 participants. The average mutual fund IRA has $3,277 in assets and 1.1 participants. In contrast, the average private pension plan (excluding Keoghs and IRAs) has $425,000 in assets and 60 participants. (Data for Keogh plans and IRAs based on 1977 mutual fund industry statistics; data for private pension plans derived from Yohalem, Martha Remy, "Employee-Benefit Plans 1975" Social Security Bulletin, November, 1977).

As discussed above, the merchandising of bank securities affiliates in the 1920's and bank REITs in the 1970's traded on the expertise and representation of the bank itself. The same phemonenon is occurring today with respect to bank pooled investment funds for employee benefit plans. The ad run by the First National Bank & Trust Company of Tulsa announces: "We're specialists in stocks, bonds, oil, real estate, and the complexities of ERISA." Morgan Bank's ad states that "Morgan has a highly skilled group of investment managers working exclusively in the fixed-income field." The First National Bank of Birmingham's ad asks: "How can a bank from Birmingham get this kind of results for its clients?" This type of advertising naturally induces plans to invest in reliance on the sponsoring bank -- this is precisely what occurred in connection with bank securities affiliates in the 1920's and bank REITs in the 1970's. Promotional tactics which seek to exploit the bank's reputation create the inevitable backlash against the bank itself when bank-sponsored investment vehicles perform badly, whether or not through any fault of the bank. In Camp the Supreme Court warned: "Imprudent or unsuccessful management of the bank's investment fund could bring about a perhaps unjustified loss of public confidence in the bank itself." This actually occurred when bank securities affiliates and bank REITs entered into periods of poor performance.

While promotional excesses may cause their own problems, various abuses of fiduciary responsibility can also occur in the management of these funds. Here too it appears that certain abuses which took place when banks sponsored securities affiliates in the 1920's and REITs in the 1970's are occurring today.

In some cases bank trust departments purchase securities issued by good commercial customers of the bank, despite the fact that such investments may be imprudent.* The evidence indicates that banks use their pooled investment funds as dumping grounds for undesirable securities issued by good commercial customers:

> "For example, one bank trust department a few years ago bought a large block of bonds of a director-interlocked customer, whose common stock was not on the trust department's approved list. The bond specialist of the bank informed the author that this purchase of bonds was 'expected of the bank' as a quid pro quo for the board directorship, the bank's award of the role of collection agent on the bond issue, and the generally good customer relationship. A large fraction of these bonds was put into one of the bank's common trust funds and into a nonprofit trust account managed by the bank; that is, into relatively weak and insensitive accounts. An examination made by the author of fourteen trust portfolios held in this bank in mid-1967, revealed that 'special notes' of the bank's own customers tended to show up regularly in the common trust fund and in nine of ten randomly selected portfolios of small nonprofit accounts, but in only one of three portfolios of major companies."**

Similarly, there are indications that bank trust departments do not sell securities issued by good commercial customers, despite adverse financial information

* See, e.g., Herman, "Conflicts of Interest: Commercial Bank Trust Departments" (The Twentieth Century Fund 1975), at 49-50:

> "The company then approached a large trust bank with which it had a director interlock and a major customer relationship and asked it to take some or all of the bonds. According to two employees of the bond department, the customer applied pressure on the commercial arm, including a threat of withdrawal of deposits and shift of other business. Pressure was then put on the trust department, which had not been interested in private placements and ordinarily only bought bonds of a higher quality. After some resistance, the trust department succumbed, and after some haggling over the price, it eventually absorbed half of this large private placement."

** Ibid, at 62-63.

concerning the companies. *

There is also evidence that banks give preferential treatment to large individually-managed accounts over their pooled investment funds. This occurs in the allocation of investment opportunities:

> "For example, the largest and most important commercial customer of one bank did not want its pension fund participating in a pooled fund, but did want a portion of its investment portfolio in the same kind of 'hot' issues. An officer of the bank described the situation as follows: 'When the research department came up with an idea that would be useful for the pooled fund, there was a problem with regard to allocating investment opportunities between the pooled fund and the customer's account. Although pro rata division between these two accounts was not the general rule, there were some exceptions. On occasion we could favor the customer's account, because it was the bank's largest customer and had tough investment people who were very performance oriented." **

But favored treatment to good customers can also be given after the fact. An investment officer of a national bank recently alleged that the bank's pooled fund had purchased securities which increased in value and which were then transferred at original cost to other accounts. ***

It also appears that banks have pressured commercial customers to retain the bank to manage their pension assets:

* See the discussions of the Air Line Pilots Association suit against Continental Illinois Bank and the Penn Central case in Herman, supra, at 54-55; and in Hunsicker "Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions", 50 Southern California Law Review 611, at 655-56 (1977).

** Herman, supra, at 61.

*** "Hamar Case: Did the Bank Regulators Fail in Their Duties", New York Times, April 10, 1978, p. D1, col. 2.

> "A former Continental Illinois National Bank employee told the Wall Street Journal that pressure is commonly applied to commercial customers. The commercial lending officer tells the potential commercial customer how their full service bank would 'love' to manage his pension fund, and '[t]he executives get the message pretty quickly. *

Commercial bank customers are not only pressured to retain the bank for pension management, but many then find that the bank uses their pension portfolio as a dumping ground for weak issues of other bank customers:

> "In one such case described to the author by an investment banker, one customer, highly dependent on credit from a powerful trust institution, was virtually forced to place its pension fund with the bank. Approximately 10 percent of the assets of this fund were shortly thereafter placed in the stock of a financially stricken customer with whom the bank was deeply involved and whose stock was of less than investment grade. Almost immediately after acquisition, this issue fell to a small fraction of its original price. The investment banker believes that a very strong and alert pension fund customer of the bank learned of the coming debacle and insisted that the shares of the sagging company be removed from its portfolio. Because the market was thin, the shares were placed in weaker portfolios. The investment banker claims that the customer knew this but was too dependent on bank credit to withdraw, sue or even complain. "**

Recent studies point to a variety of other problems reminiscent of those uncovered in connection with bank-sponsored securities affiliates in the 1920's and bank-sponsored REITs in the early 1970's. These include use of inside information

* Hunsicker, supra at 650-651, quoting from Wall Street Journal of January 7, 1975, p. 1, col. 6, at p. 31, col. 2.

** Herman, supra, at 63.

obtained from the bank's commercial activities;* use by the bank of uninvested cash of trust and pension accounts;** and banks using trust and pension accounts to assist commercial customers in takeover battles.*** Citibank's pooled equity fund for Keogh plans apparently invests in certificates of deposit issued by the bank, a self-dealing practice which is prohibited by the Investment Company Act for a mutual fund registered under the Act. It is unclear to us whether the enactment of ERISA has curbed these abuses.

Full-scale investigations tend not to occur until abuses finally result in a major crisis. However, the existing evidence indicates that bank pooled investment funds for employee benefit plans are embarking on the same road as prior pooled investment vehicles sponsored by banks. An early indication is the aggressive advertisements aimed at employee benefit plans -- advertisements which purposely induce the plans to rely on the expertise and reputation of the bank itself. Then there are the studies which present instances of the use of bank pooled funds as dumping grounds for securities issued by favored bank commercial customers and by the banks themselves; of banks favoring large individually-managed accounts over their pooled investment funds; of commercial bank customers being pressured to entrust their pension assets to banks who then proceed to unload imprudent investment into their portfolios; and of banks profiting by using customers' uninvested cash, and by using pension assets to assist favored commercial clients of the bank.

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* See, e.g., Herman, <u>supra</u>, at 73-87; and Hunsicker, <u>supra</u>, at 630-647.

** See, Herman, <u>supra</u>, at 107-121; and Hunsicker, <u>supra</u>, at 619-630.

*** See, e.g., Herman, supra, at 50:

> "One major trust bank, which managed the pension funds and held about 5 percent of the stock of a good commercial customer, was faced with the attempt of a conglomerate to take over the customer. The bank brought the customer's stock for the customer's own pension fund accounts, even though the trust department did not like the stock."

We believe that the mass-merchandising of interests in bank pooled investment funds through aggressive advertising compaigns aimed at employee benefit plans constitutes a clear violation of the Glass-Steagall Act. In the Camp case, when the Supreme Court struck down the attempt by banks to operate mutual funds, it repeatedly stressed the promotional and merchandising nature of the venture as contrasted with the simple commingling of personal trust and estate assets which the bank "has received for a true fiduciary purpose rather than for investment":

> "These activities, unlike the operation of an investment fund, do not give rise to a promotional or salesman's stake in a particular investment; they do not involve an enterprise in direct competition with aggressively promoted funds offered by other investment companies; they do not entail a threat to public confidence in the bank itself; and they do not impair the bank's ability to give disinterested service as a fiduciary or managing agent. In short, there is a plain difference between the sale of fiduciary services and the sale of investments."*

* ICI v. Camp, 401 U. S. 617 (1971). The leading commentators on the Camp case emphasize the fact that the decision turned on the promotional and merchandising nature of pooled funds, as opposed to traditional personal trust activities.

"Whatever might be said about the factual validity of the Supreme Court's distinction in Camp between commingled agency accounts and other bank-sponsored investment management arrangements, the Court did attempt to tie security status to concern over the methods of promotion banks might adopt." Bines, The Law of Investment Management 3.03[2][b] at p. 3-65 (1978).

"[T]he key difference under the Glass-Steagall Act, as interpreted by the U. S. Supreme Court, between traditional trust department advisory activities, and other investment management services must thus be the manner of offering advisory services." Lybecker, "Bank-Sponsored Investment Management Services: A Legal History and Statutory Interpretative Analysis-Part 2", 5 Securities Regulation Law Journal, at 223 (Autumn 1977).

We submit that, at a minimum, what clearly is needed is a full-scale Congressional airing of this matter. And, as set forth above, the Senate Securities Subcommittee has been conducting an in-depth study in this very area. But enactment of the second provision of Section 274 of S. 3017 would moot this detailed investigation by simply declaring that interests in bank pooled investment funds for employee benefit plans, including Keogh plans and IRAs as well as corporate plans, are not securities. We cannot believe that these Subcommittees intend this result, which would reverse over 100 years of federal banking laws with broad implications, not only for hundreds of thousands of employee benefit plans, their participants and beneficiaries, but also for the nation's entire financial system.

II. THE FEDERAL SECURITIES LAWS

A. Present Law

The reform legislation enacted in the 1930's not only prohibited banks from engaging in the securities business, but established a system for regulating those persons who were permitted to engage in these activities.

The first reform measure, the Securities Act of 1933, was premised on the belief that "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."* The 1933 Act requires that an issuer of securities file a registration statement with the Securities and Exchange Commission containing specified information about the security, the issuer and the underwriters. All

* Brandeis, Other People's Money (1914).

prospective investors must be furnished with a prospectus containing the basic information set forth in the registration statement. The 1933 Act limits the type of advertising which may be conducted before the investor receives a full statutory prospectus.

Whereas the 1933 Act relates to the initial offering of securities, the Securities Exchange Act of 1934 primarily deals with post-distribution trading. The 1934 Act covers such matters as the regulation of stock exchanges; registration and regulation of broker-dealers; the filing of periodic reports by issuers; proxy solicitations; takeover bids and tender offers; insider trading and fraud and manipulation.

Congress realized that pooled investment funds present problems which are not present in the case of other issuers of securities. "Because...[their] assets are usually liquid and readily negotiable, control of the companies' large funds of cash and securities offered many opportunities for exploitation by unscrupulous management."* A lengthy SEC study led to the enactment of the Investment Company Act of 1940. The 1940 Act not only requires disclosure, but imposes numerous substantive restrictions on the structure and operations of pooled investment funds to prevent conflicts of interest and other forms of over-reaching. For example, at least 40% of the fund's directors must be independent of the fund's investment adviser (Section 10).
The investment advisory contract between the pooled fund and its adviser must be approved by the fund's independent directors and by its shareholders (Section 15). A pooled fund must establish fundamental investment policies which can only be changed by shareholder vote (Section 13). Transactions between the pooled fund and any

* 1 Loss, Securities Regulation, at 146 (1961).

"affiliated person" (including the fund's investment adviser, officers and directors) are prohibited without prior SEC approval (Section 17). Shares in the pooled fund must be priced daily for purposes of both new sales and redemptions of outstanding shares (Section 22). A pooled fund's investment adviser has a "fiduciary duty" with respect to compensation received from the fund, and the SEC and fund shareholders may bring suit to enforce this standard (Section 36).

The members of these Subcommittees are well aware of the controversy engendered by the Daniel case as to whether an employee's interest in an employee benefit plan is a security within the meaning of the federal securities laws. However, there is no dispute that shares of a pooled investment fund, whether sold to individuals, institutions or employee benefit plans, are securities.* Thus, unlike the controversy over the Daniel case, these pooled investment funds have long been understood to be subject to the securities laws by the Congress, the courts, the SEC and the sponsors of such funds.

The issue of course did not arise in the 1930's with respect to bank pooled investment funds for employee benefit plans since the Federal Reserve Board did not permit national banks to create such pooled funds until 1955.** When in the late

* For example, beginning with the passage of the Securities Act of 1933, some 7 years before the enactment of the Investment Company Act, interests in mutual funds were regarded as securities and were required to be registered under the 1933 Act.

** 30 Fed. Reg. 3305 (1955).

1950's banks did begin to sell interests in pooled investment funds to corporate plans, the SEC took the position that the interests were exempt from registration under the 1933 Act based on the private offering exemption.* The SEC position was based on the assumption that corporate employers generally are able to protect themselves in dealing with bank pooled investment funds.**

However, the enactment of the Self-Employed Individuals Tax Retirement Act of 1962*** created a new situation. The 1962 Act permitted self-employed individuals for the first time to create retirement plans ("Keogh plans") covering themselves and their employees. Since annual contributions to Keogh plans were sharply limited ($2,500 up to 10% of self-employed income), banks could only offer Keogh plan programs using master plans, standardized documents and interests

* See SEC Membrandum re Securities Act Release No. 4552, reprinted in Hearings on Common Trust Funds -- Overlapping Responsibility and Conflict in Regulation Before a Subcomm. of the House Comm. on Government Operations, 88th Cong., 1st Sess., (1963) (hereinafter 1963 Hearings): "The Commission has consistently taken the position that the commingling of corporate pension plans and the operation of common trust funds involves the issuance of a security -- although often in a transaction not involving a public offering."

** It is assumed that he [the corporate employer] will set up the pension trust with the aid of a lawyer, accountant and actuary -- all of whom presumably are experienced in the area of pension plans and know whether or not the investment medium offered by the particular bank's commingled fund is satisfactory in relation to the investment media provided by other institutions. At a minimum, such employers are thought to be sufficiently sophisticated (and important) to request (and obtain) any information which they think is necessary to an intelligent investment choice. These assumptions may be consonant with the facts in many cases; but they are not in every case." Mundheim & Henderson, "Applicability of the Federal Securities Laws to Pension and Profit-Sharing Plans", 29 Law & Contemporary Problems 795, at 820 (1964).

*** Pub. L. No. 87-792, 76 Stat. 809.

in pooled investment funds on an "assembly-line approach."* Since banks openly sought to mass-merchandise shares of their pooled investment funds to millions of small Keogh plans, the SEC naturally took the position that the shares had to be registered with the Commission and prospectuses provided to prospective investors.** Committees in both Houses of Congress repeatedly considered this issue from 1967 through 1970. SEC Chairman Cohen testified in favor of legislation codifying the SEC's position exempting interests in pooled funds for corporate plans from registration. However, he opposed legislation which would have removed the SEC's disclosure

* See, e.g., "A Fork in the Road," Address by G. T. Lumpkin, Jr., Vice-President, Wachovia Bank & Trust Co. Before the 44th Midwinter Trust Conference of the American Bankers Association, New York City, N.Y. (Feb. 5, 1963):

"[Corporate] plans usually involve large sums, well diversified, to provide future security for their hundreds of beneficiaries. Now comes the opportunity to serve as trustee of hundreds (or thousands) of very small [Keogh] retirement trusts.

"This is a dramatic change in the nature of trust business. We must meet it with a mind open to possible dramatic change in approach. Rather than the close personal basis on which other types of trust service have been handled, we must look toward an assembly-line approach, a semiautomated approach, or even possibly a fully automated approach. Rather than a daily, weekly, or monthly personal contact with a trust customer, we must look to an indirect yearly contact, in many cases through an annual statement mailed to his home or business address. Rather than a trust customer judging us on his intimate knowledge of our service to him to fill his personal needs, he will be judging us strictly on the investment return he receives. Rather than a man-to-man relationship, we must consider a machine-to-man concept of fiduciary service."

** Since it is clear that participations in the pooled fund will be publicly offered, registration of the security with this Commission is required under the Securities Act of 1933." Testimony of SEC Chairman William L. Cary, 1963 Hearings, at 7.

And as another SEC Chairman, Ray Garrett, Jr., stated with respect to bank pooled funds: "If a bank operates and distributes shares of something that is indistinguishable from a mutual fund for all purposes except legal form should it not be subject to the same regulation as the mutual fund itself?" Address of Chairman Ray Garrett, Jr., Before 55th National Trust Conference, 15-16 (February 4, 1974).

jurisdiction over bank pooled investment funds for Keogh plans: "[Keogh] plans involve a complex arrangement for the investment of funds by self-employed persons, small businessmen and their employees for retirement purposes in a diversified portfolio of equity securities. There is a need for adequate and understandable disclosure concerning the risks, obligations, rights and costs which are involved." *

After some three years of hearings in both Houses, Congress enacted the Investment Company Act Amendments of 1970, which adopted the pattern which the SEC had applied since 1962. Bank and insurance company pooled funds for corporate plans and Keogh plans were exempted from registration as investment companies (Investment Company Act Section 3(c)(11)). Interests in pooled funds sold to corporate plans were exempted from registration under the Securities Act of 1933 (Section 3(a)(2)). Interests in pooled funds sold to Keogh plans were required to be registered under the 1933 Act (with the SEC given authority to issue appropriate exemptions) (Section 3(a)(2)).

Congress' distinction between corporate plans and Keogh plans was based on the fact that Keogh plans tend to be far smaller and less sophisticated than corporate plans and therefore in need of greater protection. In the words of the Report of the Senate Committee on Banking and Currency:

* Statement of SEC Chairman Manuel F. Cohen at Hearing Before the Senate Comm. on Banking and Currency on Amendment No. 438 to S. 1659, 90th Cong., 1st Sess., at 1328 (1968).

"The amendment does not exempt [from the 1933 Act] interests or participations issued by either bank collective trust funds or insurance company separate accounts in connection with 'H. R. 10 plans,' because of their fairly complex nature as an equity investment and because of the likelihood that they could be sold to self-employed persons, unsophisticated in the securities field." (Report to Accompany S. 2224, at 27-28, May 21, 1969).*

The passage of ERISA reinforced the need for continued SEC disclosure jurisdiction in this area. ERISA permitted part-time self-employed persons to contribute 100% of earned income up to $750 to a Keogh plan. Many persons who are eligible to establish such "mini-Keogh" plans undoubtedly fall into the class of unsophisticated investors Congress sought fit to protect in 1970. (The passage of the 1976 Tax Reform Act further reinforced the need for disclosure in this area by limiting "mini-Keogh" plans to persons with less than $15,000 in earned income).

When it enacted ERISA, Congress not only did not make any changes in the application of the federal securities laws to pooled investment funds for corporate plans and Keogh plans, but provided that the federal securities laws would apply to pooled

* Other provisions in the 1970 legislation reflected special Congressional concern with pooled investment funds for employee benefit plans. For example, Congress amended Section 205 of the Investment Advisers Act to permit certain types of performance fee arrangements for advisory accounts with over $1 million in assets. However, Congress totally prohibited performance fee arrangements for pooled investment funds for employee benefit plans.

investment funds for the new Individual Retirement Accounts authorized by ERISA.* The Senate Securities Subcommittee faced this matter again after the enactment of ERISA but did not seek to amend the existing statutory pattern.**

B. The Second Provision of Section 274 of S. 3017

The enactment of the second provision of Section 274 of S. 3017 would totally repeal the regulatory pattern which Congress developed before, during and after the enactment of ERISA. Specifically:

1. In the case of pooled investment funds for employee benefit corporate plans, the provision would remove the anti-fraud protections of federal securities laws - the only present application of the securities laws to such pooled funds.

* Page 338 of the Conference Report stated: "The conferees intend that this legislation with respect to individual retirement accounts is not to limit in any way the application of the Federal securities laws to individual retirement accounts or the application to them of the laws relating to common trusts or investment funds maintained by any institution. As a result, the Securities and Exchange Commission will have the authority to act on the issues arising with respect to individual retirement accounts independently of this legislation." Thus, interests in pooled investment funds offered to Individual Retirement Accounts must (like interests in pooled Keogh funds) be registered under the 1933 Act and prospectuses given to prospective investors. In addition, pooled investment funds for IRAs (unlike such funds for corporate plans and Keogh plans) are subject to registration under the Investment Company Act. This latter distinction appears to be based on the fact that the typical IRA is not an employee benefit plan and hence is not subject to Title 1 of ERISA relating to fiduciary standards. See letter of Continental Illinois National Bank of Chicago to the SEC Division of Investment Management Regulation dated October 5, 1975, in 1975-76 CCH Federal Securities Law Reporter ¶ 80,411, at pages 86,092 and 86,094.

** On February 21, 1975, William W. Graulty testified on behalf of the American Bankers Association before the Subcommittee in connection with the Securities Acts Amendments of 1975. He requested that the Subcommittee report out legislation exempting bank collective funds for Keogh plans and IRAs from the federal securities laws. The Subcommittee did not report out the requested legislation. See Hearings on S. 249 Before the Senate Securities Subcommittee, 94th Cong., 1st Sess, 463-75 (1975).

2. In the case of pooled funds for employee benefit Keogh plans, the provision not only would remove anti-fraud protections, but would permit banks and insurance companies to mass-merchandise interests in pooled funds to Keogh plans without providing any sort of disclosure documents.

3. In the case of employee benefit Individual Retirement Accounts, the provision not only would remove anti-fraud protections and disclosure requirements, but also would remove the substantive protections provided by the Investment Company Act.

What must be emphasized is that ERISA does not attempt to regulate the matters covered by the federal securities laws. ERISA basically seeks to protect an employee in an employee benefit plan, for example, by requiring that he receive a summary plan description and an annual plan report. However, when an employee benefit plan purchases shares in a pooled investment fund, be it a bank collective trust, an insurance company separate account or a mutual fund, it does so on the same basis as any other investor. It is the federal securities laws, not ERISA, which require sponsors of pooled investment funds to provide Keogh plans and IRAs with prospectuses. It is the federal securities laws, not ERISA, which limits the types of advertisements which sponsors of pooled investment funds can direct at Keogh plans and IRAs. It is the federal securities laws, not ERISA, which provide employee benefit plans with the right to sue the sponsors of pooled funds for fraud and misrepresentation in connection with the plan's purchase of shares of the pooled fund.*

We believe it is essential to consider what would occur if the second provision of Section 274 were enacted into law.

First, banks would be free to advertise interests in their pooled investment funds to employee benefit Keogh plans and IRAs, with no restraints whatever imposed by ERISA or the federal banking laws. These small plans will be told by United Jersey Bank that "We're # 1 nationally in investment performance"; by Hibernia National Bank that it is "# 1"; and by the Fifth Third Bank of Cincinnati that it is "Entering our second decade of outperforming the Dow Jones". Banks will be free to select the time periods used in their ads so that they can choose the periods of their best performance. And they will be free to select the particular stock market index which best suits their needs. In contrast, every single one of the ads attached to our testimony is prohibited in the case of an issuer subject to the Securities Act of 1933.

* Nor do the federal banking laws offer protections equivalent to those provided by the federal securities laws. For example, the regulations adopted by the Comptroller of the Currency governing the operation of pooled investment funds for employee benefit plans do not require a bank to provide any sort of disclosure material to an employee benefit plan considering whether or not to invest in the fund. 12 C.F.R. §9.18 (1977). Similarly, the Comptroller's regulations do not regulate in any fashion whatever the type of advertisements which banks can run for their pooled investment funds for employee benefit plans. 12 C.F.R. §9.18(b)(5)(iii)(1977). Finally, "aggrieved participants in bank services appear to have significantly fewer opportunities for private rights of action to protest effectively allegedly unlawful activities where the particular investment management service is not also registered under or subject to some of all of the federal securities laws." Lybecker, "Bank-Sponsored Investment Management Services: Consideration of the Regulatory Problems, and Suggested Legislative and Statutory Interpretive Responses", 1977 Duke Law Journal 983, at 1036.

Second, banks will not be required to provide employee benefit Keogh plans and IRAs with prospectuses, but will be free to utilize any sort of sales materials they desire. In order to demonstrate exactly what will occur if the provision is enacted, we examined the materials which 17 banks provide to prospective Keogh plan investors concerning the banks' pooled investment funds (which take advantage of present exemptions from the federal securities laws since they are only offered to Keogh plans in one state). * Our examination of these documents was to determine whether Keogh plans investing in these funds are being provided with the most basic kind of information deemed essential under the federal securities laws. The lack of such disclosures is startling. None of the 17 banks describe the fund's investment restrictions; none provide relevant information describing the bank operating and advising the fund; none give background information regarding the bank's officers and directors; none disclose the total fees paid to the bank in each of the last three years; none describe the fund's policy with respect to buying or selling portfolio securities; none disclose the amounts of brokerage commissions paid by the fund or to whom; and over half do not contain the fund's current financial statements or the fund's current portfolio. In contrast, every

* These banks, which we selected on a random basis, are: Bank of the Southwest (Houston); Capitol National Bank (Houston); The Central Trust Company (Cincinnati); Citibank (New York); The Fifth Third Bank (Cincinnati); First Virginia Bank (Falls Church); First National Bank (Cincinnati); First Pennsylvania Bank (Philadelphia); Girard Trust Bank (Philadelphia); Maryland National Bank (Baltimore); Mercantile-Safe Deposit and Trust Company (Baltimore); National City Bank (Cleveland); New England Merchants National Bank (Boston); Philadelphia National Bank (Philadelphia); Provident National Bank (Philadelphia); Shawmut Bank of Boston (Boston); and Southern Ohio Bank (Cincinnati).

mutual fund registered under the Investment Company Act must continuously provide all of this information to all prospective investors, including corporate plans, Keogh plans and IRAs.* We note that the Federal Trade Commission's Bureau of Consumer Protection recently issued a lengthy report criticizing the inadequate disclosure provided to IRA participants who invest in products which presently are not subject to the federal securities laws (e.g., bank savings accounts and certificates of deposit).** The enactment of the second provision of Section 274 would place employee benefit Keogh plans and IRAs which invest in pooled investment funds in exactly the same position as the unprotected IRAs discussed in the FTC Report.

Third, if the provision is enacted, all employee benefit plans will lose the right to bring actions under the federal securities laws for fraud and misrepresentations in connection with their purchases of shares of pooled investment funds. It appears that

* In addition, our review of the sales materials for these 17 pooled funds indicates the existence of practices which would be prohibited in the case of a pooled fund subject to the Investment Company Act of 1940. It appears that several of the pooled funds invest in certificates of deposit issued by the bank, a self-dealing practice that is clearly prohibited by Section 17 of the Investment Company Act. A number of them permit withdrawals only on a quarterly or monthly basis, whereas Section 22 of the Investment Company Act requires a mutual fund to redeem any outstanding shares at any time. Some of the banks calculate the funds' advisory fees using only the fund's net assets at the beginning of the year and at the end of the year; most mutual funds compute this using their daily net assets. Moreover, of course, bank pooled funds for employee benefit plans do not have any directors, no less independent directors, as required by the Investment Company Act. Similarly, there is no independent director or shareholder approval of the advisory relationship between the pooled fund and the bank.

** Staff Report of the Bureau of Consumer Protection of the Federal Trade Commission Submitted to the Subcommittee on Oversight of the House Ways and Means Committee on Individual Retirement Accounts/Annuities (IRAs), dated March 1978. Also see the FTC's comments on proposed ERISA Prohibited Transaction Exemption 77-9, urging increased disclosure requirements.

ERISA does not provide defrauded employee benefit plans with an equivalent right of action. Section 502 of ERISA provides plans with the right to bring certain civil actions. However, we do not believe that ERISA provides a plan the right to sue the sponsor of a pooled investment fund for fraud or misrepresentation in connection with the plan's purchase of shares in such pooled fund. At the most critical time, when the plan makes its initial investment in the pooled fund, it appears that the sponsor of the fund is not a "fiduciary" as defined in ERISA, and Section 409(b) of ERISA expressly provides that a fiduciary is not liable for a breach of fiduciary duty if such breach was committed before he became a fiduciary. Further, and more important, even if the sponsor is a fiduciary, it appears that ERISA does not provide a plan with a right of action comparable to those provided by the securities laws for misleading statements or omissions of material facts in connection with the sale of securities to the plan. ERISA primarily relates to a fiduciary's selection of investments for the pooled fund, and not to disclosures made by the fiduciary to the plan concerning interests in the pooled fund.

Since the introduction of S. 3017, we have attempted to ascertain the reasons underlying the second provision of Section 274 of the bill. We have learned of two explanations offered by representatives of the banking industry.

First, we were informed that a number of banks maintain that the application of the federal securities laws to bank pooled investment funds would inhibit banks from participating in the new Special Master and Prototype Plan program proposed in Title IV of the bill. * We question the representations made by the banking industry. ** First, we expect that many, if not the majority, of the employee benefit plans which will utilize this new program will be corporate plans. As set forth above, the <u>only</u> applicability of the federal securities laws to bank pooled investment funds for corporate plans is in the area of anti-fraud protections. The evidence is overwhelming that this has not in any way inhibited bank sponsorship of pooled investment funds for corporate plans. For example, at year-end 1975, the top 115 banks alone operated 465 pooled funds for corporate plans with assets of $21.5 billion. *** We have been unable to obtain data as to the total assets of the bank pooled funds for Keogh plans and IRAs.

* We strongly endorse this part of the bill. Indeed, on March 27, 1978, we met with staff members of the Committee on Human Resources to discuss this proposal, and on April 13, 1978, we submitted our detailed suggestions designed to improve this most-worthwhile proposal.

** It should be noted that in the 1960's, representatives of the banking industry made the same representations with respect to bank pooled funds for Keogh plans. Yet in the 1960's a number of trade and professional associations (including the American Bar Association, the American Medical Association, the National Council of Salesmen's Organizations and the Salesmen's Self-Employed Retirement and Thrift Plans), various insurance companies and at least one bank (National Bank of Detroit) registered interests in their pooled Keogh funds under the 1933 Act without protest. See Mundheim & Henderson, <u>supra</u>, at 823-24. Further, at least 7 banks currently have registered interests in their pooled Keogh funds under the 1933 Act.

*** SEC Report, <u>supra</u>, at 154. In contrast, in 1967, the assets of bank pooled funds for corporate plans amounted to only $607 million. <u>See Bank Administered Pooled Equity Funds For Employee Benefit Plans, supra.</u>

However, we know of at least seven major banks which have registered interests in their pooled funds for Keogh plans under the Securities Act of 1933.* If these banks can operate under the disclosure standards of the Securities Act of 1933, we see no reason why other banks cannot do so. In addition, countless banks presently offer shares in their pooled Keogh funds which are exempt from 1933 Act registration by reason of only being offered to Keogh plans located in one state. Since the vast majority of banks, particularly smaller banks, do business in one state, banks all across the country can and do have success in sponsoring intrastate collective Keogh funds without SEC registration.

Further, if the second provision of Section 274 of the bill merely is designed to relieve banks of the necessity of registering shares in their pooled investment funds for Keogh plans established under the new program, it is unclear why the provision has been drafted in such a was as to exempt <u>all</u> employee benefit plans (including corporate plans, Keogh plans and IRAs) -- not only from the registration requirements of the 1933 Act but also from the anti-fraud provisions of the securities laws.

Finally, and most importantly, even if one accepts the argument that the registration requirements of the 1933 Act will inhibit banks from participating in the new program, it is essential to balance this with the loss of investor protections that would occur. The new Special Master and Prototype Plan program is intended to encourage small employers to establish employee benefit plans. It is precisely these

* These banks are: First National Bank of Boston; Continental Illinois National Bank & Trust Company of Chicago; United Missouri Bank of Kansas City; American Security and Trust; Wells Fargo & Co.; National Bank of Detroit; and Commerce Bank of Kansas City.

small unsophisticated plans who are in the greatest need of protection. Yet the enactment of the second provision of Section 274 would deprive these small plans (as well as all other employee benefit plans) of the anti-fraud and disclosure protections afforded by the federal securities laws.

The second reason advanced by some banks in support of Section 274 is the present disparity in treatment under the federal securities laws of pooled investment funds for corporate plans versus pooled investment funds for Keogh plans and IRAs. As discussed above, the distinction which Congress drew in 1970 (and renewed in 1974) between pooled investment funds for corporate plans and pooled investment funds for Keogh plans and IRAs was based on the belief that most corporate employers are sufficiently large and sophisticated to fend for themselves.* In contrast, Congress concluded that interests in pooled investment funds for Keogh plans would be "sold to self-employed persons, unsophisticated in the securities field."** Indeed, the banking industry made it absolutely clear that banks intended to mass-merchandise interests in their pooled investment funds to millions of small Keogh plans using master plans,

* "It is assumed that he [the corporate employer] will set up the pension trust with the aid of a lawyer, accountant and actuary -- all of whom presumably are experienced in the area of pension plans and know whether or not the investment medium offered by the particular bank's commingled fund is satisfactory in relation to the investment media provided by other institutions. At a minimum, such employers are thought to be sufficiently sophisticated (and important) to request (and obtain) any information which they think is necessary to an intelligent investment choice. These assumptions may be consonant with the facts in many cases; but they are not in every case." Mundheim & Henderson, supra, at 820.

** Report of the Senate Committee on Banking and Currency to Accompany S. 2224, 91st Cong., 1st Sess., at 27-28, May 21, 1969.

standardized documents and an "assembly-line approach", methods which the banks had never used in selling interests in their pooled funds to corporate plans. *

The distinction which Congress drew in 1970 between corporate plans and Keogh plans (extended by ERISA to IRAs) was the result of three years of consideration in both Houses of Congress. As in the case of any generalized distinction (such as permitting plans with less than 100 participants to file short Form 5500-C rather than Form 5500; limiting "mini-Keogh" plans to persons earning less than $15,000; and proposed ERISA administrative exemptions for plans with less than 100 employees), there obviously are exceptions to the general rule. There undoubtedly are unsophisticated corporate plans and likewise there undoubtedly are sophisticated Keogh plans and IRAs.

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* See, e.g., "Fork in the Road," Address by G. T. Lumpkin, Jr., Vice-President Wachovia Bank & Trust Co. Before the 44th Midwinter Trust Conference of the American Bankers Association, New York City, N.Y. (Feb 5, 1963):

"[Corporate] plans usually involve large sums, well diversified, to provide future security for their hundreds of beneficiaries. Now comes the opportunity to serve as trustee of hundreds (or thousands) of very small [Keogh plan] retirement trusts.

* * *

"This is a dramatic change in the nature of trust business. We must meet it with a mind open to possible dramatic change in approach. Rather than the close personal basis on which other types of trust service have been handled, we must look toward an assembly-line approach, a semiautomated approach, or even possibly a fully automated approach. Rather than a daily, weekly, or monthly personal contact with a trust customer, we must look to an indirect yearly contact, in many cases through an annual statement mailed to his home or business address. Rather than a trust customer judging us on his intimate knowledge of our service to him to fill his personal needs, he will be judging us strictly on the investment return he receives. Rather than a man-to-man relationship, we must consider a machine-to-man concept of fiduciary service."

But the available data indicates that distinction drawn by Congress between pooled investment funds for corporate plans and pooled investment funds for Keogh plans and IRAs generally makes good sense.* We previously furnished the staff of the Human Resources Committee with data regarding this matter.** Since that time we have had an opportunity to obtain more detailed data.

* Even those critics who assert that the SEC should have become more deeply involved in the area of employee benefit plans agree that the distinction is basically justified. See Mundheim and Henderson, supra, at 839-40:

"The Commission's pre-H. R. 10 belief, that interests in commingled funds sold to qualified pension plans were being sold to persons who did not require the help of the federal securities laws in obtaining the information they needed in order to evaluate the comparative quality of investment media suitable for their pension plans, was probably never fully in accord with the facts surrounding all offerings or sales of such interests. Nevertheless, it probably was sufficiently in accord with the facts surrounding the preponderance of offerings and sales of such interests to constitute a defensible basis for the administrative policy which the Commission adopted. On the other hand, the circumstances which bankers themselves have indicated would surround the offerings of H. R. 10 commingled funds, plus a recognition that the employers who would be setting up H. R. 10 plans would in general not be well equipped to fend for themselves, indicated to the Commission that the private offering exemption could not realistically be applied to H. R. 10 commingled funds. Although several professional or trade associations like the American Bar Association and the American Medical Association have registered the H. R. 10 bank-trusted commingled funds which they are sponsoring for their members, and one bank has itself registered its H. R. 10 funds, the banking industry, with the encouragement of the Comptroller of the Currency, has in general strongly resisted the Commission's position. The American Bankers Association has proposed legislation which is designed to remove bank-sponsored investment funds from the scope of the Securities Act. The Commission has quite correctly opposed this legislation. It is difficult to understand why investors in bank-sponsored investment funds should be entitled to fewer protections than investors in investment funds sponsored by others -- or why banks should be afforded more favorable treatment when they decide to sponsor investment funds than are other sponsors."

** Letters dated June 13 and July 28, 1978 to Steven J. Sacher, Special Counsel, and Peter Turza, Minority Professional Staff Member, Senate Subcommittee on Labor.

First, we conducted a study of Keogh plans funded with mutual fund shares (which account for over 30% of all Keogh plan assets). At year-end 1977 the average Keogh plan funded with mutual fund shares had assets of only $8,106 and 1.4 participants. Second, we conducted a study of Individual Retirement Accounts funded with mutual fund shares (which account for approximately 2.5% of all IRA assets). At year-end 1977 the average IRA funded with mutual fund shares had assets of only $3,277 and 1.1 participants. In contrast, at year-end 1975 the average employee benefit plan (excluding Keogh plans and IRAs) had assets of $425,000 and 60 participants.* Even the smaller corporate plans which participate in the pooled investment funds of the largest 115 banks, rather than being individually-managed, had average assets of $254,000 at year-end 1975.** We also retained an independent consulting firm, Insurance Research, Inc., to determine the number of participants in large corporate plans as opposed to those in small corporate plans. The firm obtained data concerning all corporate plans which had filed Forms 5500 and 5500C with the Department of Labor for 1977. This survey included over 262,000 corporate plans with 23.4 million participants. In 1977, 61% of the participants were in corporate plans with assets of $5 million or more; 73% were in corporate plans with assets of $1 million or more; and 85% were in corporate plans with assets of $100,000 or more. Similarly, 88% of the participants were in corporate plans having 100 or more participants, and 94% were in corporate plans with more than 25 participants.

* Yohalem, Martha Remy, "Employee-Benefit Plans, 1975", Social Security Bulletin, November 1977.

** SEC Report, supra, at 154.

Thus, the data we have been able to obtain clearly indicates that corporate plans on average are much larger than Keogh plans and IRAs, and that the vast majority of participants in corporate plans are in large plans which are likely to be far more sophisticated than the average Keogh plan or IRA. Therefore, the data indicates that the distinction which Congress has drawn between corporate plans and Keogh plans and IRAs generally is still justified.

CONCLUSION

The second provision of Section 274 of S. 3017 raises extremely important questions of public policy -- questions which are unrelated to the central focus of ERISA, the relationship of an employee to his employee benefit plan.

The provision would sanction massive bank entry into the general securities business, activity which has been barred for over 40 years by the Glass-Steagall Act of 1933. And it would do this in perhaps the largest and most rapidly expanding area of the securities business - the merchandising of securities to employee benefit plans.

The provision also would deprive employee benefit plans of the basic anti-fraud and disclosure protections afforded by the federal and state securities laws - protections which are not provided by ERISA. If the provision is enacted into law, sponsors of pooled investment funds would be free to run advertisements aimed at millions of Keogh plans and IRAs with no restraints whatever imposed by ERISA; sponsors would not be required to provide Keogh plans and IRAs with prospectuses but could utilize any type of sales materials they desire; and all employee benefit plans would lose the right to sue such sponsors for fraud and misrepresentation.

We respectfully suggest that if Congress determines to take legislative action in these most important areas, it should do so only after careful consideration of the study presently being conducted by the Senate Securities Subcommittee and after hearings which would give these important issues the undivided attention they deserve.

Attachments

Newark STAR-LEDGER - June 20, 1978

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INSTITUTIONAL INVESTOR, APRIL 1978

Hibernia National Bank

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Bank Equity Fund Manager for the five years ended December 31, 1977 as measured by Frank Russell Co., Inc.; Computer Directions Advisors, Inc.; and Rogers, Casey, & Barksdale, Inc.

For Information Contact:
Gregory N. Schedler, Trust Officer,
(504) 586-5787, Hibernia National Bank,
Post Office Box 61540, New Orleans, Louisiana 70161

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PENSIONS AND INVESTMENTS, APRIL 24, 1978

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PENSION WORLD, NOVEMBER 1977

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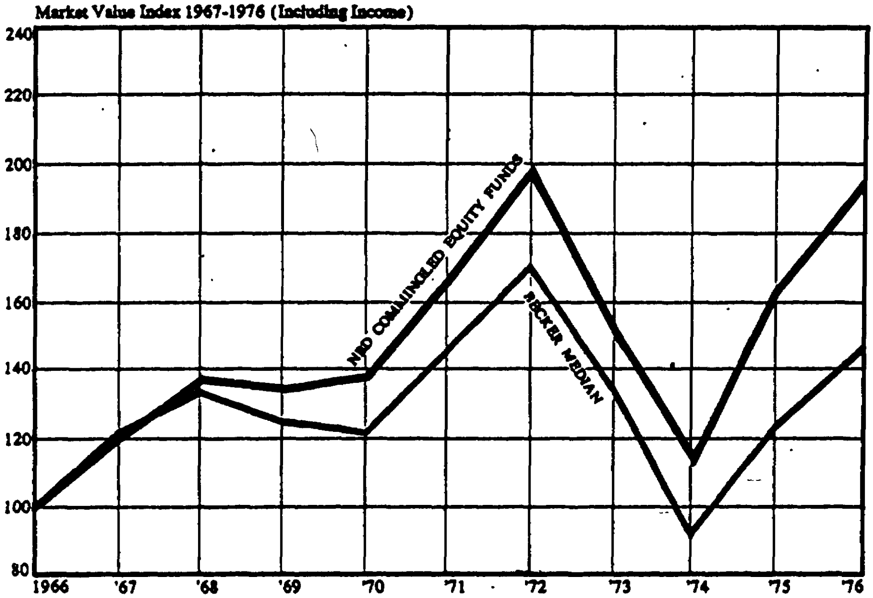

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NBD Trust Division National Bank of Detroit

New York Times, October 13, 1976

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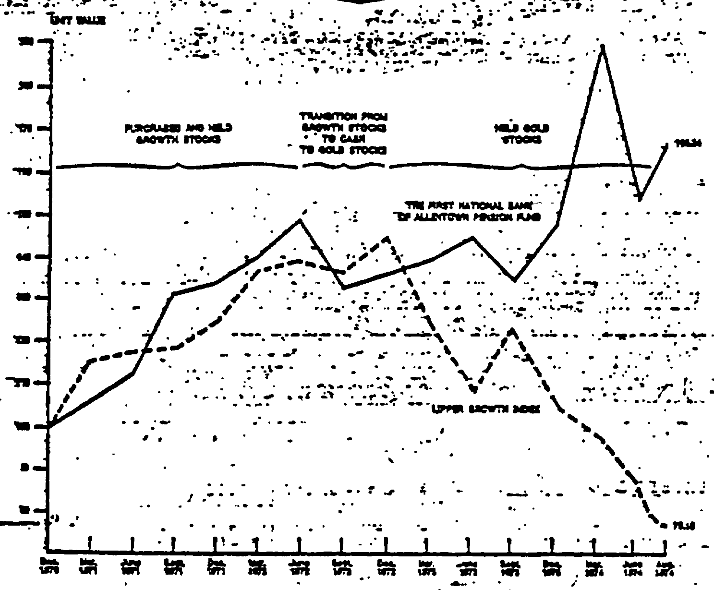

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Pensions & Investments July 31, 1978

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Our pooled Fixed Income Fund for Employee Benefit Plans has averaged an 8.89 percent annual return over the last eight years while maintaining a low level of risk. In fact, only one manager out of the 82 bank-pooled fixed income funds measured by Frank Russell Co., Inc. delivered a higher return at a lower risk.

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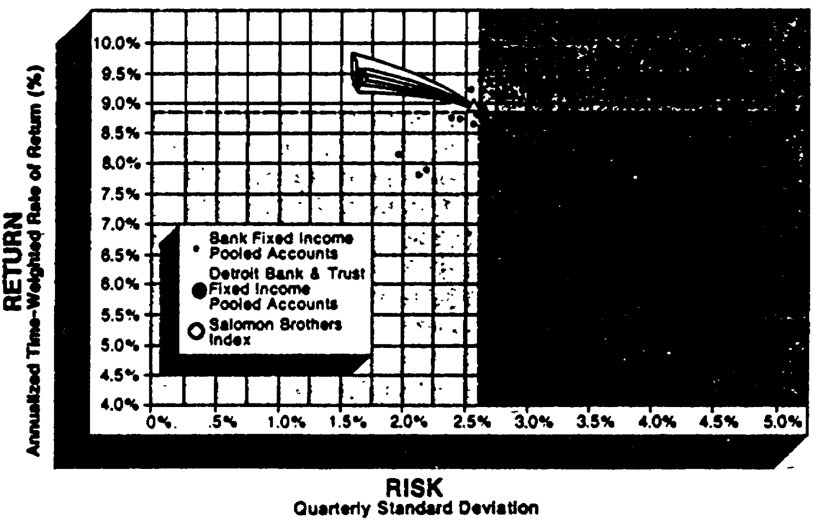
Time-Period-8 Year Performance (1-1-70 to 12-31-77)



The Indian head leads you to Detroit's first family of banks DETROITBANK Corporation.

Journal - June 29, 197[illegible]

[illegible]

Why pension fund sponsors are choosing Morgan for fixed-income management

Increasingly, sponsors of employee benefit plans are choosing The Morgan Bank to manage their fixed-income investments. Here are some of the reasons why.

Morgan has a highly skilled group of investment managers working exclusively in the fixed-income field. This team of ten specialists has consistently achieved superior results, outperforming standard industry indexes. The chart compares their record over the past nine years with a leading index.

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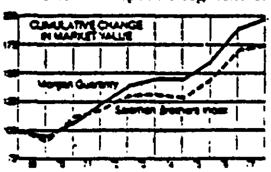
Employee benefit plans with fixed-income assets managed by Morgan gain added flexibility and diversification through use of our eight commingled funds. Each concentrates on a specific segment of



Morgan median [illegible] Salomon Brothers High Grade Corporate Bond Index [illegible]

the fixed-income markets, including leasebacks, corporate private placements, mortgages, money-market investments, as well as publicly traded bonds. The newest specializes in foreign bonds, using Morgan's far-reaching international research capabilities. In fact, we are the leader in investing abroad.

For more about how Morgan's management of fixed-income assets can be tailored to your needs, send for the new edition of our detailed booklet, "The Management of Fixed-Income Investments for Employee Benefit Funds." Write on your letterhead to Vice President Henry D. Cavanna at Morgan Guaranty Trust Company, 9 West 57th Street, New York, N.Y. 10019.

PENSION WORLD ----- December 1975

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PNB Philabank Stock Fund	+98.1%	+14.7%
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INTERIM REPORT

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PENSION WORLD, MARCH 1978

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We specialize in fine tuning fixed-income employee benefit accounts for consistent performance, with low volatility through market cycles, to produce the superior results you're looking for.

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PENSIONS & INVESTMENTS, APRIL 25, 1977

IT'S ABOUT TIME INVESTMENT MANAGERS WERE JUDGED ON THEIR SUCCESSES INSTEAD OF THEIR ADDRESSES.

In other words, it's about time that managers of employee benefit plans realized that you don't have to be located in one of the great investment centers to have a great investment record.

Take us, for example. The First National Bank of Birmingham. We're certainly not at the hub of the investment industry, yet our Trust Division has been outperforming the industry standards for years.

1972-76 is a good example. During that time, our Corporate commingled equity fund's rate of return was 7.9 percent versus only 4.9 percent for the Standard & Poor's 500. And for 1976 itself, our overall return was more than 14 points higher than the S&P – a hefty 38.5 percent.

How can a bank from Birmingham get this kind of results for its clients? Because despite all the myths and misunderstandings, it's still philosophy that determines investment success. Not geography.

And we have a philosophy that would be just as sound no matter where we had our office. Which is simply that if you consistently buy stocks that are undervalued and then sell them when they reach full value, the results will be consistently good.

As a result of this philosophy, we already have one of the largest trust departments in the Southeast. And it's still growing. Which just goes to show that there must be a lot of people out there who are more interested in our return on investment than our return address.

If you're one of them, please contact Davis H. Crenshaw, Vice President and Trust Marketing Officer, The First National Bank of Birmingham, P.O. Box 11007, Birmingham, Ala. 35288; tel. (205) 326-5397.

THE FIRST NATIONAL BANK OF BIRMINGHAM
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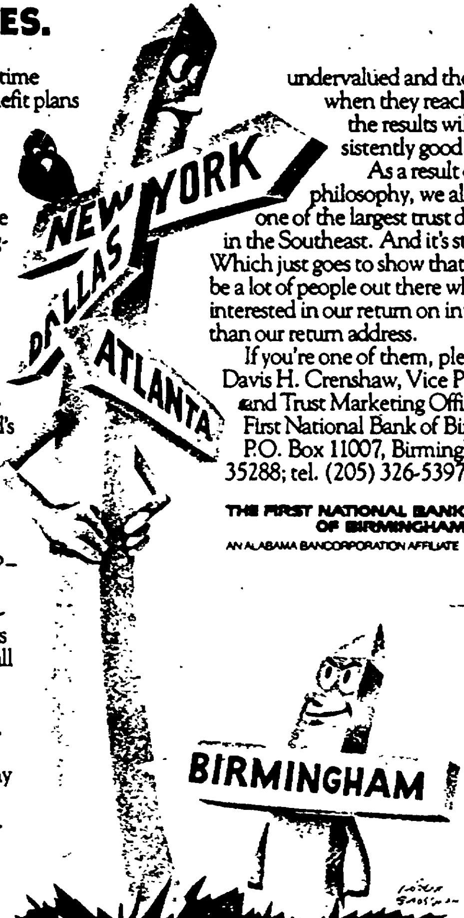

PENSION WORLD, NOVEMBER 1977

Your company's employee benefit plan can't profit from a bad fit.

Most money managers prefer that your company's pension or profit sharing plan be designed to fit one of their standardized investment programs.

At First of Tulsa, we don't think that's in your best interest. That's why we design our investment and administrative programs to fit your individual plan.

We're specialists in stocks, bonds, oil, real estate, and the complexities of ERISA. And regardless of the size of your trust, we analyze your particular requirements, then tailor an investment and administrative program to meet the performance goals of your plan.

This flexibility has enabled First of Tulsa's investment record to rank in the top 12% of those money managers surveyed nationwide by the Becker Securities Corporation.*

For more information about how our administrative and investment capabilities can help your company (and you), call collect for John Heard at (918) 586-5384. Or write First of Tulsa today.

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PENSIONS AND INVESTMENTS, APRIL 24, 1978

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TELL IT TO THE MARINE

As good as our performance is, Marine Midland doesn't believe that performance is the only way to judge management. We believe there are other important issues to consider in addition.

That's why you should ask yourself these questions—even if your pension fund had a good year.

Does the performance run hot and cold as the market runs hot and cold?

Will the investment philosophy that worked in the past be flexible enough to work tomorrow?

Do you feel comfortable with the long-term goals set up for you?

Understanding this total picture is the way we approach pension funds. And it's paid off.

Marine Midland had the highest rate of return on a 5-year basis for collective equity funds among the largest 25 U.S. bank trust departments.[1]

We also ranked first in 1-year performance. And number seven in the 3-year category. (All periods ending 12/31/77.)[2]

In fact, Marine Midland is one of the few major investment managers whose collective equity fund has beaten the Standard & Poor's average over the last 5 years.

If you want the kind of performance that goes deeper than just a good rate of return, tell it to the Marine. Contact Mr. Robert L. Kuney, Vice President, Marine Midland Bank, 250 Park Avenue, N.Y., N.Y. 10017, telephone (212) 949-6511.

[1] Trust Assets of Insured Commercial Banks, Joint Publication of Comptroller of the Currency, FDIC, and Federal Reserve Board, latest issue.

[2] Pensions and Investments' Performance Evaluation Report (P.I.P.E.R.)—Comparative Data through 12/31/1977.

MARINE MIDLAND BANK

Buffalo, New York City (212 797-[illegible]), Beirut, Bogotá, Buenos Aires, Caracas, Frankfurt, Hong Kong, Jakarta, London (01-441-[illegible]), Madrid, Manila, Mexico City, Nassau, Panama, Paris, Rio de Janeiro, Rome, São Paulo, Seoul, Singapore, Sydney, Tehran, Tokyo, Toronto.

Senator WILLIAMS. Thank you very much.

You know we have a certain continuity here. I am on the Banking Committee, where I chair the Securities Subcommittee. Our staff here today, in addition to Mr. Sacher, our Special Counsel for ERISA, includes the former Counsel for the Securities Subcommittee, Mr. Paradise, who is now General Counsel of the Human Resources Committee, and he will study everything you prepared for us. And he has been succeeded on the Securities Subcommittee by Howard Menell who is also here. They are here to hear you and to apply what we have learned from you to our study that is going on in the Securities Subcommittee.

There is a continuity that runs from this subject through many committees.

We are very glad that Mr. Potts is here to represent that thread of continuity.

Mr. POTTS. Indeed, Mr. Chairman, it is a pleasure to be here.

Senator WILLIAMS. We will, with your situation, follow the same order as we did with the other panel. We will probably want to present questions to you after further study.

Next, we will hear from the American Bankers Association; Mr. Bernard Curry and Mr. Robert Bevan.

Mr. Curry, we welcome you to this committee one more time.

STATEMENT OF BERNARD F. CURRY, CHAIRMAN, EMPLOYEES TRUSTS COMMITTEE, AMERICAN BANKERS ASSOCIATION, ACCOMPANIED BY ROBERT L. BEVAN, ASSOCIATE FEDERAL LEGISLATIVE COUNSEL

Mr. CURRY. Thank you very much. It is a pleasure to be back again, Mr. Chairman.

I am accompanied by Mr. Robert L. Bevan, associate Federal legislative counsel of the American Bankers Association.

Mr. Chairman, I ask permission to make our prepared statement part of the record so that I may give a resume of our thoughts on several of the more important issues before you today.

Senator WILLIAMS. We will be pleased to have your full statement inserted in the record.

Mr. CURRY. Mr. Chairman you have heard often that the American Bankers Association has over 13,000 members. Some 4,000 of this number exercise fiduciary powers, and most serve as trustees and/or investment managers to employee benefit plans.

Our business in no small measure is intertwined with the continued health and vitality of private employee benefit plans.

Beyond our own pecuniary interest in providing fiduciary services to these plans, we are acutely aware of the millions of current stake holders whose financial security is dependent on the continued vitality of existing plans, and additional millions who wait for the opportunity to achieve the security afforded by participation in a private pension plan.

Our roles as trustees and fiduciaries have always required that we subordinate our self-interest to the requirements of our beneficiaries. We have shaped our comments today as an extension of that obligation.

What is at issue here is the continued existence of the private system and the impact of the decisions which only you can make on the prospects for future plan coverage. We are not so insensitive as to believe that the narrow interests of our members will weigh heavily in your considerations. We recognize that the real tragedy underlying the paperwork burden, excessive regulation and the confusing and unresponsive regulatory scheme is measured in their chilling effect on new plan formation and benefit improvement. Stated simply, we are convinced that something needs to be done quickly, to stimulate creation of new plans and to regain momentum in improving old plans.

In reviewing the bills before you, we would like to extend our appreciation for your understanding of the need to address this problem. In particular, S. 3017 undertakes to ease some of the burdens on existing plans and proposes a solution to the dilemma of further coverage. Specifically, we support the special master plan proposal. This concept, if enacted in an appropriate form, could substantially broaden coverage among smaller and medium size employers. We have heard much today about the implications of one of the elements of this proposal, exempting collective investment trusts from SEC regulation. I would like to suggest to this committee in the clearest terms possible that the fiduciary obligations of ERISA, coupled with specific regulations of the various State and Federal banking agencies are more than adequate to protect participants in these trusts.

There is no real substantive interest of any participant underlying the arguments of those who oppose commingling. If this provision is not enacted, the injury will fall most heavily not on trust banks, even though they will find themselves excluded from this market. If these collective trusts are not exempted from at least the registration requirements, the effect will be to preserve the marketplace as the sole domain of those who preceded us. The success of this program will require the participation of the entire financial community. As is so often the case, when little franchises are extended in the marketplace, those who suffer will be the customers and in this case the program itself.

Quite frankly, we believe that the resources and commitment of our 4,000 members can make the difference to the success of your proposal.

On another point we are particularly concerned with section 406(a) of the act. We urge its elimination.

We urge the substitution of the standard of adequate consideration. The exemption procedure has just not worked. The laundry list of prohibited transactions and the interrlationship of the party in interest definition, have created a stifling effect on substantial pension investors and particularly in the private placement area.

There is still too much paper being filed to no purpose. In previous testimony to the Finance Committee, we have supported the ameliorating provisions of S. 901 and S. 3193.

We endorse the approach taken in S. 3017 on preemption. Complete preemption of State law is the only appropriate policy. We agree with the position taken by the American Bar Association. The plaintiff in the *Daniel* case has adequate remedies beyond those which are the object of your amendments.

A previous speaker has set up a strawman in our contemplation and we would like an opportunity to retort in writing a detailed analysis of Mr. Fink's presentation, if we may have that opportunity.

Senator WILLIAMS. Rebuttal?

Mr. CURRY. Yes.

Senator WILLIAMS. Which gives rise to surrebuttal.

Mr. CURRY. We will have to stop at some point. One of us will get tired.

Senator WILLIAMS. You do not want to undertake that at this point?

Mr. CURRY. I would like to submit it in writing.

Senator WILLIAMS. And you can exchange it.

Senator JAVITS. If each side feels that another paper is necessary in addition to the first one, why do we not, Mr. Chairman, set a limit of two. That is the total of the exchange; let us say the first exchange within 1 week and the second within a week after that?

Senator WILLIAMS. And telephone calls to follow. [Laughter.]

Mr. CURRY. I would be perfectly willing to have just one from each side.

Senator JAVITS. This area that has been highlighted at the very end of your testimony is one of the most knotty, as I appreciate it now, and we will be served by your further and in depth illumination of your viewpoints.

Thank you.

Mr. CURRY. Thank you.

Senator WILLIAMS. Anything further, Jack?

Senator JAVITS. No.

[The prepared statement of the American Bankers Association and additional comments of the American Bankers Association and the Investment Company Institute follow. Exhibits I–V of the American Bankers Association statement of September 1, 1978, and the attachment referred to in footnote 3 of the Investment Company Institute of September 7, 1978, are being held in the files of the Human Resources Committee, 4230 Dirksen Senate Office Building, Washington, D.C. 20510.]

STATEMENT OF THE AMERICAN BANKERS ASSOCIATION ON PENSION SIMPLIFICATION BEFORE THE LABOR SUBCOMMITTEE OF THE SENATE HUMAN RESOURCES COMMITTEE AND THE PRIVATE PENSION SUBCOMMITTEE OF THE SENATE FINANCE COMMITTEE

August 17, 1978

The American Bankers Association is a trade association composed of 13,254 banks, approximately 92 percent of the banks in the United States. About 4,000 of our members have fiduciary powers and most of these serve as trustees and/or investment managers to employee benefit plans. Further, a substantial number of our 13,254 members have their own pension plans. Therefore, the Association is extremely interested in the efforts of the Labor Subcommittee and the Private Pension Subcommittee to address the problems found today in the administration of private pension plans in the United States.

During 1977 our Association had the opportuniy to testify before both of these Subcommittees on aspects of the Employee Retirement Income Security Act of 1974. We continue to find that the everyday business of bank trustees and investment managers and the interests of our trust beneficiaries are significantly affected in an adverse manner by some of the regulatory provisions of ERISA. The Act has produced conflicting, duplicative and unnecessary administrative procedures. While bank trustees have the ability to cope with the regulatory burdens imposed by ERISA, we can do so only in costly and inefficient ways. Many of our customers find themselves hard pressed to meet the added burdens required to maintain an employee benefit plan, and question if the added burdens are worth the effort and expense of offering pension benefits to their employees. We are very pleased to see these joint hearings being conducted as part of a comprehensive review of ERISA which was enacted four years ago. We hope that as a result of this review Congress will discard all those provisions of ERISA found to provide no direct benefits to plan participants.

We would like to structure our comments to focus first on what we view as the major topics addressed in S. 3017, "The ERISA Improvements Act of 1978", and then comment on other provisions in the bills being considered by the Subcommittees during these hearings.

Preemption

The ABA commends most highly Senator Williams and Senator Javits for their efforts to make it clear that most pension plans are not subject to the counterproductive requirements of State and Federal securities laws. The Association has filed an amicus brief with the U.S. Supreme Court in the Daniel case supporting the position that interests in pension plans are not securities.

We wholeheartedly support the language of both Sections 271 and 274 which would clarify the law in this regard.

The ABA also wholeheartedly supports, with a suggestion, the language of Section 274 that states that interests or participations in bank single or collective trusts or insurance separate accounts are not securities under Federal or State law nor are such trusts or accounts investment companies under the Investment Company Act of 1940.

S. 3017 takes a major step forward to provide pension plans for employees of small employers. The special master and prototype plan concept offers a breakthrough in extending pension plan coverage if costs can be minimized under a responsible, effective regulatory scheme. Because of the size of the employers that will participate in the special master plans, it will be an economic necessity that the contributions of individual employers to their pension trusts be collectively invested. This raises securities law problems. The provisions of Section 274 would go a long way toward solving these problems by allowing banks to collectively invest assets of pension plan trusts without the added regulatory burden of SEC regulation.

As we read the bill a special master or prototype plan would have to meet the requirements of Section 401 of the Internal Revenue Code, the requirements of new Section 601 of ERISA and the other requirements of ERISA to qualify. All small employers regardless of business organization would be able to adopt the plan. Thus, considering the past and current attitude of the Commission relative to Keoghs and IRAs it seems doubtful that the current Federal securities laws exemptions for single or collective trusts for pension plan assets would be applicable and without section 274 the problems now experienced by banks in attempting to provide professional management of a diversified portfolio for smaller pension trusts would be exacerbated.

Under current law the assets of corporate plans may be collectively invested regardless of the size of the company without registration under Section 3(a)(2) of the Securities Act of 1933. Before proceeding into the mire which exists due to the SEC's attitude relative to collective investment of trusts we believe it is important to describe and emphasize the relationship between a pension plan, its trust, its trustee and a collective trust. Under ERISA a separate trust must be established for each pension plan. At the discretion of the trustee the assets of an individual separate trust may be invested in a collective trust provided it is permitted by the governing instrument or by an independent fiduciary who has authority to manage and control the assets of the plan. The existence of the separate trust for each plan whose assets are invested in a collective fund and the use of discretion by the trustee are further called for by the Internal Revenue Code, banking law and trust law.

Congress did not exempt Keogh plan collective trusts specifically from registration under the 1933 Act but rather gave the SEC authority to exempt them. The SEC, to date, has not exercised this authority, at least on a class basis, and has given no evidence that it might. Banks with very few exceptions, however, have not registered their collective trusts for Keoghs but have relied upon the intrastate exemption of Section 3(a)(11) of the '33 Act. This has resulted in some strange consequences. In multi-state communities such as Washington, D.C., New York and Chicago, Keogh plan trusts have to be tailored carefully so that the interest in the plan of any participant who resides out-of-state is not invested in a collective trust fund. The interest of such a person may be invested in an interest bearing deposit account. Because of the intrastate restriction, plans that are collectively invested must be policed continually to ascertain when any participant moves out of the state so the participant's interest can be withdrawn from the collective trust and reinvested in a deposit account. These non-productive costs are borne by the plan and the bank trustee but the really unfortunate aspect is that the participant loses his ability to have his pension account invested in a diversified, professionally managed portfolio. Before leaving this point it should be pointed out that Keogh trusts for the most part are too small for efficient sound individual management.

Many smaller banks have considered collectively investing their Keogh plan trusts and their corporate pension trusts in one fund despite the Keogh intrastate restriction because they do not hold sufficient assets to maintain two separate collective trusts. However, they have decided against such action because registration would be required to do this, according to the SEC, unless all corporate plans including all their participants also satisfy the residency requirement. The reason for this result is that the corporate collective trust exemption is found in a separate subsection of the definition of exempt securities in the '33 Act from the intrastate exemption.

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When Congress created Individual Retirement Accounts, it attempted to remove impediments to the collective investment of such accounts with Keogh plan assets and other 401 pension plan assets. The SEC, however, has taken the position that interests in collective trusts for IRAs are not exempt from the 1933 and 1934 Securities Acts and the trusts themselves are not exempt from the Investment Company Act. The reason for this is that the exemption provisions of these securities laws are couched in terms of trusts qualified under Section 401 of the Internal Revenue Code and IRA trusts qualify under Section 408. There is nothing in the legislative history as to why Congress utilized an entirely new section in authorizing an entirely new type account. It is sheer speculation to assume, as some do, it was to avoid the exemptive provisions of the securities laws. Nevertheless the SEC has not allowed banks to invest IRAs collectively without registration nor without compliance with the 1940 Investment Company Act. About three years ago, one bank agreed to register a collective fund for Keoghs and IRAs and pursued with the Commission limited administrative exemptions from the 1940 Act. After many months it was reported on the verge of success when it decided to drop the exemption application because a threatened lawsuit would have substantially escalated the already costly procedure which had been followed and it was not worth the economic risk to continue forward. As a consequence, banks do not invest IRA accounts in securities except for a few large rollover accounts where they can be managed economically on an individual basis.

Another problem exists under the securities laws where a smaller bank wishes to invest collectively assets it holds as trustee for personal trusts with assets it holds as trustee for pension trusts because, again, it does not hold sufficient assets to establish two separate collective trusts. Presumably, the intrastate exemption would be avaible under the 1933 Act if all the accounts met the residency requirement or, maybe, even the exemptions for common trust funds and corporate pension trusts might be available. But according to the SEC such a collective trust could not find an exemption from the Investment Company Act because the pension trust exemption and the common trust fund exemption are found in different sub-sections of the Act and there is no intrastate exemption which might cover all the individual trusts. The common trust fund exemption alone is not available because the SEC holds that the trustee of a pension trust is not a trustee.

Medium size banks have also encountered this same road block when they have sought to improve their ability to keep the cash balances of their personal and pension trust accounts invested in short-term interest bearing securities. Collective investment often is the best approach but again, there may not be enough cash to establish two short-term investment collective funds and under the SEC position, a single fund would have to register under and be subject to, the Investment Company Act. The result is that banks must find another less efficient, more costly way to invest cash.

If the special master and prototype plan proposal is enacted without action being taken to deal with the securities laws, it appears that the same situation will exist as with IRA accounts. No current exemption from the 3 Federal securities laws will be available but collective investment will be essential to sponsoring such a plan. Section 274 would cure the problem for the special master plan trusts and further would cure many of the other problems we have discussed relative to other type pension plans.

It is long past time to straighten out the hodge-podge quilt work found in the application of our securities laws to collective investment of trusts. The securities laws, as construed by the SEC, contain exemptions under which personal trusts, corporate pension trusts and Keogh pension trusts can be collectively invested so long as assets from the different types of trusts are not combined in one fund. Thus smaller banks may often find that they are precluded from using a collective trust fund not because of a lack of an exemption for each type of trust that they would like to invest collectively but because they do not have sufficient assets to establish a separate collective fund for each type of trust; personal, corporate pension and Keogh.

We would make two suggestions relative to the language of Section 274. We understand that it is intended that all Keogh plans including the "Mom and Pop" Keogh, those without common-law employees, be covered. We are concerned that the reference to employee benefit plans described in Section 4(a) and not exempt under Section 4(b) may exclude Keogh plans with no common-law employees. According to our estimates, about 60 percent or more of the Keogh plans trusteed by banks have no common-law employees. Thus, making available an exemption for Keogh trusts which does not include trusts for plans without common-law employees would only create another category requiring a separate collective trust fund. For trustees establishing two funds it would require policing of plans so those losing their common-law employees could be withdrawn from the one collective trust fund and reinvested in the other. We urge that the Subcommittees make it clear that all Keogh plans are included.

Next, if maximum participation in the special master plan program is to be achieved among banks, they will need the ability to collectively invest in one fund all types of pension trusts, corporate, Keogh, IRA and special master plan, without the unneeded counterproductive burden of SEC registration. Thus we urge that the language be further clarified to include not only employer and union sponsored IRAs but all IRAs.

With these clarifications S. 3017 offers a real possibility of providing a significantly larger number of working people with retirement security.

Reporting and Disclosure

We feel the whole approach taken in ERISA to reporting and disclosure is fundamentally wrong. The statute is much too specific in how, what, when and where information on the pension plan must be reported. Section 103 on Annual Reports is particularly unwieldy in terms of content. Section 110 gives the Secretary a great deal of latitude on devising alternatives to the enumerated reporting requirements. Although the Secretary has made several important changes in the form, it seems to be difficult for agency personnel to take the bold steps needed to escape the unnecessarily precise statutory requirements.

We urge the Subcommittees to review whether the reporting requirements really need to be elaborately spelled out in the statute. We favor the approach taken in S. 901 and S. 3193 which would eliminate the statutory specifics currently found in Section 103 and augment the authority of the Secretary to require employee benefit plans to file such reports as he determines necessary to carry out the policy of ERISA, and to furnish or make available to participants and benficiaries for inspection copies or summaries of the reports. At the same time the regulators should be given a strong Congressional directive to devise a system to simplify and ease the reporting burden but which at the same time includes all the information which is really important and significant. We call the Subcommittees' attention to the need also to modify ERISA Section 104 since it concerns disclosure to participants and is directly tied to the reporting requirements of existing Section 103. Modification of Section 103 without changing Section 104 would only further complicate and confuse matters.

If Congress does not favor repealing all the statutory specifics in Section 103, we certainly feel that a serious review of the provisions are necessary to determine what information is really of benefit to the regulatory agencies and participants. We find that S. 3017 does little to modify the specificity of ERISA Section 103. We feel, for example, in subparagraphs

(E) and (F) of Section 103(b)(3) you should eliminate the requirements that the original principal amount of the loan and the approximate value of the lease at the date the property was leased be shown.

S. 3017 would amend Section 103(a)(3)(A) to state that examinations by independent qualified public accountants be conducted in accordance with generally accepted auditing standards, "except to the extent required by subparagraph (B)." Subparagraph (B) would be changed to state that in offering his opinion, the accountant shall (rather than may) rely on the correctness of any actuarial matter certified to by an enrolled actuary. We feel that the amendment to subparagraph (A) should be revised to read "except to the extent required by subparagraphs (B) and (C)." We believe this is necessary as a minimum to support the proposal in S.3017 which would amend Section 103(a)(3)(C) to say that a public accountant shall rely on a bank's statement of assets. We have been dismayed by the position taken by the auditing community that reliance on a bank's certification of assets is a breach of generally accepted auditing standards and accordingly further testing and confirmation must be done. This additional audit work has added unnecessarily to the expense of administering an employee benefit plan without any commensurate benefit. If past experience is an indicator of what can be expected from the auditing community, the Congress cannot overstate its determination that accountants comply with Section 103(a)(3)(C).

The regulatory agencies have been moving in the right direction to simplify some of the reporting burdens. For instance, last year they agreed that Form 5500 only had to be filed with the IRS. However, we continue to have major problems with how the agencies deal with annual reporting. One problem is that the agencies continue to change the annual reporting requirements each year thereby making expensive reprogramming an on-going event. Moreover, the agencies continue to get the forms and regulations out late every year. The final regulations for 1977 Plan Year reporting were not promulgated until March 1978, months after many plan years had ended. We recommend that Congress incorporate a provision into this bill that any revised reporting form and its accompanying regulations must be issued in final form 180 days before the beginning of the plan year for which the form is to be used. Otherwise, the sponsor can use the prior form to fulfill agency reporting requirements. We believe that this requirement will cause the agencies to undertake more timely review of annual reporting regulations.

A number of our member banks are experiencing a new reporting problem which demonstrates unconscionable and unnecessary regulatory overkill in the annual reporting requirements of ERISA. A bank may act as trustee for a "master trust" which is a single trust maintained for a controlled group of companies for the collective investment of a number of different employee benefit plans maintained by the members of the controlled group. The master trustee has custody of all the assets of the plans participating in the trust, processes all transactions, and provides unified reporting. Corporations have found the master trust to be a useful means for comprehensive analysis of asset diversification and investment management services.

After the issuance of the final regulations in March 1978, the regulatory agencies discussed how master trust reporting should be handled. The regulations are quite ambiguous on this matter. The evolving regulatory view apparently is to require the allocation of assets and reportable transactions of the master trust among participating plans. This requirement serves no meaningful purpose and will require expensive operational changes in the way that master trustees disseminate information to plan sponsors. We feel there is no legal or accounting basis for such an interpretation. The asset of each participating plan is a beneficial interest in the master trust, not an interest in each security held in the master trust. Similarly, so far as a participating plan is concerned, a transaction is represented by the acquisition or liquidation of units in the master trust and not by the individual security transactions of the master trust. We have asked the agencies to permit the plan administrator to file a package consisting of the asset and reportable transaction data for the master trust along with a Form 5500 for each participating plan showing its beneficial interest in the master trust. Our reporting proposal would fulfill the reporting requirements of ERISA, would disclose all the necessary information so that the regulatory agencies could adequately review the reports for potential problems, would keep down unnecessary operational costs, and would give the same protection to the interests of participants and beneficiaries. We feel a directive from Congress, perhaps conference report language, that such reporting of master trusts is the proper approach would settle this regulatory problem. Attached as an Appendix is our letter to the agencies discussing this and other reporting problems.

Prohibited Transactions and Parties in Interest

Almost everyone who is familiar with ERISA would agree that the current system of overlapping jurisdiction of the Internal Revenue Service and the Department of Labor mandated by the statute is extremely awkward. The current system requires extraordinary communication, cooperation and agreement between two federal agencies in order for the system to function. We feel it is important to recognize that each of these agencies understandably interprets the pension law from different perspectives based on their differing public missions. The IRS has as its primary responsibility the collection of taxes, and the Labor Department has as its primary responsibility the protection of the interests of workers. These two different perspectives make joint regulatory action a slow process at best.

Two bills before your Subcommittees today take different approaches to try to solve the jurisdictional problem of ERISA. One would divide the regulatory duties of ERISA between IRS and DOL. The other would create a new regulatory agency to consolidate the functions. Both bills are significant pieces of legislation because they recognize the major problem which exists today in the administration of ERISA. From the perspective of the banking industry as trustees and investment managers, our primary interest is to see a regulatory structure emerge which will have the fiduciary responsibility provisions (which encompass the prohibited transaction provisions) and the reporting and disclosure provisions of ERISA made the responsibility of one agency. Our fundamental concern with both the bills dealing with the administration of the fiduciary responsibility provisions of ERISA is that neither will resolve our overriding problem as fiduciaries--the problem of prohibited transactions as defined under the current law.

Section 406(a) of ERISA prohibits all transactions between a plan and a party in interest, such as sales or exchanges of property, lending of money, furnishing of goods or services, and the transfer to or use by a party in interest of any of the plan assets. Prior to the passage of ERISA, we expressed concern about the breadth of the application of these prohibited transaction provisions. We recommended that the law should prohibit only those transactions entered into for less than adequate consideration when a plan's assets are being sold, leased or otherwise transferred and those transactions entered into for more than adequate consideration when assets or services are being acquired.

The significant impact of the enacted provisions on traditional fiduciary practices can only be understood when the almost limitless definition of party in interest is considered. We are aware that S. 3017 includes some redefinition of party in interest. We feel that the deletion of "employee" from Section 3(14)(H) will be helpful. However, the limited changes in the definition of party in interest will not solve our basic problems. The number and variety of possible transactions that would still be prohibited by the statute are enormous, and the vast majority of such transactions would not only be innocently entered into but would also be in the plan participants' best interests. For example, investments in private placements are a nightmare under existing rules. Where there are significant borrowings by U.S. companies involving major financial institutions serving a great number of large employee benefit accounts, the opportunity for interrelationships of interests are endless. Review of these potential relationships is expensive, time-consuming and not cost effective. Frequently, the result is to abort participation by fiduciaries in first class credits.

We were told at the time the prohibited transaction provisions were being formulated that the exemption procedure would be significantly liberal so as to alleviate any unnecessary severity of these provisions. We have found the exemption procedure totally unworkable. Resolving the dual administration problem by giving one agency sole jurisdiction over fiduciary provisions will not solve the basic problem with Section 406 of the statute. The ABA has spent a great deal of time considering if the prohibited transaction provisions and the party in interest definition can be changed to minimize their deleterious effects on the efficient operation of ERISA and we have found no real solutions. We have concluded that the extensive listing of flat prohibitions in the statute is just an unsatisfactory way to achieve the protection for participants which is the fundamental goal of ERISA.

Although the regulatory agencies have indicated that they are making good progress on exemption applications, only a small number of substantive class exemptions have been granted, with the broker-dealer exemption being the most notable one. Most exemptions granted have been individual exemptions which do not have widespread application. Our own experience with the regulatory agencies on the three exemption applications that the ABA has filed indicates the practical impossibility of trying to obtain class exemptions for legitimate fiduciary activities which will benefit plan beneficiaries. We commented on our progress, or more accurately our lack of progress, on these applications to your Subcommittees last year, but since all three applications have yet to be acted on, we would like to review briefly the purposes of our exemption applications.

Our first application was filed in December 1976 requesting issuance of a class exemption from prohibited transactions with respect to certain acquisitions of short-term obligations of banking organizations. The prupose of the application is to eliminate possible violations of the prohibited transaction rules of ERISA where more than one bank has been named as trustee or investment manager of a single employee benefit plan with each bank responsible for the investment and administration of its own portion. The possible violation arises when one bank invests cash in the short-term obligations of another bank serving as trustee or investment manager for another portion of assets of the same plan. Both banks are acting totally independent of the other and, in fact, they probably do not even know of the other's role as a fiduciary of the plan.

In January 1977 we filed our second application for exemption. This application requested a class exemption from prohibited transactions for purchases of securities in the public marketplace by employee benefit plans where proceeds of the sale are used by the issuers of the securities directly or indirectly to retire or reduce indebtedness to banks which are parties in interest or disqualified persons with respect to the employee benefit plans.

Our third application was filed in May 1977. It requested a class exemption from prohibited transactions for collective investment funds maintained by banks for the investment of assets of employee benefit plans. This exemption application should be unnecessary because the proper interpretation of the statutory language and the legislative history of ERISA is that a plan participating in a collective investment fund holds a beneficial interest in the fund itself, not a share of each of the underlying assets of the fund. Unfortunately, since the regulators do not find this specific language in the statute, the only way for fiduciaries to adequately guard against liability is to seek an exemption. A more desirable and direct approach to resolve this problem would be to have language added to ERISA to make clear that the assets of a collective investment fund are not assets of a plan which holds participations or interests in the collective investment fund. ERISA contains such a provision for mutual funds and similar treatment of banks is clearly justified. We recommend the following language be added to the "ERISA Improvements Act":

> "Section 401(b) of the Employee Retirement Income Security Act of 1974 is amended by adding the following new paragraph:
>
> 'In the case of a plan which invests in interests in (i) a common or collective trust fund or pooled investment fund maintained by a bank or trust company supervised by a State or Federal agency, or (ii) a pooled investment fund of an insurance company qualified to do business in a State, the assets of such plan shall be deemed to include such interests but shall not, solely by reason of such investment, be deemed to include any assets of such common or collective trust fund or pooled investment fund.'"

We have seen little evidence of progress on our first two exemption applications. Our third application has received attention as a result of our testimony on the insurance companies' pooled separate account application where we discussed the differences between their application and our collective investment fund application. The insurance company application was commenced in November 1974. Our suggested legislative language above should also solve the problem that the insurance industry has with their pooled accounts.

We urge the Subcommittees to consider legislation to change the basic concept of prohibited transactions as they relate to dealings with parties in interest. After three and one half years of struggling with ERISA's prohibited transaction provisions, we feel more strongly than ever that the proper approach is that only those party in interest transactions entered into for less or more than adequate consideration should be prohibited. This standard coupled with the duty of undivided loyalty and the exclusive purpose test of Section 404 would be sufficient to obviate any need for the prohibitions enumerated in Section 406(a).

Based on our experience, Mr. Chairman, no substantive protection would be lost to participants by this change. The breadth and force of the affirmative duties of undivided loyalty, exclusive purpose and prudence are more than sufficient to reach any conceivable misconduct by a fiduciary involving a party in interest relationship. It would appear that the enforcement efforts of the Department of Labor support this view. Our understanding is that in none of the fiduciary actions brought to date has it relied exclusively on the provisions of Section 406(a). It has in each of those cases invoked the equitable doctrines in Section 404, and we might add, been very successful in securing the relief sought.

It is our firm conviction that Section 406(a) should be repealed, not only because the burdens it imposes are excessive in relation to the protection it offers participants, but also because it gives no substantive protections that they do not already enjoy under Section 404.

There is no overt misconduct that the Subcommittees would want to see banned under Section 406(a) which would be permitted under Section 404.

Conversely, there are many beneficial transactions and relationships which have been unduly impeded by those prohibitions, to the detriment of participants and beneficiaries.

Other Fiduciary Responsibility Problems

We are concerned about the ambiguous language of Section 405(b) on the liability created for actions of co-fiduciaries. Section 405(b)(1)(A) requires a trustee "to use reasonable care to prevent a co-trustee from committing a breach." Traditionally, co-trustees exist only when the instrument creating the trust grants more than one trustee authority to act in concert over the same assets. A distinct situation exists where each of several trustees is given responsibilities over a different portfolio of assets, and in this situation these trustees have not been considered co-trustees under trust law. We feel Section 405 should be amended to more accurately assign liabilities, and the co-trustee liability of Section 405 should apply only where trustees are acting in concert over the same trust assets.

We are also concerned about the language proposed in S. 3017 in a new Section 405(e)(1). We support the aspect of the proposal that indicates in the case of an institutional fiduciary, the term "knowledge" means knowledge actually communicated to the fiduciary's officer or employee who is authorized to carry out or who in fact carries out the fiduciary's responsibilities. However, we are concerned about the parenthetical "(or knowledge which, in the normal course of business, should have been communicated)". We feel this language should be deleted because it creates an impractical confusing standard. If the co-fiduciary is going to be held liable for a breach under Section 405(a)(3), liability should be based on its actual knowledge of a breach. Without actual knowledge there is no way the institutional fiduciary can undertake reasonable efforts under the circumstances to remedy the breach as called for in Section 405(a)(3).

Furthermore we urge you to carefully consider the ambiguities arising our of the interaction of the co-fiduciary provisions, generally, and the substantive obligations of Sections 402, 403, 404, and 406. We are concerned that Section 405 may be misinterpreted to extend some unintended obligation on fiduciaries generally to be accountable for activities and undertakings which clearly occur outside the areas of their responsibilities. We feel that it was the intention of Congress to require fiduciaries to discharge their responsibilities according to the highest standards of conduct. This section is troublesome in that it creates uncertainty as to the limits of those responsibilities.

We also continue to be concerned about the definition of "fiduciary" in Section 3(21) of ERISA. Fiduciary is defined in such broad terms that the definition could even include individual employees of a corporate trustee. Every corporation must act through individuals but these individuals do not act in their own right or on their own behalf. We urge the Congress to add the following language to the Section 3(21) definition of fiduciary: "(C) If a corporation or an employee organization is a fiduciary with respect to a plan, under subparagraph (A), a director or employee of such corporation or employee organization when acting in such capacity, shall not be a fiduciary with respect to such plan."

<u>Special Master Plans</u>

As discussed earlier, S. 3017 proposes a new kind of master or prototype defined contribution plan designed to allow small employers to provide retirement benefits without incurring most of the paperwork and fiduciary responsibility of ERISA. We support these efforts to lessen the administrative burdens on small businesses to make it more attractive for them to offer pension coverage to their employees.

We believe the special master plan idea is feasible provided other substantial changes are made in the law to allow financial institutions to provide this service in an effective manner at an acceptable cost. We believe it particularly important to attract smaller financial institutions to sponsor such plans for the smaller businesses in their communities. S. 3017 recognizes some of the changes that will have to be made to have the program work, such as allowing the annual reporting of the aggregate assets of a special master plan. It also recognizes the need to amend the securities laws to allow pooling of various types of pension trust funds which we have already discussed at length. Changes would also be needed in the prohibited transaction provisions as we have discussed above so that financial institutions handling these plans will better be able to ascertain their potential liabilities.

Other Provisions in S. 3017

Section 303 of S. 3017 would amend the Internal Revenue Code to permit a deduction from taxable income for contributions made by employees to qualified retirement plans. As the section-by-section analysis observes, the deduction would be similar to the deduction that is presently permitted for contributions to individual retirement accounts, but the maximum deduction permitted would be the lesser of 10 percent of compensation or $1,000. The allowable deduction will begin to phase out for those with adjusted gross incomes above $30,000 and those with incomes above $35,000 would be denied any deduction. The ABA supports the idea that active participants in qualified retirement plans should be encouraged to further plan for their retirement by being allowed to make a deduction for money set aside for this purpose. We feel that the simple maximum contributions allowed in S. 3017 as compared to other "limited individual retirement account" calculations that have been proposed in recent years is commendable. However, we strongly oppose any proposal that would require qualified plans to be forced to accept employee contributions. This would impose upon sponsors of qualified retirement plans added accounting and other administrative responsibilities. This could serve as another disincentive for the continuation or initiation of retirement plans. This proposal can just as readily be carried out by using the framework of the individual retirement accounts which are offered by thousands of financial institutions today.

The ABA is also opposed to Section 238 of S. 3017 on joint and survivor annuities. This section would require with respect to a participant who has no less than a 50 percent vested benefit and who dies before the annuity starting date that the plan provide a survivor's annuity for the participant's spouse which begins on the annuity starting date. We oppose this proposal based on its potential cost and the existence of more appropriate alternatives, such as group life insurance, to fill the need.

Section 266 of S. 3017 gives the Secretary authority to set solvency standards for certain uninsured welfare plans. We support all such actions which will strengthen preemption of diverse state laws and enhance uniform federal pension and welfare plan standards.

S. 3193 "ERISA Paperwork Reduction Act

As we have indicated above and in a letter submitted as part of the hearings on S. 3193, we support the provisions of S. 3193 ecause we believe they will help to simplify and bring order and meaning to the reporting provisions of ERISA.

We do have concern with one of the provisions in this bill from an administrative viewpoint. Tax-qualified pension plans would be required to obtain determination letters from the Internal Revenue Service at the time a plan is created. While we do not consider this an unreasonable requirement, there is concern about how quickly the IRS will act on granting the determination letter because contributions to a plan are deductible only if the plan is qualified. We suggest the need to write some time period into the law, after which a plan will be deemed qualified if a determination letter application has not been acted on, for instance within thirty or sixty days. The only recourse which an applicant has now is that after nine months he is deemed to have exhausted his administrative remedies and he can go to court for a declaratory judgment on the qualification of the retirement plan. We do not think this is a satisfactory approach.

S. 2992, To provide uniform accounting of pension liabilities

S. 2992 would amend Section 412 of the Internal Revenue Code to require that within 90 days of enactment the Secretary promulgate uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions used in such calculations.

The ABA opposes such legislation. Many employers have a unique set of circumstances as the underlying reasons for their chosen actuarial assumptions and would want to continue to have actuarial valuations based on assumptions tailored to their individual experiences. If forced to report using uniform actuarial assumptions, these employers might end up using two sets of assumptions. However, if there has to be standardization, we strongly favor having the accountants and actuaries develop the standards, independent of formal government regulation. They are the professionals with the expertise and experience to arrive at meaningful assumptions. The 90 days called for in S.2992 unfortunately is totally inadequate as a time frame for industry standards to be developed.

S. 1745 "ERISA Small Business Paperwork Reduction and Retirement Act"

The ABA opposes any change in the statutory language of the federal "prudent man" rule of ERISA. The prudent man rule has provided flexibility to trust investment activity where as before its adoption there had been strict reliance on legal lists. We are aware of the surveys which indicate that investment managers have been misconstruing the prudent man rule of ERISA and therefore becoming more conservative in their investments. The ABA has worked during the last four years to convince pension managers that ERISA actually provides greater flexibility to the pension trustee than is enjoyed by the trustee of a personal trust. We feel the debate initiated in Congress last year by the various bills such as S. 1745 introduced on investment in small businesses and now carried on by the Labor Department has helped trustees and investment managers to realize how much flexibility the federal prudent man rule provides. Congress might take the opportunity in any conference report on the "ERISA Improvements Act" to restate its original intent in enacting the federal prudent man rule. However, we strongly believe that the language of the rule as contained in the present law should not be changed since it was developed very carefully and really states well what the law should be. Any attempt to amend it can only in the long run reduce its effectiveness.

* * *

We thank the Subcommittees for the opportunity to comment on the various bills being considered and we hope to see Congress enact in the near future legislation to improve the Employee Retirement Income Security Act.

AMERICAN
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July 6, 1978

Annual Reporting Regulations
Room C-4526
Office of Regulatory Standards
and Exceptions
Pension and Welfare Benefit Programs
U.S. Department of Labor
Washington, D. C. 20216

Mr. S. Allen Winborne
Assistant Commissioner
Office of Employee Plans and
Exempt Organizations
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D. C. 20224

Re: Form 5500 and Annual Reporting Requirements

Gentlemen:

The American Bankers Association is a trade association of over 13,000 banks and about 4,000 of our member banks exercise trust powers. Many of these banks serve as trustees for employee benefit plans and provide plan administrators with financial information necessary for the completion of annual reports required by the Employee Retirement Income Security Act of 1974. We understand that your agencies are now starting to review the current reporting requirements to determine what changes should be made. We hope our comments will be considered during your review process, and that any changes decided upon will be announced in a timely fashion. The changes for 1977 Plan Year reporting were not proposed until late 1977 and were promulgated in March 1978, months after the majority of plan years had ended. Because of the late date of publishing the final regulations, we feel it may be unreasonable to expect all the information reported for 1977 plan years to conform with some of the interpretations found in the March 1978 release.

Master Trust Reporting

Reporting requirements for master trusts are of great concern to a number of our member banks. A master trust is a single trust maintained by a controlled group for the collective investment of a number of different plans maintained by members of the same controlled group. The master trustee has custody of all the assets of the corporation's pension plans participating in the trust, processes all the transactions, and provides unified reporting. Corporations have found the master trust to be a useful means for comprehensive analysis of asset diversification and investment management services.

We understand that after the issuance of the final regulations the regulatory agencies discussed how master trust reporting should be handled. The regulations are, to say the least, ambiguous on this matter. The evolving regulatory position apparently is to require the allocation of assets and reportable transactions of the master trust among participating plans. We strongly feel there is no legal or accounting justification for this interpretation. The asset of each participating plan is its beneficial interest in the master trust not an interest in each security held in that master trust. Similarly, as far as the participating plan is concerned, a transaction is represented by the acquisition or liquidation of units of the master trust not by the acquisition or disposition of a specific security by the master trust.

- We strongly recommend that the proper reporting procedure should be to allow the plan administrator to file a package consisting of the asset and reportable transaction data for the master trust and a Form 5500 for each participating plan showing its beneficial interest in the master trust in Items 13 and 22. This package should be quite sufficient for regulatory purposes. A requirement to allocate assets and reportable transactions is an unnecessary, expensive procedure which would require significant operational changes in the dissemination of information from master trustees to plan administrators.

The explanation of the reporting requirements which appeared in the Federal Register on March 10, 1978 indicates that the reason the agencies will not allow master trusts to be treated like common or collective trust funds for purposes of reporting is "the likelihood that individual decisions regarding the assets in such trusts will be subject to the influence of the single employer or the controlled group is greater than where such a trust consists of assets of unrelated participating entities." (43 F.R. 10132, March 10, 1978.) The agencies' position excluding master trusts from the definition of "collective trust" apparently is taken because under the special collective trust regulations, disclosure of the transactional information of the collective trust is not required; plans participating in common or collective trusts report only the value of the units of participation and the acquisition and disposition by the plan of units of participation, not individual transactions made by the common or collective trust itself. We are not proposing that reporting for master trusts be identical to collective trusts, but since master trusts are similar to collective trusts, they also should be subject to special reporting regulations. Our reporting proposal would fulfill the reporting requirements of ERISA, would disclose all the necessary information so that regulatory agencies could adequately review the reports for potential problems, would keep down unnecessary operational costs, and would not lessen the protection of the interests of participants and beneficiaries since the master trustee is subject to the fiduciary standards of ERISA.

As we have indicated, this matter is of great importance to a number of member banks which offer master trust services. We feel it is unreasonable to expect that plans which participate in master trusts will uniformly report their holdings for 1977 Plan Years. The regulations were not issued until March of this year and they are not clear as to what reporting is expected in this area. We hope our recommendation on master trust reporting will not only be adopted in order to clarify reporting requirements for 1978 plan year, but that it is made clearly applicable to all Forms 5500 filed for 1977 and prior plan years.

If each plan is to be required to report its portion, we question how a plan's "allocable portion" is to be determined. It would be extremely burdensome to require "allocable portion" to be determined using a point other than year end figures. For example, if such calculation had to be done at the time of the reportable transaction, this would be unnecessarily time-consuming. We assume that the allocation of assets and transactions will be determined based on each plan's year end beneficial interest in the master trust.

Line Item 13 - Reporting of Plan Assets and Liabilities

The information called for in line item 13 is more cumbersome than necessary under the Congressional directive in ERISA Section 103(b)(3)(A) which calls for "a statement of the assets and liabilities of the plan aggregated by categories and valued at their current value, and the same data displayed in comparative form for the end of the previous fiscal year of the plan."

We feel the following changes should be made in Item 13:

(1) Line items 13(a)(ii)(A) and 13(a)(ii)(B) should be combined into one category of "interest bearing." There is no reason to have the breakdown between certificates of deposit and other interest bearing accounts. The segregation of cash between interest bearing and non-interest bearing deposits appears justified so that the agencies can determine that the plan is investing excess cash wisely.

(2) Line item 13(c) should be renamed "General investments" instead of "General investments other than party-in-interest investments."

(3) Line item 13(c)(viii) "Loans other than mortgages" should be defined.

(4) Line item 13(d) "Party-in-interest investments" should be deleted. This information is not required by ERISA to be in the statement of assets and liabilities, and

it is covered by Line Item 22(a). If this item is not deleted, item (d) should be placed below item (h) so that information which is computer generated for the other line 13 items will not have to be adjusted to exclude any party-in-interest investments. Specific instructions will have to be added to this form to explain that the line "party-in-interest investments" is simply an identification of such investments which are already included in the categories listed above and does not constitute additional assets.

(5) If Line item 13(d) is not deleted, the instructions for line 13 relating to "Common/Collective Trusts and Pooled Separate Accounts" (p. 5) need some clarification. We are not certain as to the purpose of the reference to item 13(d)(vi), "Other investments" under "Party-in-interest investments." If the intention is that one must separate out a plan's beneficial interest in any "party-in-interest" securities held in a commingled fund in which the plan has a beneficial interest, we strongly object. Such information is not worth the effort and expense necessary to obtain it. Certainly for purposes of line 13 reporting, there should be no "look through" with respect to any participation in a common or collective trust fund, and the entire amount of such investments should be reported in line 13(c)(ix), "Value of interest in pooled fund(s)."

Line Item 22 - Plan Transactions

Line item 22(a)(iv), asking if there were any leases in default or classified during the year as uncollectable, should be amended to relate to the end of the plan year as in the case of line item 22(a)(iii) pertaining to loans and fixed income obligations. A lease in default may be cleared up by the end of the year, and there appears to be no greater reason to report such a lease than there would be to report a defaulted loan that was cleared up before the end of the year. Requiring a review of the status of all leases throughout the plan year adds an unnecessary operational burden.

Line Item 22 and 29 CFR 2520.103-6 - Reportable Transactions

Regarding line item 22(a)(v) on reportable transactions, we continue to believe that reporting of purchases and sales of (1) units of participation in common or commingle funds, and (2) temporary investments should be excluded. Both these types of transactions may occur frequently and may aggregate large volumes. Reporting these transactions will divert attention from less frequent transactions of greater significance and will only add to the reporting burden of both plan sponsors and trustees without being meaningful. In preparing data for our customers to report 3% transactions, our members have found them to consist overwhelmingly of purchases and sales of units of participation in common or commingled funds and temporary investments. We also suggest that the regulatory agencies seriously consider limiting reporting of reportable transactions to those transactions that exceed $300,000. This would be particularly helpful to sponsors of small plans while maintaining a meaningful reporting level.

We suggest the following changes be made in 29 CFR 2520.103-6:

(1) The last sentence of section 2520.103-6 (b)(2)(i) should be changed to read: "For the purposes of this section, "securities" does not include a unit of participation in a common or collective trust or a pooled separate account." (Section 2520.103-6(b)(2)(ii) will need some conforming revisions.)

(2) Section 2520.103-6(c) should have a new subsection (v): "(v) For purposes of this section, purchases or sales of debt obligations having an original maturity of not more than one year shall be excluded." This will have the effect of excluding temporary investments from the reportable transaction requirements. (Section 2520.103-6(b)(2)(ii) will need some conforming revisions.)

(3) "Maturity" as used in Section 2520.103-6(b)(2)(ii)(A), (B), (D) and (E) should be defined to mean original maturity. This is operationally the easiest data from which to measure.

(4) Regarding Section 2520.103-6(b)(2)(ii)(B) on repurchase agreements, banks follow different procedures in reporting repurchase agreement transactions to their customers. Some report the underlying collateral (i.e., debt obligations of the United States or United States agencies) as the asset acquired, but others report only the actual repurchase agreement. In the latter case, a plan administrator could not readily determine if the transaction would meet the criterion of this subsection. Therefore, we suggest that the provision be restated to cover

any repurchase agreement having a term of less than 91 days which is fully collateralized by debt obligations of the United States or any United States agency.

(5) Regarding Section 2520.103-6(b)(2)(ii)(E) on commercial paper ratings, we believe that an "A" rating by one of the recognized rating services should be sufficient for this purpose. We understand that not all companies (bank holding companies for example) are presently listed with more than one such rating service. Precedent for allowing less than the highest rating by one rating service can be found in the U.S. Department of Interior's regulations on the Trans-Alaska Pipeline Liability Fund (42 FR 31789, 31793, June 23, 1977) which allow investment in fixed income securities or obligations issued by a corporation having a rating by Standard and Poors, Moody or Fitch of "AA".

(6) We assume that "securities" in Section 2520.103-6(b)(3)(ii)(B) includes bonds that are listed on a national securities exchange.

We would like to add that in most instances, the criteria used to identify those 3% transactions that will not trigger additional reporting do not readily lend themselves to computer determination. We believe that many banks servicing employee benefit plans will be unable to provide plan administrators with the information they require to take advantage of the relief the regulations attempt to provide.

Most of the comments we have made on Section 2520.103-6(b) are also applicable to Section 2520.103-11(b).

Line Item 22 - Report Format

· The form and regulations should make clear that the format of attached schedules shown in the printed materials are illustrative only and that it is not necessary to follow them exactly as long as the requested data is supplied. Additionally, 29 CFR 2520.103-10(b)(6) appears to mandate use of a specific format which precludes use of existing computer printing devices which are typically limited to a "Field" size of 132 print positions. The agencies should review the regulations to see if size uniformity is so important as to make plans incur additional operating expenses.

Section 2520.103-5(d) -- Certification of Annual Reports of Common Trusts or Pooled Accounts

Banks and insurance companies maintaining collective trusts or pooled separate accounts are required by 29 CFR 2520.103-5(d) to certify the accuracy and completeness of the annual reports issued thereon. We believe this requirement to be duplicative and unnecessary when the annual report of the collective investment arrangement contains the opinion of an independent qualified public accountant. Therefore, we suggest that Section 2520.103-5(d) (1) be reworded to read:

> "(d) Certification - (1) An insurance carrier or other organization, a bank, trust company, or similar institution, or plan sponsor, as described in paragraph (b) of this section, shall certify to the accuracy and completeness of the information described in paragraph (c) of this section by a written declaration which is signed by a person authorized to represent the insurance carrier, bank, or plan sponsor, provided that such certification of the

annual statements required by Sections 2520.103-5(c)(1)(ii) and 2520.103-5(c)(2)(i) shall not be necessary if such annual statements contain the opinion of an independent qualified public accountant. Such certification will serve as a written assurance of the truth of the facts stated therein." (Changes underscored.)

Section 2520.103-9(b)(2)(i)(B) - Direct Filing of Annual Reports of Common or Commingled Trusts

We appreciate the Secretary's implementation of the authority granted by the Act in Section 103(b)(4) to provide for direct filing of such reports, rather than repetitive filings by plan sponsors as well as the requirement that the plan administrator provide the plan number, sponsor EIN, etc.. However, we still believe the implementation in 29 CFR 2520.103-9 to be cumbersome, particularly in Section 2520.103-9(b)(2)(i)(B) which requires that the financial institution making the direct filing shall include as a part of the direct filing: "A list of all plans, assets of which are held in the common or collective trust or pooled separate account identified by the Plan number as on the Annual Return/Report Form, name and EIN of the plan sponsor...." Therefore, we request Section 29 CFR 2520.103(b)(2)(i) be modified by deleting subparagraph (B).

* * *

We hope that the agencies are undertaking a thorough review of the annual reporting regulations and we hope that our comments will be considered. If your staff would like to have further information, representatives of the ABA

Employees Trusts Committee will be pleased to discuss the regulations with them.

Sincerely,

Bernard F. Curry

Bernard F. Curry
Chairman
Employees Trusts Committee

STATEMENT OF THE AMERICAN BANKERS ASSOCIATION
COMMENTING ON THE INVESTMENT COMPANY INSTITUTE'S
STATEMENT OF AUGUST 17, 1978 ON S. 3017

September 1, 1978

The American Bankers Association is deeply moved and comforted by the concerns of the Investment Company Institute for the soundness and safety of banking and protection of our trust customers and depositors. Most of the comments and observations of the ICI in their statement on S. 3017 dated August 17, 1978, however, bear little, if any, resemblance to fact and the real world. Whether one is familiar or not with the history of banking and the financial world of today, it is clear to see that the statement is an emotional exhortation against banks, bank trust departments and any legislative action which would allow banks to more effectively and efficiently provide trust services to small pension plans.

The ICI challenges that banks would be able to provide better trust services to small pension plans if the second provision of Section 274 were enacted by stating that the provision "would permit the nation's largest financial institutions to mass-merchandise securities to millions of small investors...." The ICI appears oblivious to the trustee role even though ERISA requires, with certain exceptions, that plan assets be held in trust by one or more trustees and defines the duties of co-trustees. The myopia of the ICI is undoubtedly due to its inability to view the world and particularly banking outside the context of securities. The ICI commentary would have one believe that despite centuries of trust law, decades of banking law and supervision and ERISA only the Securities and Exchange Commission and the federal securities laws have the capacity and the means to protect sponsors of employee benefit plans and their participants against bank wrongdoing.

The ICI's statement is a compendium of charges of bad judgment, incompetency and wrongdoing against banks, trust departments, bank regulators and Congress. The fallacy of many of the charges is evident of their face and most of the others fall because they are a total distortion of their source or the source is lacking in authority.

To deal specifically with every charge would require a paper much longer than the ICI statement merits. Instead, we will comment on a number of the major charges that are erroneous or totally without support.

The ICI paper on page three charges that "[T]he second provision of Section 274 would repeal two of the basic reform measures enacted by Congress in the 1930's. First, it would authorize massive bank entry into the securities business, activity which for over 40 years has been barred by the Glass-Steagall Act of 1933." This part of the charge is totally wrong. Section 274, on its face, in no way impacts Glass-Steagall. It deals only with the 1933 Securities Act, the 1934 Exchange Act and the 1940 Investment Company Act. Nothing in Section 274 would give a bank authority to do anything it can not do now. It would, however, relieve banks from SEC and securities law <u>regulation</u> in the operation of certain collective trust funds for pension plan trusts.

The second charge has been referred to already. The ICI said; "Second, it (Section 274) would permit the nation's largest financial institutions to mass-merchandise securities to millions of small investors without regulation under the federal securities laws which for almost 50 years have provided the cornerstone of investor protections." Again, the charge falls on its face because Section 274 would in no way authorize banks to mass-merchandise securities. The ICI on page 26 quotes the Supreme Court in ICI v. Camp: "In short, there is a plain difference between the sale of fiduciary services and the sale of investments." We think it only fair to quote a further statement of the court in that case: "For at least a generation, therefore, there has been no reason to doubt that a national bank can, consistently with the banking laws, commingle trust funds on the one hand, and act as a managing agent on the other. No provision of the banking law suggests that it is improper for a national bank to pool trust assets...."

Justice Blackmun in his dissent adds meaning to this statement of the court. "...there is, for me, an element of illogic in the ready admission by all concerned, on the one hand, that a national bank has the power to manage, by way of a common trust arrangement, those funds that it holds as fiduciary in the technical sense, and to administer separate agency accounts, and in the rejection, on the other hand, of the propriety of the bank's placing agency assets into a mutual investment fund."

In short, the Supreme Court has found that under Glass-Steagall banks may sell trust services and may collectively invest assets held in a fiduciary capacity. So Section 274 does nothing more than allow banks to invest collectively pension trust assets without the additional layer of SEC regulation over and above existing fiduciary law, banking regulation and ERISA.

The ICI commentary on page five makes the totally erroneous statement that, for over 100 years, federal banking laws have sought to prevent commercial banks from engaging in the securities business. As we shall see, this statement is not supported by the facts. Federal law, today, including Glass-Steagall does not prohibit banks from being in the securities business. Banks may underwrite and deal in U.S. Government securities and in general obligation securities of states and their political subdivisions.

Returning to page five, the ICI states that the National Banking Act of 1864 totally prohibited banks from underwriting or dealing in non-Government securities. Further, the ICI states, "...in the 1920's, the Comptroller of the Currency lobbied on behalf of the commercial banking industry to completely break down the historic separation of commercial banking and the securities business." ICI cites for authority the Department of the Treasury Issues Paper: Public Policy Aspects of Bank Securities Activities and The Securities Affiliates of National Banks written by W. Nelson Peach. The Treasury Department paper on the cited page states that "[i]nitially, the Act (National Banking Act of 1864) was narrowly interpreted to restrict the securities activities of national banks. National banks were prohibited from underwriting or dealing in the securities of entities other than the Government." The Treasury paper then goes on to say that "...national banks, as a result of the limitations on their powers in the investment banking field, were placed at an increasing disadvantage in competing with state commercial banks and trust companies and private bankers in servicing large corporate clients." According to the Treasury paper, during the latter half ot the 19th century state trust companies and state commercial banks became firmly established in the investment banking field. Also, the courts during that time began to interpret the National Banking Act to allow national banks to invest in state, municipal and corporate bonds. Then by the early 1900's the Comptroller permitted national banks to underwrite and deal in municipal and corporate bonds to the extent they were entitled to invest in them. In 1902 the Comptroller ruled that national banks could not underwrite and distribute corporate equities. As a consequence, the major national banks commencing in 1908 began to establish securities affiliates chartered under state law. By 1924, the Comptroller in his annual report requested legislation which would specifically allow national banks to underwrite certain investment securities. Congress, in 1927, passed the McFadden Act which reaffirmed the power of national banks to underwrite investment securities determined eligible by the Comptroller. The Comptroller initially approved only debt securities but subsequently expanded the eligible list to include equities. The Treasury Department paper then concludes; "By the end of the 20's the commercial banks, both state and national, became the dominant force in the investment banking field." So until Glass-Steagall, there was no ban on state commercial banks being in the securities business and except for a few years after 1864 there has been little restriction on national banks especially in the debt securities area. The historic separation of commercial banking and the securities business is nothing more than a myth. Attached, as Exhibit I is a paper Commerical Banks and Investment Banking prepared by Golembe Associates for the ABA which discuss in more detail the history of commercial banks in investment banking.

The ICI on page six enumerates what it describes as the myriad abuses which resulted from commercial bank entry into the securities business in the 1920's. For authority it cites "Hearings Before a Subcommittee of the Senate Committee on Banking and Currency, 71st Congress, 3rd Session, Part 7, at pages 1063-44 (1931)." Attached, as Exhibit II, are those two pages. Actually the two pages are from a Subcommittee report based on six questionnaires sent out to selected banks. The report was included as an appendix to the printed record of the Subcommittee hearings on the operation of the National and Federal Reserve Banking Systems. None of the ICI enumerated "abuses" is found on these pages not even the one with the word risky in quotation marks. The list of activities set out by the Senate Subcommittee is described in completely different and non-accusatory language.

The ICI on page seven states that abuses similar to those enumerated are occuring today in connection with bank-sponsored pooled investment funds for employee benefit plans. However, it fails to come forward with any evidence to support the allegation other than distortions of material contained in a Twentieth Century Fund Report Conflicts of Interest: Commercial Bank Trust Departments written by Edward Herman.

Another example of the ICI difficulty with its authorities is found in the third footnote on page seven. Section 21 of the Glass-Steagall Act does not prohibit "a national bank from engaging in 'the business of issuing, underwriting, selling or distributing, at wholesale or retail, or through syndicate participation, bonds, debentures, notes or other securities....'" Rather Section 21 makes it unlawful for any person, etc. engaged in the business of issuing, underwriting, etc. securities to engage in the business of receiving deposits subject to a check or to repayment by various means. This prohibition is limited by the specific authority granted to banks in Section 16 of the Act to underwrite, deal in, and otherwise purchase securities.

Beginning on page ten the ICI paper spends eight pages discussing REITs. In its opinion the problems of REITs have led to the greatest strain on our financial system since the Great Crash. We are not really sure what this whole discussion of REITs has to do with bank collective investment of pension trust assets and the applicability of the securities laws. However, since the ICI discusses the problems of REITs we are attaching as Exhibit III our response to the REIT questions in the Study Outline on The Securities Activities of Commercial Banks published by the Senate Subcommittee on Securities.

Most of the sources cited by the ICI in this portion of its statement are not authoritative. On pages 11 and 17 of the statement it is claimed that two banks, the first time, and two bank holding companies, second, failed trying to rescue REITs. The source cited for this statement is an academic paper but it does not support the ICI statement. As set out in the footnote on page 17, Professor Roy Schotland in his paper reported on two bank holding companies that failed but their failure was the result of the purchase by constituent banks of bad loans from mortgage bank affiliates not REITs.

Also on page 17, the ICI quoted from an article by Federal Reserve Governor Henry R. Wallich to the effect that the recession of 1974 had such adverse affect on some bank holding companies that the banks were fortunate not to have been burdened, at the same time, with securities affiliates. "In 1974, Glass-Steagall stood the banks in good stead," the Governor remarked. The ICI, however, did not report on other observations of Governor Wallich. The Governor suggested a need for bank participation in the retail end of the securities business. "Operating efficiencies, and perhaps specialized forms of stock ownership through common trust funds or mutual funds (currently barred by Supreme Court verdict), might offer more viable alternatives" to the current custodial services of banks. "The present commission structure, which embodies strong economies of scale for large orders, should enable banks to make available to small investors some of these economies." So, rather than opposing any change in Glass-Steagall, as the ICI seeks to imply, by quoting only the one observation, Governor Wallich actually suggests that banks should be allowed to be in more retail securities activities. These additional comments on Governor Wallich's article, while irrelevant to the Section 274 issue, have been made merely to indicate the care with which one must read the ICI statement.

Beginning on page 20, the ICI discusses banks advertising as if it were shocked. They fail to indicate that the newspapers and magazines in which the ads appeared, with rare exception, were financial trade journals and not of general circulation. Thus, the ads were aimed at corporate financial officers and not the general public. However, there is no reason why a bank could not aim its advertising at Keogh and IRA customers so long as it is selling trust services and not interests in its collective funds. The ads reference collective funds only to demonstrate performance experience. A review of copies of the magazines and newspapers involved will disclose that banks highlight their administrative trust abilities through advertisements as well as investment performance. Any false or fraudulent statements made by a bank in advertisements which causes a loss to a bank customer who purchases trust services based on those statements would be actionable under state and probably federal law. If the ICI was truly concerned for the public over advertising they would would not be seeking to undo current SEC regulation of mutual fund advertising.

Beginning on page 22 the ICI statement catalogues a series of excerpts from the Edward Herman report mentioned earlier which for the most part are taken out of context. It also reports on the allegations contained in the complaint of a law suit. Other allegations are from newspaper stories. Some do not involve collective trusts or even pension trusts. Also the examples of "abuse" are often so lacking in facts that it is impossible to reach a responsible judgment in the specific case. The ICI statement fails to discuss the conclusion of Professor Edward Herman, which in general finds that it might be worthwhile to make some specific changes such as additional public disclosure of holdings, relationships and trading activity. He found, however, no need for major structural change and in fact, he concluded on page 126 of his report, "In short, legally enforced total separation of trust and commercial banking could not now be based on the level of present abuses and anticipated benefits to consumers of trust or commercial banking services." His conclusions are contained in Exhibit IV which is attached. It should be kept in mind that Professor Herman's study and report preceded SEC actions in implementing section 13(f) of the '34 Exchange Act (institutional investment manager disclosure) and expansion of beneficial ownership disclosure under section 13(d), the comptroller's new trust department examination procedures which focus on protection of the trust customer and conflict of interests potentials, and for all intent and purposes, the Comptrollers's rules requiring disclosure of securities holdings and transactions and the effective date of the fiduciary provisions of ERISA.

A discussion of Federal securities laws begins on page 27. The ICI in discussing investment companies consistently refers to them as pooled investment funds as they have continuously referred to bank collective trusts. Even in quoting Louis Loss on page 28, they translate his reference to "investment companies" to "pooled investment funds."

On page 28, the ICI statment enumerates provisions of the Investment Company Act which are designated to protect the shareholder. Regulation 9.18 of the Comptroller of the Currency establishes detailed restrictions on bank operations of collective trusts, for example, a bank may not lend money to a collective fund, sell property to or purchase property from a fund. No assets of a collective fund may be invested in stock or obligations of the bank or any of its affiliates. Attached as Exhibit V is a copy of Regulation 9.18.

The ICI on page 31 and elsewhere has repeatedly talked of banks seeking to mass-merchandise shares of their pooled investment funds to millions of small Keogh plans. For support they cite a speech made at the ABA Midwinter Trust Conference in <u>1963</u> and nothing else. Some banks over the past 15 years have advertised and actively sought to serve as trustees or custodians for Keogh plans but for the most part the investment of the sought after trusts has been in time deposits and certificates of deposit not in securities portfolios either individually or collectively managed.

We have attempted to respond to the major issues raised by the ICI even though much of its statement is irrelevant to Section 274, any other provision of S. 3017 or ERISA in its entirety. The problems of REITs and the separation of commercial and investment banking are not issues associated with pension law or even securities law. We regret the necessity of this paper but we felt the magnitude of the accusations compelled response.

If the Subcommittee would like any additional materials or comments on any additional allegations of the ICI, we would be glad to respond further.

ADDITIONAL STATEMENT OF THE

INVESTMENT COMPANY INSTITUTE

September 7, 1978

On August 17, 1978, the Investment Company Institute testified before the Subcommittee on Labor of the Senate Committee on Human Resources and the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Finance Committee. In our testimony we expressed our opposition to the enactment of the second provision of Section 274 of S. 3017. The American Bankers Association testified following our presentation, and also requested and were granted the opportunity to submit an additional statement in response to our testimony. We were also granted leave to submit a reply to the additional statement of the ABA. We have received a copy of the ABA's additional statement dated September 1, 1978, and respectfully submit this statement in response thereto.

As set forth in our testimony, our opposition to the enactment of the second provision of Section 274 is based on two principal grounds.

First, enactment of the provision would permit the nation's largest financial institutions to mass-merchandise securities to millions of small investors without regulation under the federal securities laws which for almost 50 years have provided the cornerstone of investor protections. Specifically, we noted in our testimony that if the provision is enacted: "banks would be free to advertise interests in their pooled investment funds to employee benefit Keogh plans and IRAs, with no restraints whatever imposed by ERISA or the federal banking laws"; "banks will not be required to provide employee benefit Keogh plans and IRAs with prospectuses, but will be free to utilize any sort of sales materials they desire"; and "<u>all</u> employee benefit plans will lose the right to bring actions under the federal securities laws for fraud and misrepresentations in connection with their purchases of shares of pooled investment funds." The ABA's rebuttal statement of September 1, 1978 does not dispute any of our statements. (Indeed, in its testimony of August 17, 1978, the ABA urged that the proposed repeal of the protections afforded by the federal securities laws be extended to all Keogh plans and IRAs and not only to those plans which qualify as employee benefit plans).

In our testimony we also stated that our opposition to the provision is based on the fact that it would authorize massive bank entry into the securities business, activity which for over 40 years has been barred by the Glass-Steagall Act of 1933. The ABA's statement of September 1 seeks to rebut our assertion by stating that: "Section 274, on its face, in no way impacts Glass-Steagall" (emphasis added). If Congress enacts pension legislation providing that interests in pooled investment funds are not securities for purposes of the federal securities laws, there can be no doubt that the banking industry will assert that Congress "in effect" has provided that these interests are not securities for purposes of the Glass-Steagall Act. The banking industry has recently employed precisely this tactic. 1/

1/ The ABA has previously argued that pension legislation can serve to implicitly repeal the Glass-Steagall Act. For example, in its response to the 1975 Study Outline of the Senate Subcommittee on Securities on The Securities Activities of Commercial Banks the ABA stated (at p. 73):

> "A common investment fund in which custodial IRA accounts are invested would seem to be indistinguishable from the commingled fund in which agency accounts had been invested by First National City Bank in Investment Company Institute v. Camp, 401 U.S. 617 (1971). Thus it would seem that Congress did, in effect, amend the Glass-Steagall Act by authorizing the collective investment of IRA accounts in common investment funds."

In an attempt to divert attention from the central Glass-Steagall issue, the ABA now pretends that the Supreme Court has already interpreted the Glass-Steagall Act to permit national banks to engage in activities of the type that would be authorized by Section 274. However, the Court's opinion in the Camp case makes it clear that the language on which the ABA relies was referring to the simple pooling of trust assets in bank common trust funds.[2/] The whole point of the Camp case was to distinguish for purposes of the Glass-Steagall Act between traditional trust activities, such as the simple pooling of trust assets, and different kinds of publicly distributed collective funds.

The issue raised by Section 274 is not the simple pooling of pension trust assets in bank common trust funds, but the mass-merchandising by banks of interests in collective pension funds. It is clear from the materials cited in our testimony and from the advertisements attached thereto that banks are not simply attempting to pool pension trust assets in common trust funds, but are seeking to sell interests in collective pension funds to millions of investors. It is this kind of activity, which goes far beyond the simple pooling of trust assets in common trust funds referred to in the Camp opinion, which the Court held violates the Glass-Steagall Act.

The banking industry has repeatedly sought back-door repeal of the Glass-Steagall Act to permit banks to sponsor various types of pooled investment funds. Rather than seeking to accomplish this result in bills directly concerned with the federal banking

2/ The Court's language immediately preceding the excerpt quoted by the ABA reads: "The first common trust fund was organized in 1927, and such funds were expressly authorized by the Federal Reserve Board in 1937. Report on Commingled or Common Trust Funds Administered by Banks and Trust Companies, H. Doc. No. 476, 76th Cong., 2d Sess. 4-5 (1939)." The context thus makes it plain that the Court's discussion at this point was confined to traditional trust activities.

laws, the ABA has followed the technique of asking committees of the Congress considering other legislation for amendments aimed at the direct or indirect repeal of the Glass-Steagall Act. Although three of these attempts occurred this year, similar efforts span the last decade:

- In 1967 when the Senate Securities Subcommittee was considering securities legislation, the ABA supported a proposed amendment which would have amended the Glass-Steagall Act to permit banks to sponsor mutual funds. (The final 1970 legislation did not contain such a provision).

- In 1975, when the Senate Securities Subcommittee was considering the Securities Acts Amendments of 1975, the ABA requested amendments exempting bank pooled investment funds for Keogh plans and Individual Retirement Accounts from the federal securities laws. (The Subcommittee did not report out the legislation requested by the ABA).

- On February 24th of this year, the ABA testified before the Subcommittee on Oversight of the House Ways and Means Committee urging legislation exempting bank pooled investment funds for Individual Retirement Accounts from the federal securities laws. (The Ways and Means Committee has not reported out such legislation).

- On July 19th of this year, just before the hearings on S. 3017, the ABA was trying to convince the House Subcommittee on Capital Investment and Business Opportunities to add a provision to a bill dealing with small business investment companies so as to "authorize banks to operate commingled managing agency accounts for investment in small business" and to "define the interests in such collective funds and the accounts themselves as not being securities under Federal or state securities laws." (Press reports indicate that the ABA's proposal was "dismissed out of hand" as constituting a repeal of the Glass-Steagall Act. See Securities Week of July 24, 1978 at p. 11).

- We submit that the ABA's current attempt to utilize much-needed pension reform legislation as yet another vehicle to repeal the Glass-Steagall Act should also be similarly rejected.

The attempts to repeal the Glass-Steagall Act through indirection permit the ABA to manifest indignation when its legislative proposals are discussed in Glass-Steagall terms. Thus in its statement of September 1, 1978, the ABA notes that we devoted a substantial portion of our testimony to the bank REIT debacle of the early 1970's and states that "We are not really sure what this whole discussion of REITs has to do with bank collective investment of pension trust assets and the applicability of the securities laws."

As set forth in our testimony, the Glass-Steagall Act was enacted in response to the abuses of bank-sponsored securities affiliates in the 1920's.[3/] Since its enactment, the prohibitions of the Glass-Steagall Act have largely prevented the reoccurrence of these abuses. Yet, ironically, the very success of Glass-Steagall has enabled the banking industry to argue that the Act is no longer needed. It is therefore necessary to examine closely related areas to determine whether Glass-Steagall remains

3/ On pages 6 and 7 of our testimony we summarized the abuses uncovered by a Subcommittee of the Senate Committee on Banking and Currency in 1931. In its September 1 statement the ABA disputes our summary of the 1931 report. We urge the members of these Subcommittees to read the pages we summarized, as well as the attached pages from the Department of the Treasury 1975 Issues Paper on "Public Policy Aspects of Bank Securities Activities" which recite the abuses uncovered in 1931.

apposite to modern conditions. The recent history of bank-sponsored REITs detailed in our testimony offers as abundant evidence as can possibly exist for the continued need for the Glass-Steagall Act. As we stated in our testimony:

> "The importance of the REIT debacle is that bank involvement in the securities business led to a disaster for the banking system and hence for the nation. At least two banks failed as a result of the REIT debacle. 4/ Chase Manhattan Bank was placed on the Comptroller's secret list of problem banks, largely due to loans to its REIT. The holding company for Chemical Bank was forced to call off a proposed public offering of its securities due to investor concern over the bank's loans to REITs. Investment bankers warned investors against purchasing bank stocks generally as a result of the REIT problem. The Federal Reserve Board ultimately was forced to pressure banks to 'bail out' their REITs out of fear that REIT failures would lead to a 'financial panic' and would endanger 'the stability of the financial system.' The disastrous economic consequences of bank REITs fully bear out the premise of Glass-Steagall that confidence in banks may be impaired by imprudent or speculative investment activity and banks would be forced to indulge in unsound banking practices to keep their securities affiliates afloat."

As we have also shown in our testimony, the specific catalogue of conflicts of interest and other abuses which preceded the debacle of bank securities affiliates in the early 1930's were again to be found in the bank REIT story of the 1970's. The extent to which these abuses can occur under modern conditions and the current regulatory environment would be of obvious importance in any legislative reconsideration of the Glass-Steagall Act.

4/ In its statement of September 1, 1978, the ABA points out that we erred in stating in our testimony that "At least two banks failed as a result of the REIT debacle." Rather, the ABA suggests that, based on Professor Schotland's paper, we should have stated that "At least two bank holding companies failed as the result of the purchase by constituent banks of bad loans from mortgage bank affiliates." We regret our error, but frankly fail to see any difference from the point of view of sound banking practice.

We thus disagree with the ABA's assertion that: "The problems of REITs and the separation of commercial and investment banking are not issues associated with pension law or even securities law." The ABA's assertion is belied by its own statement quoted in note 1 above arguing that pension legislation can "in effect, amend the Glass-Steagall Act", and by its repeated attempts to obtain legislation which would at the same time amend both the federal securities laws and the Glass-Steagall Act.

In conclusion, we again note that the Senate Securities Subcommittee currently is studying the issues of bank entry into the securities business and the application of the federal securities laws to these activities. Moreover, this study is specifically studying bank sponsorship of pooled investment funds for employee benefit plans and bank sponsorship of REITs. We respectfully suggest that if Congress determines to take legislative action in these most important areas, it should not proceed on a fragmented basis, but should take action only after careful consideration of this study. More importantly, hearings on the Glass-Steagall Act should obviously involve a full legislative airing as to whether the conditions which gave rise to the Act still exist. Such hearings would give these important issues the undivided attention they deserve. The ABA tactic of sponsoring amendments to pension laws and securities laws in legislative hearings which are focused on other important matters should be rejected.

We would be pleased to furnish any additional information requested and to meet with the members of the Subcommittee and their staffs.

Respectfully submitted,

Matthew P. Fink
General Counsel

Attachment

Senator WILLIAMS. Next we have the Church Alliance for Clarification of ERISA, Mr. Charles Cowsert and Mr. Gary S. Nash.

STATEMENTS OF CHARLES C. COWSERT, EXECUTIVE SECRETARY, BOARD OF ANNUITIES AND RELIEF OF THE PRESBYTERIAN CHURCH OF THE UNITED STATES, ATLANTA, GA.; GARY S. NASH, GENERAL COUNSEL, ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION, CHURCH ALLIANCE FOR CLARIFICATION OF ERISA

Dr. COWSERT. Mr. Nash is my colleague here, and we are dividing the time.

I am executive secretary of the Board of Annuities and Relief of the Presbyterian Church in the United States, headquarters in Atlanta, Ga.

On my own behalf, and behalf of the Church Alliance for Clarification of ERISA, I wish to express appreciation to you, Mr. Chairman, and to my own highly esteemed Senator Talmadge of Georgia, and to other members of this committee for letting the alliance and me testify today.

Mr. Nash and I will divide the time equally as we discuss first the problems that ERISA imposes upon member churches of the alliance, and Mr. Nash will talk about what the alliance is, and how this legislation, in S. 3182, will eliminate some of the problems.

We want to request that the committee put in the record our formal prepared statements, as well as our testimony here today.

Senator WILLIAMS. Excellent. It will be included in the record.

Dr. COWSERT. We will be speaking in favor of legislation S. 3182, and I will speak first on the standpoint of my own board, the Presbyterian Church of the United States, which is the second largest Presbyterian body in America, and has its roots in the mainstream of American presbyterianism, which as early as 1717 initiated benefits for disabled ministers and ministerial widows and orphans.

The board of annuities and relief which I represent, incorporated under the laws of the Commonwealth of Kentucky, is a separate legal entity controlled by the denomination. By charter this board administers pensions and health care programs to nonprofit, self-supporting enterprises, based on dues and premiums. Ministerial relief, strictly a benevolence, supported by freewill offerings, is also administered by this board.

The ministers' annuity fund is a defined benefit plan and provides members and spouses age retirement annuities, as well as family protection along the way. It is fully funded with no unfunded past service liabilities, and it offers 100-percent vesting privileges within 5 years.

Investments are professionally managed under the strictest fiduciary standards.

The employees' annuity fund for lay persons is directed primarily for retirement benefits. It took offers 100-percent vesting privileges within 5 years.

My board also administers welfare benefits, and provides income assistance and free health care coverage to eligible retired employees of the church.

Mr. Chairman, on behalf of my board and the Church Alliance for Clarification of ERISA, I wish to share with you legislators some of the concerns I have about the detrimental effect of ERISA upon long established church plans which have operated successfully for many years, and which you yourselves intended to be exempt from ERISA.

My remarks, as indicated, are in support of S. 3182, a bill to clarify the ERISA definition of church plans. This legislation will remove the uncertainty that now surrounds decisions that trustees and administrative officers of church plans must make regularly.

The ERISA church plan definition presently lends itself to a multiplicity of interpretations, with different plan administrators using different applications. Let me mention only a few.

Most church plans are administered by a corporation, composed of highly competent, but unpaid trustees. These corporations are legal entities, apart from, but controlled by the denomination.

A question now exists as to whether a pension plan thus administered can qualify as a church plan as defined by ERISA. The ERISA says that employees of agencies not a part of the church plan prior to January 1, 1974, may not be enrolled.

Some church administrators think the restriction applies to denomination plans, whether it was in existence on that date, while others assume it applies to local agency. My board has taken the latter position, and consequently I have declined to enroll employees of a half dozen local institutions which have been created since January 1, 1974.

Thus, by Government prohibition under ERISA, these employees have been deprived of accumulating pension credits for retirement with devastating effect, which effect, I believe, is the very opposite of what you desire.

Finally, there is the question of what is, and what is not an agency of the church, and who shall have the authority to define such. The church, or the Government, through the Internal Revenue Service, or perhaps the Labor Department, if they should happen to agree.

The board supports S. 3182, because this would clear up much confusion that now prevails.

Mr. Chairman, it is the certainty about ERISA, rather than the uncertainty that troubles me the most.

The law states clearly that December 31, 1982, all employees of church agencies must be divorced from the church plans. Since such employees in the Presbyterian Church of the United States are considered to be church employees, and have no place else to turn for pension participation, then the board would have no alternative but to create new plans for these employees, and make them subject to ERISA.

Thus, instead of administering two pension plans, the board will administer four such plans. Such useless increase in actuarial, accounting, legal, and administrative expense can serve only one purpose; namely, to greatly reduce dollar benefits to plan beneficiaries whose pensions are already small.

The Talmadge-Bentsen bill, S. 3182 will eliminate the unnecessary removal of such agency employees.

Under ERISA a church plan cannot enroll a minister not currently employed by a church. Yet, traditionally, this board has continued enrollment of clergy in good standing while they were on study leave, college professors, evangelists, and the like. Also, members enrolled in the board's plans frequently labor outside the denomination in ecumenical structures.

Withdrawal of this much needed coverage, as required by ERISA, penalizes these church workers.

The legislation we favor would correct this inequity.

In conclusion, let me emphasize that the board's plans not only meet, but far exceed the spirit of the standards imposed by ERISA.

What we seek is the clarification of the definition of church plans in such a way as will permit us to serve all employees of churches and church agencies, without Government entanglements.

We feel that S. 3182 corrects legislative defects that create unnecessary confusion in administration, cause excessive expenditures at the expense of employee pension benefits or freewill offerings from church people, and result in undue hardships for the church's pensioners.

Thank you, Mr. Chairman.

Senator WILLIAMS. Thank you.

Mr. Nash?

Mr. NASH. Mr. Chairman, I am Gary Nash, general counsel and secretary of the Annuity Board of Southern Baptist Convention, headquartered in Dallas, Tex.

The Church Alliance for Clarification of ERISA is a coalition of persons acting on behalf of the pension programs of the following religious denominations in the United States:

The Union of American Hebrew Congregations.
The United Presbyterian Church in the U.S.A.
Presbyterian Church in the United States.
African Methodist Episcopal Church.
The Lutheran Church Missouri Synod.
Catholic Mutual Relief Society.
General Conference of Seventh Day Adventists.
United Synagogues of America.
Southern Baptist Convention
United Methodist Church.
United Church of Christ.
Episcopal Church.
The Christian Church—Disciples of Christ.
Church of the Brethren.
The American Luthern Church.
Lutheran Church in America.
Church of the Nazarene.
American Baptist Churches.
Reorganized Church of Jesus Christ of the Latter Day Saints.
Presbyterian Church in America.
Church of God in North America.
The Wesleyan Church.
Christian Reformed Church in North America.

Unitarian Universalist Association of Congregations in North America.

I believe this movement of common interest and concern about pensions is an unprecedented ecumenical type of concern that has been expressed through the Church Alliance for Clarification of ERISA.

Senator WILLIAMS. We planned it that way. We wanted to bring you all together. [Laughter.]

Mr. NASH. We find ourselves in agreement. Several of the chief executive officers or representatives of church pension boards are here today: Mr. Leo Landis of the United Synagogue of America; Dr. John Ordway of the United Church of Christ; and Elder William Murrell of General Conference of Seventh-day Adventists.

Also, our Washington counsel, Mr. James Quiggle and Mr. Jack Myers of Williams, Myers & Quiggle.

The church alliance members share a common concern about the need for clarification of the ERISA church plan definitions. Many religious denominations, such as the Southern Baptists, the Disciples of Christ, the Seventh-day Adventists, and others, have gone on record as being opposed to Government entanglement in their pension programs.

We are concerned about the ERISA mandate which prohibits our church agencies from continuing their participation in our church plans after 1982. We are concerned about the constitutional issues involved in the present church plan definition.

ERISA has exempted church plans from major portions of coverage under the act. However, because of the way church plan is defined by ERISA, the church plan exemption is not available to many traditional church plans. By threatening to fragment denominational pension plans, ERISA is having an adverse impact on organized religion, and it threatens to undermine the way churches have functioned successfully and responsibly for years.

The legislatively mandated splitting of church retirement programs into fragments by 1982 contrasts sharply with fundamental principles of separation of church and state. By carving out certain church ministries and functions, the Government has taken upon itself the role of defining and limiting church ministries through the ERISA church plan definition. ERISA's splitting up of churches through their pension programs fails to recognize the uniqueness of organized religious denominations today and the vital role that denominational pension programs play.

S. 3182 is supported by all church alliance members. S. 3182 will clarify the following areas, and make it possible for church pension boards to continue to serve their denominational workers.

It will clarify that ministers may participate in church plans, even if the minister is not currently employed, or is serving outside the denominational structure.

It will clarify what is a church plan, and establish a procedure for resolving church plan status.

Today there is considerable doubt whether many of the major churches in the United States actually have church plans, as defined by ERISA.

The bill will reduce the constitutional questions that are presently in issue.

The bill will clarify who is entitled to participate in a church plan, regardless of the form of church organization.

Right now, depending on the organizational structure of the church, whether it is organized along hierarchical lines, pseudo-hierarchical lines, or congregational lines, the law might have different effects on different types of churches.

Finally, the law will avoid costly disruptive duplications of professional services and paperwork burdens, which can only be picked up through tithes and offerings of church members.

In conclusion, church plans have served their denominations successfully for many years without Government interference. We ask that your church plan definition in ERISA be clarified to recognize traditional church plans which serve the unique needs of their religious denominations.

Thank you.

Senator WILLIAMS. Thank you very much.

Are there any reservations you have in any of the provisions of S. 3182.

Mr. NASH. I do not believe so.

Senator WILLIAMS. The coming together of all the churches you have mentioned in this alliance—they have considered S. 3182; have they taken any collective formal action of any kind?

Mr. NASH. What we have done, we have a steering committee that has worked hours and hours and hours discussing the legislation, debating the merits of particular positions in that particular legislation.

We have come to unanimous agreement without a dissent concerning the substance of S. 3182 among the membership of the Church Alliance.

Our comments here today were summarized, and written materials are significantly more expansive than our comments.

Senator WILLIAMS. I think we have acted to include all your additional material in the record. If we have not, we will do so now.

Thank you very much.

Senator Bentsen, who is cochairman of this joint hearing that we are embarked upon, I see is a sponsor, together with Senator Talmadge.

Mr. NASH. Yes, sir.

Senator WILLIAMS. Do you know whether there was any effort to get any broader sponship than that? I would imagine there was not. This was introduced on June 7, of this year, and probably Senator Talmadge and Senator Bentsen from the committee put it in together.

Mr. NASH. That is correct.

Senator WILLIAMS. What the word gets out, there may be broader sponsorship.

Mr. NASH. We hope so.

Senator WILLIAMS. I thank you.

[The prepared statement of the Church Alliance for Clarification of ERISA follows:]

CHURCH ALLIANCE FOR CLARIFICATION OF ERISA

STEERING COMMITTEE:
Dr. Derold H. Morgan, Chairman
Mr. Thomas J. Hanrahan
Mr. John C. Kozel
Mr. Leo J. Landes
Mr. Stanley D. Morrow
Dr. John D. Ordway

MEMBERS ACTING ON BEHALF OF THE PENSION PROGRAMS OF THE FOLLOWING DENOMINATIONS:
Mr. Robert Adler, Union of American Hebrew Congregations
Mr. Arthur W. Brown, United Presbyterian Church in the U.S.A.
Dr. Charles C. Cowsert, Presbyterian Church in the United States
Rev. James M. Granberry, Jr., African Methodist Episcopal Church
Mr. Earl E. Haake, The Lutheran Church—Missouri Synod
Mr. Thomas J. Hanrahan, Catholic Mutual Relief Society
Mr. John C. Kozel, General Conference of Seventh-day Adventists
Mr. Leo J. Landes, United Synagogues of America
Dr. Derold H. Morgan, Southern Baptist Convention
Mr. Stanley D. Morrow, United Methodist Church
Dr. John D. Ordway, United Church of Christ
Dr. Robert A. Robinson, Episcopal Church
Dr. William Martin Smith, The Christian Church (Disciples of Christ)
Mr. Joel K. Thompson, Church of the Brethren
Rev. Henry F. Treptow, The American Lutheran Church
Dr. L. Edwin Wang, Lutheran Church in America
Rev. Dean Wessels, Church of the Nazarene
Dr. Dean R. Wright, American Baptist Churches

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August 11, 1978

The Honorable Harrison A. Williams, Jr.
United States Senate
Chairman, Senate Committee on Human Resources,
Labor Subcommittee of the Human Resources Committee,
Room G-237, Dirksen Senate Office Building
Washington, D. C. 20510

Re: ERISA HEARINGS

Dear Senator Williams:

Enclosed please find 80 copies of the statement submitted on behalf of the members of the CHURCH ALLIANCE FOR CLARIFICATION OF ERISA. This statement will be summarized by Dr. Charles Cowsert, Executive Secretary of the Board of Annuities and Relief of the Presbyterian Church in the United States, Atlanta, Georgia, and by Gary S. Nash, General Counsel and Secretary of the Annuity Board of the Southern Baptist Convention, Dallas, Texas, at the hearings before the Senate Human Resources Subcommittee on Labor and the Senate Finance Subcommittee on Private Pension Plans and Employee Fringe Benefits.

We understand that the invitation for us to testify concerns matters described in S. 3182 which was introduced by Senator Herman Talmadge for himself and Senator Lloyd Bentsen to amend ERISA to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan. This bill has been referred to the Committees on Finance and Human Resources jointly by unanimous consent. A similar bill to amend the Internal Revenue Code (as amended by ERISA), S. 3172, has been referred to the Senate Finance Committee.

These bills have the support of the members of the Church Alliance for Clarification of ERISA. The members of the Church Alliance are acting on behalf of the pension programs of the denominations shown on the letterhead of this letter and the following additional religious denominations: Reorganized Church of Jesus Christ of Latter Day Saints, Presbyterian Church in America, Church of God in North America, The Wesleyan Church, Church of the Brethren, the Christian Reformed Church in North America and the Unitarian Universalist Association of Congregations in North America.

Should you desire further information or explanation concerning any of the observations or recommendations, please let me know. We understand that our testimony is to be presented shortly after 9:30 a.m. August 17, 1978 in room 4232, Dirksen Senate Office Building.

Very truly yours,

Gary S. Nash

Gary S. Nash

GSN:nt
Enclosures

THE NEED FOR CLARIFICATION IN THE ERISA CHURCH PLAN DEFINITION

This statement will discuss briefly the background of church pension programs in this country, the impact of ERISA on church plans, the need for clarification in the law with respect to church plans, and specific recommendations for legislative action.

BACKGROUND OF CHURCH PENSION PROGRAMS IN THIS COUNTRY

Churches have traditionally felt a sense of responsibility for making provision for their aged and disabled workers and their families. Church pension programs have developed as a ministry of churches.

The first pension programs in the United States were set up by churches in the early 1700s (before there was an Internal Revenue Code or an income tax) to provide benefits to ministers and other church employees. As early as 1717 the Presbyterian Church established a "Fund for Pious Uses." One of the first functions of this fund was to provide a grant to the widow of a deceased minister. In 1784 the Methodist Church established "The Preachers' Fund" to make provision "first, for the worn-out preachers and then for the widows and children of those that are dead." Church relief ministry became a denomination-wide concern because ministers passed from one presbytery to another or from one synod, diocese, conference, district or state to another. The denominational boards of relief that were developed became the denominational pension boards of today which still operate relief, welfare and assistance programs in addition to the pension programs which they operate. As churches grew and their ministries increased, church boards, commissions, and agencies were created to carry out the ministries and missions supported by tithes and offerings of members of local churches.

The nature of church work now may require ministers and lay workers to serve not only in local churches, but also to serve in church agencies. Additionally, many ministers in pursuit of their ministry, serve as chaplains in church and non-church related organizations, as evangelists, as church fund raisers, as employees of social service or religious organizations and as employees of social service agencies or religious organizations sponsored by other denominations or faiths. The denominational pension boards have served the unique needs of the ministers and lay workers within their respective denominations. Generally no church pension board program is identical to that of another denomination's since church denominations are organized differently, and a program serving the needs of a hierarchically organized denomination might not meet the needs of one serving a congregationally organized denomination.

Many congregationally organized churches and denominations have developed individual account plans which provide annuity type benefits to participants throughout their denominational careers. Although many of these programs were developed prior to the existence of the Internal Revenue Code, many of these programs have been treated as Code section 403(b) annuities for tax purposes. For years many of these plans have been fully funded and participants have enjoyed immediate vesting. ERISA has established standards that many exempt church plans meet or are striving to achieve.

THE IMPACT OF ERISA ON CHURCH PLANS--BASIC ISSUES

The Employee Retirement Income Security Act of 1974 (ERISA) has exempted church plans from major portions of coverage under the Act. However, because of the way church plan is defined in ERISA, the church plan exemption is not available to many traditional church plans. By threatening to fragment denominational pension plans, ERISA is having an adverse impact on organized religion and it threatens to undermine the way churches have functioned successfully and responsibly for years.

Under the present definition found in Title I of ERISA at section 3(33) and in Title II of ERISA under what is now known as Internal Revenue Code section 414(e) a church plan is defined so as to prohibit a church plan from covering employees of church agencies after 1982. Furthermore, the law may be interpreted to require that a church plan may not cover employees of new church agencies coming into the plan after 1974.

The legislatively mandated splitting of church retirement programs into fragments by 1982 contrasts sharply with fundamental principles of separation of church and state. By carving out certain church ministries and functions, the government has taken upon itself the role of defining and limiting church ministries through the ERISA church plan definition. ERISA's splitting up of churches through their pension programs fails to recognize the uniqueness of organized religious denominations today and the vital role that denominational pension programs play.

Under ERISA, existing church plans must by 1982 undo many years of responsible experience and create two or more plans, one covering church employees and one covering agency employees. Since churches and agencies are generally dependent upon the voluntary tithes and offerings of church members, the costs of reorganizing a church plan and maintaining different plans may significantly reduce plan benefits or require an unnecessary additional economic burden on churches to provide the same level of benefits to participants in order to comply with ERISA's rigid administrative and government reporting requirements. If churches and church agencies are faced with additional costs of complying with ERISA, many of these organizations may have no alternative but to abandon their retirement programs or to cut down on their ministries so as to pay the increased ERISA costs which afford no real economic benefit.

SPECIFIC EXAMPLES OF ERISA PROBLEM AREAS FOR CHURCH PLANS

The following paragraphs describe some specific examples of ERISA problem areas for church plans. The list of examples below is by no means exhaustive but rather is merely representative of some of the problem areas facing church plans. Comments to proposed "church plan" regulations enclosed with this statement describe in more detail some of the "church plan" problem areas.

As noted by attorney Pat Persons in "ERISA and the Churches", copy enclosed, the application of ERISA to retirement and other benefit plans established by religious denominations would raise questions of church-state relations under the First Amendment of the U.S. Constitution. The possibility of such a church-state confrontation was recognized by Congress, as evidenced by the statement in the Senate report explaining why church plans were not made subject to the plan termination insurance requirements of ERISA. This report states:

> "The committee is concerned that the examination of books and records that may be required in any particular case as part of the careful and responsible administration of the insurance system might be regarded as an unjustified invasion of the confidential relationship that is believed to be appropriate with regard to churches and their religious activities."

Although this statement was made with reference to the plan termination insurance provisions, it seems clear that the same reasoning underlay the exemption accorded to church plans under other parts of ERISA.

By exempting church plans from ERISA, Congress was endeavoring to adhere to the long-established principle of separation of church and state as expressed in the First Amendment. Decisions of the Supreme Court in recent years have held that where a statute calls for governmental action that raises a question under the religion clauses of the First Amendment, in order to be constitutional "the statute must not foster an excessive government entanglement with religion." Church Alliance members believe that an excessive entanglement would result if ERISA were applied to church plans. It is therefore important to take effective steps to prevent this situation from arising.

The statutory ban on new agencies participating in church plans in ERISA section 3(33)(B) and (C) has already resulted in many employees of church denominations being denied pension plan coverage. Other denominations have allowed new agencies to join existing retirement programs by taking the position that the denomination's existing program was "established and maintained" for all church affiliates prior to 1974 regardless of whether the new agencies' employees were participating in the plan. Neither position is satisfactory since one leaves employees without pension benefits and the other jeopardizes the "church plan" status of the program.

In its proposed regulations the Treasury Department took the position that if a church plan should ever, at any time or for whatever reason, fail to meet the requirements of a church plan it can never thereafter regain its exempt status under ERISA. This position is unnecessarily harsh because a failure to meet the requirements of a church plan may result from insignificant violations of rules that are not now clearly defined and will take years to resolve. S. 3172 would give a church plan which has violated the applicable rules an opportunity to correct the violation and thereby retain its exemption from ERISA. Such a provision seems essential to the orderly functioning of church plans.

Church plans are exempt from the reporting and disclosure requirements of Title I of ERISA, but the IRS has a requirement that all churches having plans must file Form 5500. For congregationally organized denominations, this requirement can mean that thousands of local churches could each be required to file a Form 5500, even if they each have only one plan participant in the plan.

The problems involved in fragmenting church plans by 1982 promises to be a difficult and expensive administrative nightmare. No regulations on how church plans are to accomplish this task have been proposed. The problem of portability of benefits from an ERISA qualified plan to an exempt church plan has not been addressed. Ministers and lay persons desiring to move about within the denominational structure may find that ERISA regulations would require them to endure gaps in retirement coverage.

Under the existing statute, it is possible that a church plan might lose its exemption under ERISA if it covers a minister who is not an employee of a church (or until December 31, 1982, an employee of a church agency). However, numerous ministers pursue their ministries from time to time by serving outside the formal denominational structure. Examples would be ministers employed as chaplains in hospitals, prisons or colleges, or teaching religious studies in an educational institution, or serving as self-employed evangelists. It is important to such ministers, and to the denomination, that their membership in Church Pension Board's benefit plans be maintained during such period of service as a minister outside the denomination. The proposed bill would make clear that this can be done without jeopardizing the exempt status of the plans under ERISA.

A similar question exists under present law with respect to the coverage of congregational ministers or lay employees who are not currently employed because they are disabled or in transition from one job to another.

ERISA contains extensive rules regarding the investment of assets of employee benefit plans, and the purposes for which such assets may be disbursed. These rules, which in some cases are quite rigid, are appropriate for the typical employee benefit plans with which ERISA is concerned. In such typical plans, contributions are made to a fund by the employer, or the employees, or both, for the purpose of providing benefits that are specified in the plan. ERISA provides that the assets of such plans shall be used for the <u>exclusive</u> purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plans. However, since most church pension boards were established for broader purposes than the exclusive purpose rule of ERISA, the Federal government might be placed in the position of determining the extent to which a church pension board's endowment and other funds could be used for the board's general and religious purposes, as distinguished from benefit plan purposes.

By failing to recognize church pension boards in ERISA section 403 requiring the establishment of a trust or the issuance of insurance contracts "issued by an insurance company qualified to do business in a State," ERISA fails to deal with the question of whether a church pension board will be allowed to continue to fund or administer annuity programs of church agencies without operating under a "church plan" exemption.

There are no statutory exemptions in ERISA section 408 for church pension boards--they are not needed as long as the "church plan" exemption applies. Statutory exemptions from the ERISA section 406 prohibited transactions provisions, such as those applicable to banks and insurance companies in section 408(b)(4), (5), (6), and (8), would probably not apply to a church pension board operating without the "church plan" exemption. These sections appear to be important enough for the insurance industry and others to seek even greater exemptions just so they can carry on business as usual. If the technical application of section 406 is to apply to church pension boards without similar exemptions, traditional church pension boards, if they continue to perform their traditional roles in denominational pension programs beyond 1982, may be faced with unusually large legal expenses to avoid technical violation of the law.

The problem that is of the greatest concern to a number of the denominations is the so-called church agency problem. As previously mentioned, under present law a church plan cannot retain its ERISA exemption after December 31, 1982 if it continues to cover employees of church agencies. Examples of church agencies would be any of the following organizations which is affiliated with a church or a convention or association of churches: a hospital, a school or college, a nursing home, a retirement home, a drug-abuse center, or a children's home or camp.

The Church Alliance has taken the position that because of the close relationship that exists between churches and their affiliated agencies, it is essential that the employees of the agencies be eligible for coverage under the benefit plans of the church. If this is not permitted, the agencies will have only two alternatives; that is, either to establish ERISA plans for their employees or to terminate their plans on December 31, 1982. Because of the expense and red-tape connected with establishing ERISA plans, it is feared that many agencies will choose to terminate their plans, thus depriving their employees of benefits which they are now receiving as members of the church plan. Also, it is believed that if agency employees are not allowed to participate in church plans, the mobility of church employees within the denomination will be greatly restricted. S. 3182 would permit the continued coverage of agency employees in church plans after December 31, 1982.

It is not an overstatement to say that if S. 3182 is not enacted, the consequences for all religious denominations will be very serious. The type of regulation mandated by ERISA is simply not appropriate for an organization with a religious history and purpose such as the pension boards of religious denominations.

LEGISLATIVE RECOMMENDATIONS

Members acting on behalf of the pension programs of over twenty-five religious denominations in the United States have formed the Church Alliance for Clarification of ERISA (the "Church Alliance"). The Church Alliance members support the amendment of the ERISA "church plan" definition so as to recognize traditional church plans which cover employees of churches and church agencies. In addition, the Church Alliance members support the removal of a number of technical defects in the law which do not recognize the differences in the denominational structures of various churches. Church Alliance members are concerned that many churches' plan participants will not have pension benefits provided for them if they are forced out of church plans by ERISA requirements.

Bills to clarify the church plan definition supported by the Church Alliance members have been introduced by Senator Herman E. Talmadge of Georgia and Senator Lloyd Bentsen of Texas, (S . 3182). Similar bills have been introduced in the House of Representatives by Congressman Barber B. Conable, Jr. of New York. Copies of these bills and the introductory statements discussing them are attached to this statement. The bills are summarized briefly below:

H.R. 12312 referred jointly to House Committee on Education and Labor and House Committee on Ways and Means;

S. 3182 referred jointly to Senate Committee on Human Resources and Senate Committee on Finance.

These bills are to amend the "church plan" definition in ERISA Title I Section 3(33) to recognize that church plans may cover agency employees.

H.R. 12172 referred to the House Committee on Ways and Means;

S. 3172 referred to the Senate Committee on Finance.

These bills are to amend the "church plan" definition in Internal Revenue Code section 414(e) [Title II of ERISA section 1015] to recognize that church plans may cover agency employees.

APPENDIX

Letters of comments on proposed "church plan" regulations to Commissioner of Internal Revenue:

- dated May 1977 from Darold H. Morgan, Chairman of Churhc Alliance For Clarification of ERISA
- dated November 18, 1977 from Gary S. Nash, General Counsel of Annuity Board of the Southern Baptist Convention
- dated October 7, 1977 from John D. Ordway, Executive Vice President of The Pension Boards of the United Church of Christ
- dated November 23, 1977 from John P. Persons, attorney for The Ministers and Missionaries Benefit Board of the American Baptist Churches

"ERISA AND THE CHURCHES" prepared by John P. Persons Attorney-at-Law, Patterson, Belknap, Webb & Tyler, for meeting of Board of Managers of The Ministers and Missionaries Benefit Board of American Baptist Churches, May 23, 1978.

Copies of introductory comments and proposed legislation:

- Comments on S. 3172, and S. 3182 by Mr. Talmadge
- Comments on H.R. 12172 by Mr. Conable
- Text of S. 3172

CHURCH ALLIANCE FOR CLARIFICATION OF ERISA

COUNSEL:
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888 Seventeenth Street N.W.
Washington, D.C. 20006
(202) 333-5900

May 20, 1977

Commissioner of Internal Revenue
Internal Revenue Service
1111 Constitution Avenue, N. W.
Washington, D. C. 20224

Attention: CC:LR:T

Re: Proposed Regulations Under Section 414(e), IRC, Defining "Church Plan"

Dear Sir:

This letter is written pursuant to the notice published in the Federal Register dated April 8, 1977, inviting comments on the definition of "church plan" as defined in Section 414(e), IRC. These comments are submitted by the Church Alliance for Clarification of ERISA, an alliance of church pension program chief executive officers acting on behalf of the pension programs of the denominations listed in the left side of this page. We believe the regulations to have been exceptionally well drafted. We have but three comments.

First. All of the churches comprising the Church Alliance permit an exceptional degree of freedom in the clergy and lay personnel to pursue their ministry and careers according to their own consciences. A minister will not necessarily upon ordination continue without interruption until retirement to serve his church in this precise capacity. He may for a time during his career accept a post, for example, at a drug rehabilitation center or child abuse agency. Nonetheless, the church plan may continue to cover the minister or

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former lay employee for the reason that the plan of his new employer may require a period of employment before eligibility to participate or may have no plan at all.

Ministers and lay employees are not munificently compensated. Nor can they look forward to retirement benefits that are munificient. A gap in pension coverage works real hardship on such persons.

Section 414(e) does not require that the employees of the church be current employees. We assume that the proposed regulations do not intend to require coverage solely of present employees in order to meet the church plan requirements. There would seem to be no compelling social or other policy for imposing such a condition. The underlying principle behind ERISA is to promote, rather than to discourage, coverage and portability.

Therefore, for purposes of clarification, we propose the addition of the following language in Proposed Regs. §1.414(e)-1(a):

> "There is no requirement in section 414(e) or this section that the employees of a church or convention or association of churches be current employees. Therefore, a church plan will not fail to meet the requirements of section 414(e) or this section merely because it provides coverage for ministers and former lay employees of a church or convention or association of churches, and, additionally, for plans described in the special rule of paragraph (d), the agencies of such church (or convention or association of churches)."

Second. In Proposed Regs. §1.414(e)-1(a), it is stated:

> "If at any time during its existence a plan is not a church plan because of a failure to meet the requirements set forth in this section, it cannot thereafter become a church plan."

There is no support for this position in the legislative history of ERISA that we can find.

When the final church plan regulations are promulgated, it will be almost three years since the enactment of ERISA. It is quite possible that a church in some minor way could have during this period failed to qualify as a church plan in spite of all good faith efforts at complying with the bare words of the statute. A rule that irrevocably denies exemption for acts or failures to act during a period when no regulations were issued is severe.

Practically no two church plans are alike in design or operation. Yet Congress has attempted in Section 414(e) to embrace the design and operation of the multitude of church plans in this country. This problem of squeezing within the definition of church plan should not be made more intolerable than it is now by a rule that once a church plan fails to qualify, it may never do so. Even with regulations, many areas are unclear and will remain so for years.

Organizations described in Section 501(c) are granted exemption from the income tax under Section 501(a). A Section 501(c)(3) organization failing to meet, say, the "exclusively" test in one year may, by changing its organization or operational characteristics, be a 501(c)(3) organization in another year. There is no more indication in Section 414(e) than in Sections 501(a) or 501(c)(3) that Congress intended that failure to meet the requirements of these sections be perpetual.

Section 410(d) grants churches an irrevocable election to elect to come within certain provisions of ERISA. There is no practical danger that a church plan might deliberately fail to meet the requirements of church plan in order to avoid the irrevocability of this election. The reason is that coming within these ERISA provisions offers no conceivable advantage to a church plan.

Therefore, we would suggest that the above-quoted language be omitted in its entirety.

Third. Under Section 414(e), a plan must be established and maintained for its employees by a church or convention or association of churches. Under Proposed Regs. §1.414(e)-1(e), a church includes a religious order or religious organization if such order or organization (1) is an integral part of the church and (2) is engaged in carrying out the functions of the church, whether as a civil law corporation or otherwise.

Most church plans are administered by or funded through a pension board. It is believed that at the very least these pension boards carry out the functions of the church and are, therefore, included as part of the church. It might be helpful, however, if the Regulations give pension boards that administer or fund church plans as an example of an organization that is engaged in carrying out the functions of a church.

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If you find any of the foregoing suggestions unacceptable, we request that a public hearing be held on the proposed regulations under Section 414(e), IRC. At such time a number of the members and spokesmen of the Church Alliance will request the opportunity to testify.

Respectfully submitted,

CHURCH ALLIANCE FOR CLARIFICATION
OF ERISA

By Darold H. Morgan
Darold H. Morgan, President
Annuity Board of the
Southern Baptist Convention
511 North Akard Building
Dallas, Texas 75201

ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION • 511 NORTH AKARD BUILDING • DALLAS, TEXAS 75201 (214) 747-9$

GARY S NASH
General Counsel

November 18, 1977

Commissioner of Internal Revenue
Internal Revenue Service
1111 Constitution Avenue, N. W.
Washington, D. C. 20224

Attention: CC:LR:T

Re: Proposed Regulations Under Section 414(e), IRC, Defining "Church Plan"

Dear Sir:

This letter is written pursuant to the notice published in the Federal Register dated April 8, 1977, inviting comments on the definition of "church plan" as defined in Section 414(e), IRC, and pursuant to the notice published in the Federal Register dated September 7, 1977, inviting comments to be delivered at a public hearing held October 6, 1977 in Washington, D. C.

I testified at the public hearing on October 6, 1977. I am enclosing with this letter a copy of my prepared testimony delivered at that hearing.

I have noted an article which appeared in the November 7, 1977 issue number 162 of the BNA Pension Reporter on page A-7 concerning the comments of Henry Rose, Pension Benefit Guaranty Corporation General Counsel, concerning the proposed "church plan" regulations. The article indicates that Rose has expressed objection to the general rule established in the proposed regulations which would provide that if at any time a plan fails to meet the requirements for being a church plan, then it can never thereafter become a church plan. Under this very harsh interpretation made in the proposed regulation, the PBGC may find itself excessively entangled in church affairs should it enforce the liability requirements of ERISA Section 4062 against an employer participating in a church plan, which inadvertently failed to meet the criteria of the proposed regulations. I would urge you to reconsider this aspect of the proposed regulations.

The proposed regulations concerning "church plans" have evoked considerable interest from the major denominations in the United States. Should you pursue Mr. Rose's apparent suggestion to define

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the term "church" in the regulations, I would respectfully request to comment on the proposed definition prior to its becoming adopted as a final regulation.

Respectfully submitted,

Gary S. Nash

Gary S. Nash, General Counsel

Annuity Board of the
Southern Baptist Convention

GSN:nt

Enclosure

ORAL COMMENTS TO THE INTERNAL REVENUE SERVICE BY GARY S. NASH ON THE PROPOSED REGULATIONS RELATING TO CHURCH PLANS ON OCTOBER 6, 1977

INTRODUCTION

I AM GARY S. NASH, IN HOUSE GENERAL COUNSEL OF ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION, 511 NORTH AKARD, DALLAS, TEXAS 75201. ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION IS A TEXAS NON-PROFIT CORPORATION, INCORPORATED IN 1918 TO PROVIDE FOR THE RELIEF, SUPPORT, BENEFITS AND ANNUITIES OF MINISTERS AND LAY EMPLOYEES OF BAPTIST ORGANIZATIONS OF THE SOUTHERN BAPTIST CONVENTION. ATTENDING THIS HEARING WITH ME TODAY IS DR. DAROLD MORGAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER OF THE ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION.

MY COMMENTS ON YOUR PROPOSED CHURCH PLAN REGULATIONS WILL PROVIDE YOU WITH BACKGROUND INFORMATION ABOUT THE ANNUITY BOARD, INFORMATION ABOUT "CHURCH PLAN" DEFINITION PROBLEM AREAS DURING THE TRANSITIONAL PERIOD AND AFTER DECEMBER 31, 1982 AND I WILL CONCLUDE WITH SPECIFIC RECOMMENDATIONS CONCERNING THE REGULATIONS.

CONSTITUTIONAL OBJECTION TO JURISDICTION

AT THE OUTSET, I STATE MY CONSTITUTIONAL OBJECTIONS, BASED ON THE FIRST AMENDMENT FREE EXERCISE AND ESTABLISHMENT CLAUSES, TO THE JURISDICTION OF GOVERNMENTAL BODIES TO PASS LAWS AND REGULATIONS RESPECTING CHURCH AFFAIRS AND THE MANNER AND POLITY THE VARIOUS DENOMINATIONS HAVE SELECTED TO DISCHARGE THEIR RELIGIOUS MISSION.

BACKGROUND

UNLIKE HIERARCHICAL DENOMINATIONS OR QUASI HIERARCHICAL DENOMINATIONS, THE SOUTHERN BAPTIST CONVENTION USES A CONGREGATIONAL STRUCTURE EMPLOYING A MULTITUDE OF CIVIL LAW CORPORATIONS TO CARRY OUT FUNCTIONS

OF WORSHIP, PREACHING, EDUCATING, HEALING AND OTHER RELIGIOUS MISSIONS AND MINISTRIES.

CONGREGATIONAL BAPTIST CHURCHES ARE AUTONOMOUS CHURCHES AND ARE NOT SUB-PARTS OF A CHURCH. SOUTHERN BAPTIST CHURCHES BAND TOGETHER THROUGH LOCAL ASSOCIATIONS, STATE CONVENTIONS AND THE SOUTHERN BAPTIST CONVENTION TO PERFORM MINISTRIES WHICH MIGHT MORE EFFECTIVELY OR EFFICIENTLY BE CARRIED OUT THROUGH THE USE OF POOLED FUNDS VOLUNTARILY GIVEN TO LOCAL CHURCHES BY INDIVIDUAL CHURCH MEMBERS. THROUGH THE VOLUNTARY DONATIONS OF SOUTHERN BAPTIST CHURCHES TO THE CO-OPERATIVE PROGRAM, MONIES ARE DISTRIBUTED TO SOUTHERN BAPTIST CONVENTION ORGANIZATIONS AND STATE BAPTIST CONVENTIONS, AND STATE CONVENTION ORGANIZATIONS TO CARRY OUT MINISTRIES WHICH SMALL INDIVIDUAL CHURCHES ALONE MIGHT NOT OTHERWISE BE CAPABLE OF CARRYING OUT.

STATE BAPTIST CONVENTIONS ESTABLISH ADDITIONAL BAPTIST ORGANIZATIONS SUCH AS HOSPITALS, UNIVERSITIES, LOCAL MISSIONS AND CHAPLAINCY PROGRAMS AND ALSO CONTRIBUTE TO THE ANNUITY BOARD ON BEHALF OF MINISTERS, AMOUNTS EQUALLING SPECIFIED AMOUNTS CONTRIBUTED ON BEHALF OF MINISTERS BY LOCAL CHURCHES.

UNLIKE HIERARCHICAL CHURCHES SUCH AS THE ROMAN CATHOLIC CHURCH OR THE CHURCH OF JESUS CHRIST OF LATTER DAY SAINTS, AND UNLIKE QUASI HIERARCHICAL CHURCHES SUCH AS THE UNITED PRESBYTERIAN CHURCH IN THE USA, WHERE THERE ARE CLEAR LINES OF RESPONSIBILITY, CONTROL AND AUTHORITY, CONGREGATIONAL BAPTIST CHURCHES ARE WITHOUT CLEAR LINES OF CONTROL FROM THE STATE BAPTIST CONVENTIONS AND FROM THE SOUTHERN BAPTIST CONVENTION. RATHER, CHURCH MEMBERS OF LOCAL CHURCHES ELECTED AS TRUSTEES ON BOARDS OF DENOMINATIONAL ORGANIZATIONS CONTROL THE POLICIES OF THE VARIOUS DENOMINATIONAL ORGANIZATIONS.

No church or other denominational organization is required to participate in any of the retirement annuity or welfare benefit programs provided through the Annuity Board of the Southern Baptist Convention. Participation is strictly voluntary.

However, the Annuity Board has been able to serve the unique requirements of the Southern Baptist Convention affiliated churches and denominational organizations established to carry out the functions and ministries of churches.

Southern Baptist ministers and lay employees are highly mobile, changing from church to church, from church to other denominational organization, from denominational organization to denominational organization and vice versa.

The Annuity Board has different investment pools to fund retirement annuity and relief benefits, Depending on the nature and the part or parts of the program in which a denominational employee may be participating.

One part of the Annuity Board program is mainly for ministers, and it receives contributions from the minister's church and matching contributions from the State Convention where the church is located. Another part of the program is similar to a thrift plan or money accumulation plan and both ministers and other denominational employees participate in this part if they so desire.

A third part of the program provides for a variable annuity benefit as a supplement to participation in one of the other phases of the program. This variable part of the program is open to any denominational employee who is also participating in some other phase of the program.

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THERE ARE NO ORGANIZATIONS PARTICIPATING IN ANNUITY BOARD PROGRAMS WHICH ARE OTHER THAN CODE SECTION 501(c)(3) ORGANIZATIONS. THE ANNUITY BOARD HAS NO PLANS MAINTAINED PRIMARILY FOR EMPLOYEES EMPLOYED IN CONNECTION WITH UNRELATED TRADES OR BUSINESSES.

PROBLEM AREAS

THERE IS A GREAT DEAL OF CONCERN OVER WHAT THE INTERNAL REVENUE SERVICE AND THE DEPARTMENT OF LABOR ARE GOING TO DECIDE ARE "AGENCIES" WHICH CANNOT PARTICIPATE IN CHURCH PLANS AFTER DECEMBER 31, 1982. WE ARE CONCERNED ALSO AS TO WHETHER CHURCH PENSION BOARDS WILL BE ABLE TO CONTINUE TO SERVE THESE AGENCIES AFTER 1982, SINCE THE SEVERAL ERISA DRAFTING COMMITTEES WERE APPARENTLY UNAWARE OF THE EXISTENCE OF CHURCH PENSION BOARDS.

BAPTIST SCHOOLS AND HOSPITALS HAVE PARTICIPATED IN ANNUITY BOARD PROGRAMS NOT ONLY BECAUSE OF THE QUALITIES OF THE PROGRAMS BUT ALSO BECAUSE OF THE INHERENT DENOMINATIONAL TIES.

THE GOVERNMENT-MANDATED DIVISION OF AGENCIES FROM CHURCHES IN CONTEXT OF CHURCH PLANS IS VIEWED WITH ALARM NOT ONLY BECAUSE OF THE INVOLUNTARY BREAKING OF RELIGIOUS TIES, BUT ALSO BECAUSE OF THE INCREASED ADMINISTRATIVE COSTS FOR BOTH THE EXEMPT CHURCH PLAN AND THE NEW NON-EXEMPT AGENCY PLANS.

WE FEEL THAT DURING THE TRANSITION PERIOD, OUR JOINT FUNDED DENOMINATIONAL ANNUITY PROGAM IS ENTITLED TO BE TREATED AS A CHURCH PLAN.

RECOMMENDATIONS

THE REGULATIONS SHOULD RECOGNIZE AS CHURCH PLANS JOINT FUNDED DENOMINATIONAL ANNUITY PROGRAMS ESTABLISHED AND MAINTAINED THROUGH CHURCH PENSION BOARDS.

WE CONCUR WITH THE OTHER DENOMINATIONAL PENSION BOARDS REPRESENTED THROUGH THE CHURCH ALLIANCE FOR CLARIFICATION OF ERISA IN ALL POINTS PRESENTED IN THE LETTER OF COMMENTS TO THE COMMISSIONER, DATED MAY 20, 1977, CONCERNING THE PROPOSED CHURCH PLAN REGULATIONS. IN THIS EXTREMELY COMPLEX AND SPECIALIZED AREA OF "CHURCH PLANS" IN THE ERISA CONTEXT, IT CERTAINLY APPEARS HARSH AND UNFAIR TO IMPOSE AN INCURABLE AND PERPETUAL BANISHMENT FROM "CHURCH PLAN" STATUS FOR A DENOMINATION PLAN WHICH, IN SPITE OF GOOD FAITH EFFORTS AT COMPLYING WITH THE STATUTORY CHURCH PLAN DEFINITION, FAILED TO MEET IT. WE THEREFORE STRONGLY URGE THAT THE FOLLOWING LANGUAGE FROM SECTION 1.414(E)-1(A) BE DELETED IN ITS ENTIRETY:

> "IF AT ANY TIME DURING ITS EXISTENCE A PLAN IS NOT A CHURCH PLAN BECAUSE OF A FAILURE TO MEET THE REQUIREMENTS SET FORTH IN THIS SECTION, IT CANNOT THEREAFTER BECOME A CHURCH PLAN."

WE URGE THAT A DENOMINATIONAL PENSION BOARD WHICH FUNDS OR ADMINISTERS CHURCH PLANS BE GIVEN AS AN EXAMPLE OF AN ORGANIZATION THAT IS ENGAGED IN CARRYING OUT THE FUNCTIONS OF A CHURCH. CHURCH PENSION BOARDS ARE INTEGRAL IN THAT THEY PERFORM VITAL AND NECESSARY FUNCTIONS FOR THE EXISTENCE OF THE CHURCHES.

CONCLUSION

THE VARIETY OF ORGANIZATIONAL STRUCTURES OF THE VARIOUS RELIGIOUS DENOMINATIONS PRESENT IN THE UNITED STATES APPEAR TO POSE A VERY DIFFICULT PROBLEM FOR REGULATIONS TO DEAL WITH IN THE "CHURCH PLAN" CONTEXT SINCE "CHURCH" HAS SO MANY DIFFERENT MEANINGS AND CONNOTATIONS, NOT ONLY IN THE TAX LAWS BUT ALSO FROM ONE DENOMINATION TO ANOTHER YOU WILL FIND THAT DENOMINATIONAL PENSION PROGRAMS HAVE GENERALLY

A GREATER DEGREE OF CONTROL IN THE PLAN MEMBER THAN OTHER PLANS OF PROFIT MAKING ORGANIZATIONS. YOU WILL ALSO FIND THAT DENOMINATIONAL PENSION PROGRAMS MAY HAVE A GREAT DEAL OF DIFFICULTY FITTING INTO A GOVERNMENT DEFINED AND ENFORCED UNIFORMITY FOR EXEMPT CHURCH PLAN STATUS. FOR THAT REASON I URGE THAT THE REGULATIONS YOU ADOPT BE AS FLEXIBLE AS REASONABLY POSSIBLE UNDER THE LAW.

THANK YOU.

The Pension Boards UNITED CHURCH OF CHRIST

JOHN D ORDWAY
Executive Vice President

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October 7, 1977

Director, Legislation and Regulation Branch
Office of Chief Counsel
1111 Constitution Avenue, N.W.
Washington D. C. 20224

Re: Proposed regulations defining the term "Church Plan".

Dear Sir:

At the conclusion of the hearing on the proposed regulations to define the term "Church Plan", it was indicated that any further written comment concerning the subjects discussed would be welcome.

During the hearing presentation, two individuals suggested that the regulations, when issued, include a church pension board as an example of the type of entity that would be considered to be within the definition of Church or an Association or Convention of Churches. In each case, Ms. Kahn asked the individual how one would distinguish a pension board from the other agencies of the church.

A pension board is clearly distinguishable from other types of agencies of the church. A pension board is carrying out the internal administration of the church necessary for the church as a whole to function. Other agencies dealing with the public as a whole or some segment of the public are pursuing their ministry by the provision of some charity or service for the people of the community. There is a distinct difference between the two.

Ultimately all of the work of the church is intended to benefit the community and there has been considerable discussion over which functions are deemed to be functions of a church and which functions, when carried out by a separate entity of a church, are such that the entity is considered an agency not exempt from the Employee Retirement Income Security Act of 1974. The questions related to such functions as health care, education, care for the aged or disabled, etc.; when such functions are carried out by the church through the provisions of service to the public, and whether or not such functions are functions of a "church" are not required to be answered to differentiate between a pension board and an agency of the church. Congress has established a difference between "churches" and such "agencies", at least for the purposes of ERISA. Accordingly, I only deal with the carrying out of the functions of a church in the more traditional sense.

In that sense, the direct functions of a church are carried out in the local community in some building usually built and paid for by a congregation who also employs a minister and others to carry out or supervise the specific functions performed within that church and to the congregation and community. This would include Sunday services in a christian church, baptism, marriage, funerals, communion, counselling, and a myriad of other items. There would normally be a Sunday School for children, a choir, a youth group, as well as an adult group, a women's group, a men's group, and a wide variety of committees dealing with specific needs and concerns in religious and spiritual matters, of the congregation, of the community, and throughout the world.

Because these concerns are common to virtually all churches, and within a specific denomination, have a common religious interpretation as a basis for dealing with such concerns, regional and national bodies are established to assist in the efficient implementation of those concerns. In a hierarchical church the national bodies would commonly be looked at as the "Church" carrying out the functions of the church through the local congregations which are normally owned or controlled by that national body. In a congregationally structured church, the general public would still view the national bodies as the "church". However, in this type structure, the national or regional bodies do not control the local congregations, and in most cases do not directly carry out the commonly thought of functions of the church. However, their role is essential to the functions of those local congregations and they are an integral part of the church as a whole.

These functions include such things as the publication of hymnals, church school materials, support of new congregations, assistance in the placement of ministers, supervision and coordination of missionary activities, coordination and assistance in the activities of local congregation in their individual ministries, financial aid for the building or extension of church facilities, and on through virtually every element of the operation of a local church, not to mention national leadership of the denomination.

One could say that such elements could be provided by some other source but such an answer does not recognize the circumstances of the church. When a church of a particular denomination wants a hymnal, they need one which reflects the theological thinking of that denomination, not a publication that some secular organization would compile, and it certainly is not practical to say that each local congregation should publish their own.

Similarly, when a congregation wants to build a new church or an extension to its existing structure, it could be said that they could borrow money from some local lending facility. Again, that solution is not possible in a great number of situations. While a church structure may cost substantial amounts to build, its value in the market place is usually limited to its use as a church. A bank attempting to foreclose on a church building has two basic problems. First, the building is unsaleable unless there happens to be another congregation in the area that needs a building. Accordingly, the value of the property is often limited to the value of the land. Second, the bank incurs a substantial public relations detriment when their foreclosure becomes public knowledge. As a practical matter, normal mortgage financing does not adequately meet the needs of a church.

Another circumstance with which national and regional bodies must deal is the employment and maintenance of the ministers of the denomination. A church cannot, as a practical matter, go to an employment agency to locate a minister. A church looking for a new minister necessarily wants a minister that adheres to the principlesof that denomination. This normally requires knowledge of those ministers within the denomination who are either presently unemployed or who are seeking, or willing to consider, a change from their present employment. A national body relating to this concern meets the needs of both the local congregation and the minister who must fulfill his calling in a variety of settings over the period of his working career. The maintenance of that minister over his career and beyond his working years is the continuing concern of the local church and the church as a whole as it is only through an effective ministry that the primary functions of the church can be effectively pursued. This includes current income and housing, but also includes provision for health care, disability income, survivor benefits, and retirement income for the minister and his dependents.

Again, it could be said that such benefits could be obtained from other sources, but such a position again does not recognize the facts of a ministry within a church. While ministers commonly will devote an entire career within a single denomination, their ministry will move within the denomination from church to church to agency, and back to another church. The great majority of churches will have, at most, three full time employees, and a large number will have only one, the minister. Other services of the church (teaching, clerical, choir director, etc.) will be obtained from persons within the congregation on a part time basis either as unpaid volunteers or for minimal compensation.

Under such circumstances, the costs of obtaining individual benefit packages for the employed individuals is prohibitive in cost as group coverages would not be available, impractical for the participants because of the necessity of changing coverages with each change in the minister's employment, and impossible for those most in need who incur health or other problems making them uninsurable with the organization selected by their next employer for the provision of such benefits. Further, it should be noted that separate pension benefits provided by each individual entity employing the minister, even if in full compliance with ERISA, could well result in the minister receiving no benefit whatsoever. The minister will commonly work in a particular entity for less than ten years, as he or she will usually want to change the setting in which his or her ministry is performed. This may simply be a desire to move between an urban or rural setting or to a larger or smaller church, but may well include a wish to impact on a particular social concern such as drug abuse, prison rehabilitation, mental health, etc. Termination of service at any entity with less than ten years service could result in forfeiture of the accrued benefit if the individual were in a plan covered by ERISA. This is not true of any church pension system of which I am aware, where service is consistently viewed as service to the denomination as a whole. These benefits are the benefits provided through the pension boards of the various churches for the ministers and lay employees of such churches. In addition, many pension boards, including the Pension Boards of the United Church of Christ, administer other funds which provide additional financial help to the ministers and his or her dependents when special financial needs arise. This would include such things as assistance with medical or hospitalization costs not covered by a health insurance plan, needed funds during periods of temporary unemployment, education assistance to the children of deceased ministers, monthly aid to ministers or spouses of deceased ministers whose income during working years was insufficient to generate even a moderate pension benefit, recognizing that there continues to be a large number of ministers still living who retired before social security even became available to ministers.

These functions of a pension board are a necessary function of a national church body, whether carried out in a hierarchical church structure where the national body is represented in a single head and operates a pension board, or in a congregational church structure where the national body is a group of individual entities each charged with a particular area of the church's concern (be it internal administration, or national or world wide pursuit of its ministry), one of which is the maintenance of the ministry through the administration of programs for their health, welfare, retirement, and relief through a pension board. The pension boards, as such, are an integral part of the church and, as such, are a necessary part of carrying out the functions of the church so as to be considered a part of the church.

Accordingly, I submit that a pension board could properly be used as an example of the type of entity that is a church, or an association or convention of churches, and could properly be distinguished from church "agencies" that perform other services to or for the community or for individuals who are not a part of the church structure engaged directly or indirectly in carrying out the functions of a "church".

Sincerely,

JDO/dek

BCC: James W. Quiggle
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RECEIVED
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LEGAL SERVICES
ANNUITY BOARD, SBC

November 23, 1977

Commissioner of Internal Revenue
1111 Constitution Avenue
Washington, D.C. 20224

Attention: CC:LR:T (LR-193-74)

Re: Proposed Regulations Under Section <u>414(e), IRC, Defining "Church Plan"</u>

Dear Sir:

By letter dated October 14, 1977, our client, The Ministers and Missionaries Benefit Board of American Baptist Churches, advised you of its desire to submit additional information and comments for your consideration in connection with the final regulations under section 414(e) of the Internal Revenue Code, relating to the exemption of church plans from ERISA. We are enclosing a letter signed by the Reverend Dean R. Wright, Executive Director of The Ministers and Missionaries Benefit Board of American Baptist Churches, providing such additional information and comments.

On pages 24 and 25, Rev. Wright points out that the large majority of church pension plans, including the one administered by The Ministers and Missionaries Benefit Board, are not "qualified plans" under section 401(a) of the Internal Revenue Code. Instead, they provide pension benefits for ministers and lay employees in the form of annuities under section 403(b) of the Internal Revenue Code. Accordingly, these "section 403(b) plans" do not, in general, come within the provisions of Title II of ERISA, which pertains primarily to "qualified" plans. It is our understanding, however, that a section 403(b) plan may constitute an employee pension benefit plan for purposes of Title I of ERISA, and also, perhaps under certain circumstances, for purposes of Title IV of ERISA.

The definition of a "church plan" is the same for purposes of all three titles of ERISA As discussed more fully in Rev. Wright's letter, this may help to explain the comments made by several church pension boards at the hearing on October 6, 1977 with respect to the coverage of "former employees" under a section 403(b) church plan.

The American Baptist denomination is grateful for the opportunity it has been given to submit additional comments for consideration. We shall be happy to provide any further information which might be of assistance.

Sincerely yours,

John P. Persons

John P. Persons

Enclosure

THE MINISTERS AND MISSIONARIES BENEFIT BOARD
of the
AMERICAN BAPTIST CHURCHES
475 Riverside Drive, New York, New York 10027

November 23, 1977

Commissioner of Internal Revenue
1111 Constitution Avenue
Washington, D.C. 20224

Attention: CC:LR:T (LR-193-74)

Re: Proposed Regulations Under Section 414(e), IRC, Defining "Church Plan"

Dear Sir:

The purpose of this letter is to provide the Treasury Department and the Internal Revenue Service with additional information and comments which we believe will be helpful in the preparation of final regulations under section 414(e) of the Internal Revenue Code, relating to "church plans."

This letter will focus primarily upon two important considerations that we believe have not been adequately stressed in the comments heretofore submitted. These are (1) the origins, structure and role of a "church pension board" such as our organization, and (2) the principles of U.S. constitutional law which underlie the exemption granted by Congress to "church plans" in ERISA, and which should be adhered to in promulgating final regulations under section

414(e) in order to avoid unconstitutional entanglements between government and religion that the Congress did not intend.

In the light of the factual and legal background provided by the foregoing considerations, we shall, in conclusion, restate briefly the specific comments we have previously made with respect to the proposed regulations and explain why they are important to the American Baptist denomination.

1. <u>The Origins, Structure and Role of a Church Pension Board</u>

Many "church plans" are administered or funded by pension boards, separate corporate entities that are associated with and controlled by the churches and other religious bodies of the denomination. Because of the differences in beliefs, structures and practices among the various religious denominations, there are wide variations in their pension boards and the plans administered by these boards. At the same time, however, there are many points of similarity.

Virtually all of these pension boards were established and in operation many years prior to the enactment of ERISA. It seems reasonable to assume, therefore, that when Congress exempted "church plans" from the requirements of ERISA, it intended to include within the exemption -- especially during the transitional period that ends on December 31, 1982 -- the plans administered by these church pension boards as they existed on January 1, 1974. It may therefore be helpful for the Service and the Treasury Department to know how the pension board of the American Baptist denomination came into being, what its organizational structure is, from what sources its funds have been derived, and what programs it carries on for the benefit of the ordained ministers, missionaries and lay employees of the denomination.

The Ministers and Missionaries Benefit Board of American Baptist Churches (the "Board") is one of four separately incorporated national organizations established by the American Baptist denomination to carry out its work. The denomination consists of approximately 6,000 local churches, and numerous other affiliated religious and charitable organizations, throughout the United States. These churches and affiliated organizations make up the institutional structure of the denomination. There are approximately 1,500,000 individual members of the local churches of the denomination. Consistent with Baptist congregational beliefs, each of the local churches is separate, independent and autonomous.

The principal coordinating and directing entity of the denomination is American Baptist Churches in the U.S.A.

("ABC"). ABC was formed as an unincorporated association in 1907 and was incorporated by a special act of the New York legislature in 1910. Its present name was adopted in 1972 when the denomination completed a major revision of its organizational structure. Prior to 1972 ABC was known first as the Northern Baptist Convention, and later as the American Baptist Convention.

At the first annual meeting of the then Northern Baptist Convention in 1908, a commission of seven was appointed to consider the needs of aged and disabled ministers and their widows and orphaned children. At that time, the dire economic straits of superannuated Baptist ministers and missionaries was a cause of great concern to the denomination. Because of the low salary levels that prevailed it was impossible for most individual ministers and missionaries to set aside, out of current compensation, a sufficient amount to provide for their cost of living after retirement or disability, or to provide for their widows and dependent children in the event of their death prior to retirement. The commission was instructed to address itself to this problem, which was one that could not be solved at the local level but only on a denomination-wide basis through the combined efforts of the autonomous local churches and other church bodies.

Because the commission was without funds, little was accomplished until May, 1911 when an anonymous layman of the denomination offered to contribute $50,000 towards a fund for the relief of superannuated and disabled ministers and missionaries, on condition that by December 25, 1911 an additional $200,000 be obtained from other sources for the same purpose. In August 1911 the Ministers and Missionaries Benefit Board was organized in unincorporated form and a financial campaign was undertaken to raise the additional $200,000. Through the help of many generous members of the denomination, including Mr. John D. Rockefeller, Sr.,[1/] the goal of $200,000 was met by the December 25 deadline. By this action, the denomination took the first step toward providing an adequate retirement income to the ministers and missionaries (and their families) who carry on the denomination's work.

The question then arose as to whether this function could best be carried on by having the Ministers and

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1/ In 1917 another denomination-wide fund raising campaign was launched, and by 1919 a total of $2,000,000 had been raised through contributions to the Board. Taking note of this progress, Mr. John D. Rockefeller, Sr. then made a matching gift of $2,000,000, bringing the Board's endowment fund to $4,000,000. Mr. Rockefeller's interest in the work of the Board continued during the 1920's, and ultimately he contributed a total of $6,900,000 to the Board's endowment. The enclosed Annual Report of the Board for 1976 contains a complete list of gifts and legacies (of $1,000 or more) that have been made to the Board for its corporate purposes.

Missionaries Benefit Board continue as an unincorporated branch of the Northern Baptist Convention itself, or whether a new entity should be established which would be legally separate from the Convention, but subject to its overall direction and control. After careful consideration, the decision was made by the denomination to follow the latter course. This decision led to the incorporation of the Ministers and Missionaries Benefit Board, in 1913, by a special act of the New York legislature.

From the start priority was given to the development of a pension plan for Baptist ministers and missionaries. This plan was initially called the Retiring Pension Fund, and it was administered by the Ministers and Missionaries Benefit Board pursuant to the Board's mandate as set forth in its original Act of Incorporation: "to administer its funds for the benefit of worthy Baptist ministers and Baptist missionaries, their wives or widows, and their dependent children...." Dues were set at 6 percent of compensation, but since it was recognized that many ministers would be unable to pay even this small amount, the Board provided, from its endowment, a subsidy ranging from 65 to 75 percent. In effect the member's annual dues to the Retiring Pension Fund amounted to approximately 1.8 percent of compensation.

During the 1930's and 1940's efforts were made to enroll ministers and missionaries of the denomination in the Retiring Pension Fund. Increased membership required greater reserves, over and above the dues received from members, and a total of $4,000,000 was placed in the Retiring Pension Fund for this purpose. Of this $4,000,000, $1,800,000 was provided through a denomination-wide fund raising campaign for American Baptist missions, and the balance was provided by the endowment fund. After the Retiring Pension Fund was firmly established, steps were taken periodically to increase the dues in order to improve the level of retirement benefits.

In the 1950's the Board was confronted with the question of how to distribute, equitably, increasingly available resources to meet growing retirement needs. After a thorough study, the Board in 1965 established a variable annuity program to replace the Retiring Pension Fund, which had provided only fixed annuities. The new variable annuity program, called the American Baptist Churches ("ABC") Retirement Plan, provides for the issuance of annuities pursuant to Section 403(b) of the Code. Virtually all members of the Retiring Pension Fund have transferred to the ABC Retirement Plan. Also in 1965 the ABC Retirement Plan was opened to lay employees of the churches and other affiliated organizations of the denomination pursuant to an amendment of the Board's charter. This was done in recognition of the fact that the denomination has a responsibility to provide for the retirement of its lay employees as well as for its ministers and missionaries.

Since the early 1960's the Board has sought to accomplish its mission[2/] of providing for the welfare and maintenance of ministers, missionaries, and lay employees who serve the denomination by providing additional benefit programs such as: (1) The Annuity Supplement, which provides a means whereby participants can increase their retirement income through the purchase of supplemental variable annuities under salary reduction arrangements; (2) The M & M Death Benefit Plan, which provides group term life insurance protection for active members prior to retirement;

2/ The purposes of the Board as now set forth in its Act of Incorporation are as follows:

> Sec. 2. The objects of the corporation shall be to administer its funds for the benefit of ministers and missionaries who have served the Baptist denomination, their spouses or surviving spouses and their dependent children, and to attain these objects either directly or through the medium of related organizations; to cooperate with such organizations in securing, so far as practicable, uniformity in the methods for the extension of such aid; to promote interest in the better maintenance of the ministry; also, to receive and administer funds to provide benefits to other persons who as employees have served the Baptist denomination, and to their spouses or surviving spouses and their dependent children; and to adopt such measures to these ends as may be recommended by American Baptist Churches in the U.S.A.

and (3) The ABC Medical Plan, which provides medical and hospital benefits to participants and their dependents, both before and after retirement. The Board also provides grants and emergency assistance to needy American Baptist ministers and missionaries and their families. In addition, it maintains a program of salary support for ministers who work for Baptist employers that are unable to pay compensation that the Board considers adequate.[3/]

Income from the Board's general fund (as distinguished from funds that are allocable to the various benefit plans or otherwise legally restricted) is presently used to meet all of the administrative expenses of the retirement, death benefit and medical plans. Income from the general fund is also used to provide supplementary benefits, such as: (1) emergency assistance to active and retired ministers and their families experiencing financial hardship, (2) supplemental grants to retired ministers and missionaries and their surviving spouses who are in serious financial need, (3) grants to augment low annuity payments, (4) medicare premiums for retired participants who are over age 65, and (5) support for orphaned children.

3/ A more complete summary of the history of the Board and its programs is set forth in the enclosed excerpt from the Annual Report of the Board for 1971, which was the Board's 60th anniversary year. Also enclosed is a copy of the Annual Report for the year 1976.

Although the Board is separately incorporated and has been determined by the Service to be exempt from federal income tax under Section 501(c)(3) of the Code, it is an integral part of the American Baptist denomination and of American Baptist Churches in the U.S.A. In carrying out its corporate functions, the Board is subject to the supervision and control of the American Baptist denomination, as exercised through the ABC and its affiliated societies and agencies. The Board's Act of Incorporation provides that in carrying out its purposes, the Board shall "adopt such measures to these ends as may be recommended by American Baptist Churches in the U.S.A." The Board is supervised by a board of directors (called "managers") varying between twelve and eighteen in number. At least nine of the managers of the Board are elected by the ABC, and an additional three of the managers are elected by the boards of directors of three other denominational bodies which are supervised and controlled by the ABC. The Board is required to submit an annual report to the ABC, and the ABC has the power to instruct the Board with regard to its general policies. The By-Laws and regulations adopted by the Board with respect to its organization, the management and disposition of its assets, the duties and powers of its officers and the management of its affairs are subject to confirmation by the ABC. The time and place of the meetings of the Board may be determined by the ABC.

In view of the foregoing, we believe and strenuously maintain, that the Board is included within the term "church" as described in § 1.414(e)-1(e) of the proposed regulations -- namely, a "religious organization [that] (1) is an integral part of a church, and (2) is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise." We believe that one of the essential functions of a church -- whether organized along congregational or hierarchal lines -- is to provide (during active employment and after retirement) for the welfare of the persons who carry on its work, and without whom the church could not function. At the hearing on October 6, 1977 we requested that this conclusion be made explicit in the regulations, and we were surprised and disturbed when this suggestion was questioned by at least one of the government representatives present at the hearings. We hope that the information presented above will help to clarify this issue, and that the final regulations will specifically recognize a church pension board as an organization that carries out the functions of a church.

Moreover, returning to a point mentioned earlier in this letter, we believe that Congress intended that the plans being administered for the American Baptist denomination by our pension board on January 1, 1974 (and also the plans then existing of other denominations) be included within the exemption accorded "church plans" at least until January 1, 1983, and thereafter if the plans do not cover church-related "agencies". Understandably, Congress did not have detailed information as to the coverage provided under all church plans in existence on January 1, 1974, and it therefore enacted specific coverage limitations with respect to only two situations. First, it provided that employees of unrelated businesses operated by churches may be covered by an exempt church plan so long as the plan is not primarily for their benefit. Second, it provided that employees of church-related "agencies" may be covered by an exempt church plan until 1983 but not thereafter. Otherwise, the definition of an exempt church plan was set forth in more general terms, and the details as to other questions that would inevitably arise were left to be filled in by regulations and administrative rulings. We believe that Congress intended these questions to be resolved in such a way as to avoid the risk of unconstitutional interference by the federal government in the programs that have been established by churches for the purpose of providing retirement and welfare benefits to the persons through whom the churches carry out their religious mission.

2. Constitutional Principles that Should Be Adhered to in the Formulation of the Final Regulations

The only explanation in the Congressional committee reports regarding the reasons for the exemption of church plans under ERISA appears in the following extract from the Senate report explaining why church plans were not made subject to the plan termination insurance requirements of ERISA:

> "At the option of an exempt church (or of a convention or association of churches), plans covering its employees may be included in the insurance coverage. The committee is concerned that the examinations of books and records that may be required in any particular case as part of the careful and responsible administration of the insurance system might be regarded as an unjustified invasion of the confidential relationship that is believed to be appropriate with regard to churches and their religious activities. However, if the church itself has determined to consent to such examinations, to the premium tax payments, and to the contingent employer liabilities, then it may elect to have the insurance program apply to its plan or plans. . . ."4/

Although this statement was made with reference to the plan termination insurance provisions, it seems clear that the same reasoning underlay the exemption accorded to church plans from the provisions of Titles I and II of ERISA.

By exempting church plans from ERISA, Congress was endeavoring to adhere to the long established principle of separation of church and state as expressed in the First Amendment: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise

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4/ Sen. Rep. 93-383, 93rd Cong., 2d Sess., 1974-3 C.B. Supp. 160.

thereof . . . ." As observed by Mr. Justice Black of the United States Supreme Court thirty years ago, this language in the First Amendment "was intended to erect 'a wall of separation between church and state.'"5/

In more recent decisions the Supreme Court has applied a three-part test in determining the constitutionality of statutes calling for governmental action raising a question under the religion clauses of the First Amendment. The third part of this test, which is directly relevant to the present discussion, requires that "the statute must not foster an excessive government entanglement with religion."6/

As Mr. Justice Blackmun stated in a case under the religion clauses decided only last year:

> "The importance of avoiding persistent and potentially frictional contact between governmental and religious authorities is such that it has been held to justify the extension, rather than the withholding, of certain benefits to religious organizations. The Court upheld the exemption of such organizations from property taxation partly on this ground. Walz v. Tax Commission, 397 U.S. 664, 674-675, 90 S. Ct. 1409, 1414-1415, 25 L.Ed.2d 697 (1970)."7/

Mr. Justice Harlan, in a separate opinion in the Walz case, supra, warned of the constitutional problems that

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5/ Everson v. Board of Education, 330 U.S. 1, 16 (1947).

6/ Lemon v. Kurtzman, 403 U.S. 602, 613 (1971).

7/ Roemer v. Board of Public Works of Maryland, 426 U.S. 736, 748 at n. 15 (1976).

are raised by governmental programs "whose very nature is apt to entangle the state in details of administration" of church functions.[8/] In Lemon v. Kurtzman, supra, the Supreme Court held unconstitutional a state statute supplementing the salaries of teachers in Catholic parochial schools because the statute created a "relationship pregnant with dangers of excessive government direction of church schools and hence of churches."[9/]

If ERISA were applied to the plans that churches have established for the welfare of their ministers and lay personnel, it would be difficult to imagine a situation that would be more "pregnant with dangers of excessive government direction" or more likely "to entangle the state in details of administration" of a vital church function.

If subject to ERISA, church plans would be required to file detailed and extensive annual reports with the Federal government -- a requirement which the churches believe would erode their rights under the First Amendment. Non-compliance with the reporting requirements could lead to governmental enforcement actions, and even criminal prosecution, against the church officials who administer the church plans. In order to enforce ERISA's requirements, the

8/ 397 U.S. 665, 695.

9/ 403 U.S. 602, 621.

Secretary of Labor could require the submission of reports, books and records, and could enter upon church property for the purpose of inspecting books and records and questioning church officials concerning any and all aspects of the church plans under their administration. Powers such as these were held in Caulfield v. Hirsch, 10/ and Catholic Bishop of Chicago v. N.L.R.B. 11/ to preclude the application of the National Labor Relations Act (NLRA) to Catholic parochial schools. In Caulfield the court stated:

> "The entangling relationships which can arise under the NLRA appear in a wide variety of ways. Because they may result in numerous conflicts and confrontations between the NLRB and the church schools, they are, in my mind, excessive and, therefore, not permissible within the meaning of the first amendment."12/

Under ERISA, moreover, the reach of governmental regulation may go to the very heart of the conduct of a church's religious mission through its pension board. Fiduciaries of ERISA plans are subject to the fiduciary responsibility provisions set forth in Part 4 of Title I. We fully subscribe to the objectives underlying these fiduciary responsibility provisions. However, because of the differences in purposes, programs and sources of funds of church pension

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10/ Caulfied v. Hirsch, 95 LRRM 3164 (E.D. Pa. 1977).

11/ Catholic Bishop of Chicago v. N.L.R.B., 559 F.2d 1112 (7th Cir. 1977).

12/ 95 LRRM 3164, 3179.

boards and the intimate involvement of such boards in the conduct of their church's religious functions, we believe that the application of Part 4, Title 1 to church pension boards would give rise to serious conflicts between such boards and the federal government concerning the investment of their funds and the purposes for which such funds could be expended.

For example, as we have previously explained, our pension board is generally responsible for the maintenance of the ministers, missionaries and lay personnel of the denomination, and their families. Substantial sums have been donated to the Board as endowment funds to enable it to carry out this general corporate purpose. Other funds have been paid to the Board as "premiums" for contractual benefits under the retirement, disability, medical and death benefit programs. The ABC Retirement Plan is a variable annuity plan under which a separate account is maintained for each participant, whose annuity benefits under the Plan are based upon the value of this account. However, in order to protect retired participants from a severe drop in income should investment experience be adverse, the Board has obligated itself to use its endowment funds to supplement the variable annuity benefits to the extent necessary to maintain retirement income at specified minimum levels. Thus, the minimum levels of income are "guaranteed" by the

Board's endowment funds, which the Board also uses for many other purposes not related to the employee benefit plans -- such as emergency assistance, salary maintenance for ministers, grants-in-aid to persons with inadequate incomes, and counselling of ministers in regard to retirement and other matters. If ERISA applied to the Board's plans, the federal government would be placed in the position of determining the extent to which the Board's endowment funds could be used for the board's general corporate purposes (as distinguished from employee benefit plan purposes). This, we believe, would give rise to an unconstitutional regulation by the government as to the use of moneys donated to the Board for its religious purposes. Other conflicts and confrontations[13/] could arise under the fiduciary responsibility provisions because of the fact that our Board -- like many other church pension boards -- is not merely a "pension" fund but has broad religious purposes as well.

Another area that involves a high potential for governmental entanglement in the affairs of churches is

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13/ For example, the endowment funds of our Board are sometimes loaned to American Baptist organizations that need financing for projects that are within the scope of the Board's general corporate purposes. If ERISA applied to our church plans and the endowment funds were held to constitute plan assets, the Board would be prohibited from making such loans because of the provisions of section 406. Such application of ERISA's prohibited transaction rules would seem clearly to interfere with the conduct of church functions in violation of the First Amendment.

Title IV of ERISA, regarding plan termination insurance. Church plans subject to Title IV would be required to pay the plan termination insurance premiums therein provided -- a burden of questionable constitutionality if imposed upon churches without their consent. Church plans covered by Title IV would also be subject to examination of books and records, and the church employer could be subject to contingent liabilities potentially leading to governmental liens and foreclosures upon church assets to satisfy such liabilities. These are some of the "entanglements" that led Congress to exempt church plans from the provisions of Title IV.

Meeting the plan participation requirements of Title I could also impose a burden upon some churches in violation of their constitutional rights. Our Board makes a strenuous effort to encourage all American Baptist local churches to cover under our benefit plans all of their employees, both ordained and lay. However, we have no power to compel a church to do this, and some churches simply do not have the financial resources to do so. In such situations a church may decide, as a matter of priorities, that it will cover its minister from the time he is first employed by the church, but it will not cover its lay employees (sexton, secretary, etc.) until they have been employed for a number of years. Such an arrangement might violate the ERISA participation standards, so that the church might be forced to terminate the coverage of its minister because it is not financially able to provide coverage for all of its employees. We question whether the government can burden in this manner the freedom of a church to employ its minister on such terms as it deems appropriate in the management of its own internal affairs.

In summary, we believe that serious constitutional questions will be raised if section 414(e), defining "church plans", is interpreted too narrowly, thereby causing the disqualification of church plans for reasons that were not clearly contemplated by Congress.

3. Summary of Comments Regarding the Proposed Regulations

In the light of the preceding discussion, we believe that certain modifications should be made in the proposed regulations in order to enable "church plans" to continue to function effectively in meeting their responsibilities to their respective denominations, while at the same time preserving their exempt status under ERISA. The changes that we suggest are as follows:

a. Coverage of ministers and lay employees not currently employed by a Baptist employer

As previously stated, the American Baptist denomination has charged our Board with the responsibility of providing for the welfare of ministers, missionaries and lay employees who have served the American Baptist denomination. The large majority of ministers carry out their ministry by serving as employees of local churches and other constituent bodies of the denomination. However, there is no authority within the American Baptist denomination that can direct a minister to serve in one capacity or another. Ministers are free to pursue their ministries as their consciences dictate.

In this connection, it may be noted that rulings issued by the Internal Revenue Service under Section 107 of the Internal Revenue Code, relating to parsonage allowances, recognize that a minister can serve his denomination without being employed by a member church. Thus, the Service has held that a minister's services are in the exercise of his ministry, and therefore the minister can exclude a bona fide parsonage allowance, if he is a traveling evangelist,[14/] a university chaplain,[15/] or a civilian chaplain or other employee of the United States, a state or a political subdivision.[16/]

Many American Baptist ministers carry on their ministry in a capacity other than as an employee of a Baptist

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14/ Rev. Rul. 64-326, 1964-2 C.B.37.

15/ Special Ruling, Sept. 1, 1955, CCH 1954 Code Tr. Binder ¶37,361.

16/ Rev. Rul. 72-462, 1972-2 C.B. 76; Treas Reg. §1.107-1(a).

church or agency. American Baptist ministers can, and frequently do, pursue their ministry in the capacity of a chaplain in a prison, a university, or a hospital. American Baptist ministers may be self-employed, serving the denomination as evangelists or fund raisers for local churches. American Baptist ministers frequently serve for a part of their career in a church or agency of another denomination, or in an interdenominational organization. In addition, American Baptist ministers may be temporarily unemployed from time to time, while moving from one position to another within the denomination, or while disabled.

In all of these situations, our Board has a responsibility under our Act of Incorporation to make coverage available to an American Baptist minister under our benefit plans, even though the minister is not currently employed by a Baptist church or organization. During such a period, the minister's closest link to the denomination may be through his or her membership in our benefit plans, and it is not uncommon for these plans to be the only coverage available to the minister and his family. It is especially important, therefore, that we be able to cover ministers in these situations without losing our exemption under ERISA as a church plan.17/

17/ Similar considerations give rise to a need to continue coverage with respect to certain career lay employees while they are not currently employed by a Baptist employer, such as a lay employee who is on temporary leave of absence while performing services for an ecumenical organization, or a lay employee who is temporarily unemployed while moving from one position to another.

We submit that section 414(e) does not preclude such coverage by a church plan. Although Congress has expressly imposed limitations upon the coverage of employees of an unrelated trade or business of a church, and also (beginning in 1983) upon the coverage of church "agencies", it has not provided that a church plan shall cover exclusively persons who are current employees of a church. Accordingly, so long as a church plan is established primarily for church employees, there would appear to be no valid reason to disqualify the plan under section 414(e) merely because the plan incidentally covers some ministers and former lay employees whom the denomination has determined it has a responsibility to cover even though they are not currently employed by a church or agency of the denomination. In this regard, it is significant that section 414(e) permits a church plan to cover persons employed in an unrelated trade or business of a church, so long as this is not the primary purpose of the plan. It would be anomalous to permit such coverage of employees of unrelated businesses -- who have no connection with the religious functions of a church -- while prohibiting incidental coverage of American Baptist ministers who are pursuing their ministry outside the denominational structure as chaplains or evangelists, or in the employ of an ecumenical organization.

Moreover, a requirement that our church plan terminate coverage of an American Baptist minister when he accepts religious employment outside the denomination would be a strong deterrent to a minister's engaging in these types of activities. It seems highly doubtful that Congress intended section 414(e) to require such a result.

It is relevant to emphasize at this point that the American Baptist Churches Retirement Plan is not a "qualified" plan under section 401, et seq. of the Internal Revenue Code. It is instead a tax deferred annuity plan under which annuity contracts are purchased for American Baptist ministers and lay employees by their employers pursuant to section 403(b) of the Code. Thus, the requirements that the ABC Retirement Plan would have to meet if it were a "qualified" plan are not applicable. There is no requirement under section 403(b) that Baptist ministers and lay employees be <u>current</u> employees of a Baptist church or organization. Instead, section 403(b) merely requires that the annuity contract be purchased by an employer which is a section 501(c)(3) organization. Accordingly, a Baptist minister who is currently working for an ecumenical organization, or as a chaplain in a hospital, can obtain the tax benefits of section 403(b) if his section 501(c)(3) employer purchases an annuity contract for him under the ABC Retirement Plan.[18]

18/ A minister working as a self-employed evangelist apparently cannot qualify for the tax treatment provided by section 403(b) because he is not an "employee." However, such a minister may wish to obtain coverage under the ABC Retirement Plan on a non-tax-deferred basis. It would seem that we should be able to make such coverage available without having the plan lose its status as a "church plan."

Since the ABC Retirement Plan is not subject to the criteria that apply to "qualified" plans under the Internal Revenue Code, our primary concern is in maintaining the status of the ABC Retirement Plan as an exempt church plan under Titles I and IV of ERISA. Since the same definition of "church plan" applies for purposes of Titles I and IV of ERISA[19/] and section 414(e), it is extremely important that the regulations under section 414(e) not impose upon section 403(b) church plans limitations that properly should be applied only to "qualified" plans. A requirement that a "church plan" cover only persons who are currently employed by the church would have this result and would, we submit, therefore be unwarranted.

b. The need for a standard of substantial compliance in determining whether a section 403(b) church plan qualifies under section 414(e)

For many of the reasons discussed above, we urge that the Internal Revenue Service, the Labor Department and the Pension Benefit Guaranty Corporation adopt a standard of "substantial compliance" in determining whether a section 403(b) plan, such as the ABC Retirement Plan, qualifies as a "church plan" for purposes of section 414(e) of the Internal Revenue Code and Titles I and IV of ERISA.

It is our understanding that the large majority of denominational pension plans are section 403(b) plans funded

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19/ ERISA Section 3(33).

through annuity contracts issued by church pension boards. Because of the requirements of section 403(b), benefits under these plans (including the ABC Retirement Plan) are fully vested and fully funded with respect to all participants.

Having been established by a broad spectrum of different religious denominations to serve their own particular religious needs, there is no uniformity in the provisions of these section 403(b) plans, or the coverages provided thereunder. It seems appropriate, therefore, for the responsible governmental agencies to take these historical differences into account in formulating regulations defining "church plans". If this is not done, some denominational plans may find themselves retroactively denied "church plan" status on the basis of regulations adopted several years after the enactment of ERISA, while other denominational plans will be more fortunate and have their "church plan" status approved because their denominational structures happen to fit within the regulations. It seems highly unlikely that Congress intended to favor some section 403(b) church plans and penalize others merely because of historical differences in denominational structures, practices and beliefs. Moreover, such a position would appear to raise serious questions under the First Amendment because, as Justice Black stated in Everson v. Board of Education, the Federal government cannot "prefer one religion over another."[20/]

These considerations appear to be relevant to the provision in § 1.414(e)-1(a) of the proposed regulations that if at any time during its existence a plan is not a church plan because of a failure to meet the requirements of the regulations, it cannot thereafter become a church plan. This provision is likely to lead to the very types of entanglements and confrontations between government and religion which the church plan exemption in ERISA was intended to avoid. An innocent mistake in the operation of a section 403(b) church plan (such as the participation of a single employer or employee later determined to be ineligible) could have the effect of permanently subjecting the plan to the regulatory provisions of Titles I and IV of ERISA. Such a situation is distinguishable from a case in which a church plan voluntarily elects to become subject to ERISA, thereby waiving its Constitutional immunities under the First Amendment. We therefore urge that this provision be deleted from the final regulations.

c. The Inclusion of Church Pension Boards Within the term "Church"

We have previously set forth the factual basis for the inclusion of our Board within the term "church" as

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20/ 330 U.S. 1, 15 (1947).

described in § 1.414(e)-1(e) of the proposed regulations, and we have requested that this conclusion be made explicit in the final regulations by the addition of an appropriate example. We should also like to point out that this Board has approximately 70 employees, all of whom are covered by the ABC Retirement Plan and our other employee benefit plans. If this Board is not determined to be included within the term "church" for purposes of the "church plan" definition in ERISA, then a question will be raised as to whether this Board will be required to terminate the coverage of its own employees under the existing plans before January 1, 1983 in order to preserve the church plan status of these plans after that date. Such a requirement would seem to be difficult to justify on any basis, and we submit that it is not consistent with purposes underlying the "church plan" exemption in ERISA.

We respectfully request that the suggestions set forth in this letter be adopted in the final regulations. We shall be happy to provide the Service with any further information which would be helpful in the formulation of the final regulations.

Sincerely yours,

Dean R. Wright
Executive Director

ERISA AND THE CHURCHES

It seems safe to say that very few Federal statutes in recent memory have attracted as much attention, or have given rise to as much debate, as the Employee Retirement Income Security Act of 1974, familiarly known as ERISA.

When ERISA was signed into law on September 2, 1974, President Ford called it the most important piece of social legislation since the enactment of the Social Security Act in 1934. The purpose of ERISA was nothing less than to reform the private pension system in the United States. The need for such reform in certain areas had been well documented. A leading authority in the field of pensions, Dr. Dan Magill of the University of Pennsylvania, summarized the regulatory situation prior to ERISA as follows:

> "Despite the fact that pension plans in the private sector of the economy were holding out the promise of retirement and other benefits to almost half of the nonagricultural work force..., and had accumulated an estimated 175 billion of assets to meet benefit promises, they were subject to only peripheral regulation prior to 1974."

There were, of course, a number of state and Federal laws that dealt with various aspects of the private pension system. However, "there was no single law or body of law designed to regulate the totality of the private pension institution."

Such laws as then existed proved ineffective in some cases in preventing abuses such as the siphoning-off of plan assets through transactions tainted by conflicts-of-interest, self-dealing, imprudent investment practices and other breaches of fiduciary duty. In addition, even in cases where abuses of these kinds did not exist, workers were sometimes denied benefits, which they rightfully expected to receive, because of unreasonable pension plan requirements regarding the vesting of benefits, or because of the failure of some employers to make adequate contributions to their plans in order to fund the benefits on a sound actuarial basis. Although only a relatively small portion of the total number of employees covered by private pension plans were affected by such abuses and inequities, Congress properly decided to put an end to them by the enactment of ERISA.

However, ERISA did not limit itself to these major areas that were in need of reform. Instead, ERISA went on with a seemingly endless stream of incredibly detailed and complex rules regulating virtually every aspect of every type of employee benefit plan. To insure that these rules would be faithfully observed, Congress gave extensive enforcement powers to the Internal Revenue Service and the Department of Labor--and also created a new Federal agency--the Pension Benefit Guarantee Corporation--to assure the payment of retirement benefits in those situations where pension plans are terminated before adequate contributions have been made to provide the benefits promised in the plans. Congress also gave to each participant in an employee benefit plan covered by ERISA the private right to sue in the Federal courts in order to enforce the provisions of the law. Finally, having created such a comprehensive system of Federal regulation, Congress declared that ERISA would supersede and preempt all state laws applicable to the covered employee benefit plans.

In view of the powerful forces that led to the enactment of ERISA, it is highly significant that Congress allowed one--and onlv one-segment of the private pension community to be exempted from the tidal /ave of regulation brought on by ERISA. The single exception which Congress allowed was for church plans. "Government plans" were also exempted, but they are, of course, public and not private plans. As to church plans, Congress provided that they would be covered by ERISA only if they voluntarily elected to be covered.

Unfortunately, in writing the definition of an exempt church plan, Congress took a more restrictive view than the churches would have liked. What Congress attempted to do was to divide the myriad institutions through which religious denominations carry on their work into two baskets. It put into Basket One those institutions which it referred to as "churches or conventions or associations of churches," and it put into Basket Two those institutions which it referred to as "agencies of a church or a convention or association of churches." Congress provided that until December 31, 1982 a church plan could cover employees of institutions in both of these baskets. However, after December 31, 1982 a church plan could cover only employees of institutions in Basket One. In other words, after December 31, 1982 an exempt church plan could cover only employees of churches or conventions or associations of churches, but it could not cover employees of so-called church agencies.

It was recognized almost immediately after ERISA was enacted that the different treatment accorded churches and church agencies would give rise to difficult problems that would ultimately have to be met. However, the 1982 deadline was then eight years away and no immediate action was required. The sitution changed abruptly on April 8, 1977. On that date the Internal Revenue Service issued proposed regulations implementing and interpreting the statutory language defining an exempt church plan. After studying these regulations the churches realized that they had a problem which required immediate action if they wished to preserve the immunity of their employee benefit plans from Federal regulation under ERISA.

Accordingly, a coalition of 25 religious denominations was formed to decide upon and carry out a program of action to deal with these crucial problems. This coalition adopted the name Church Alliance for Clarification of ERISA. The Ministers and Missionaries Benefit Board is a member of the Church Alliance and has participated actively in its work over the past year.

The Church Alliance decided that its first order of business should be to present to the Treasury Department and the Internal Revenue Service written objections regarding certain portions of the proposed regulations. These objections were filed on May 20, 1977, and in October 1977 representatives of the Church Alliance appeared at a hearing on the proposed regulations in Washington, D. C. before a panel of officials from the Treasury Department, IRS, Department of Labor and PBGC. A statement on behalf of American Baptist Churches was presented by its General Secretary, Robert C. Campbell.

It was evident from the comments made by the government representatives at the hearing that they had very little knowledge or understanding of church pension plans and the important differences that exist between these plans and the pension plans of business corporations and other organizations in the private sector. It therefore appeared that an urgent need existed to educate the government representatives concerning church pension plans. In November 1977, Dean R. Wright, Executive Director of The Ministers and Missionaries Benefit Board of American Baptist Churches, filed with the IRS and other governmental agencies involved a letter of some 29 pages describing the origins, structure and method of operation of The Ministers and Missionaries Benefit Board, and also pointing out the important constitutional considerations which motivated Congress to exempt church plans from ERISA. The efforts of the Church Alliance in heading off the issuance of regulations which could have been very harmful to church plans appear to have met with some success because no final regulations have as yet been issued.

The Church Alliance next turned its attention to the preparation and promotion in the Congress of four bills to correct what the churches perceive to be defects in the treatment of church plans and their participants under present law. Two of these bills, which are noncontroversial, would amend the Internal Revenue Code to provide more equitable tax treatment for ministers and other participants in church retirement programs who need to make greater contributions during the latter stages of their careers in order to provide a more adequate level of income after retirement. While these two bills are important, they do not deal with questions that are crucial to the churches. The third and fourth bills do deal with such crucial questions.

The purpose of these bills--H.R. 12172 and H.R. 12312--is to revise the church plan definition in ERISA so as to enable church pension organizations, such as The Ministers and Missionaries Benefit Board, to continue to serve the needs of their denominations by providing retirement, insurance. medical and other benefits to the ministers and lay employees of the denomination without becoming subject to ERISA. These bills were introduced in the House of Representatives during April by Rep. Barber Conable of New York. Senator Herman Talmadge of Georgia, and Senator Lloyd Bentsen of Texas, have agreed to co-sponsor the bills in the Senate.

At this point it seems appropriate to explain some of the reasons why American Baptist Churches and other religious denominations consider these bills to be so important. From the standpoint of The Ministers and Missionaries Benefit Board, these reasons are as follows:

1. The application of ERISA to retirement and other benefit plans established by religious denominations would raise questions of church-state relations under the First Amendment of the U.S. Constitution. The possibility

of such a church-state confrontation was recognized by Congress, as evidenced by the statement in the Senate report explaining why church plans were not made subject to the plan termination insurance requirements of ERISA. This report states:

> "The committee is concerned that the examination of books and records that may be required in any particular case as part of the careful and responsible administration of the insurance system might be regarded as an unjustified invasion of the confidential relationship that is believed to be appropriate with regard to churches and their religious activities."

Although this statement was made with reference to the plan termination insurance provisions, it seems clear that the same reasoning underlay the exemption accorded to church plans under other parts of ERISA.

By exempting church plans from ERISA, Congress was endeavoring to adhere to the long-established principle of separation of church and state as expressed in the First Amendment. Decisions of the Supreme Court in recent years have held that where a statute calls for governmental action that raises a question under the religion clauses of the First Amendment, in order to be constitutional "the statute must not foster an excessive government entanglement with religion." We and the other Church Alliance members believe than an excessive entanglement would result if ERISA were applied to church plans. It is therefore important to take effective steps to prevent this situation from arising.

2. ERISA contains extensive rules regarding the investment of assets of employee benefit plans, and the purposes for which such assets may be disbursed. These rules, which in some cases are quite rigid, are appropriate for the typical employee benefit plans with which ERISA is concerned. In such typical plans, contributions are made to a fund by the employer, or the employees, or both, for the purpose of providing benefits that are specified in the plan. ERISA provides that the assets of such plans shall be used for the <u>exclusive</u> purpose of providing benefits to participants and beneficiaries and <u>defraying</u> reasonable expenses of administering the plans.

The Ministers and Missionaries Benefit Board does, of course, administer several employee benefit plans. However, unlike the typical situation to which ERISA applies, that is not the exclusive purpose for which the Board was established. Instead, the Board has a much broader mandate which requires it to administer its funds for the benefit of the ministers, missionaries and lay employees of the denomination, and also to promote the better maintenance of the ministry. In carrying out these charter responsibilities, the Board is frequently called upon to expend its funds for the benefit of persons who are not members of its benefit plans.

Moreover, a number of the Board's programs fall outside the context of its benefit plans, such as salary maintenance for ministers, emergency assistance, grants-in-aid to persons with inadequate income and counseling of ministers in regard to retirement and other matters. The funds needed to carry on these programs are provided by the Board's endowment, which has been derived from contributions and bequests made to the Board by many generous donors since the Board was founded in 1911. The endowment also "guarantees" the minimum levels of retirement income that are specified in the Guarantees and Obligations adopted by the Board in connection with the ABC Retirement Plan.

If ERISA applied to the Board's benefit plans, the Federal government would be placed in the position of determining the extent to which the Board's endowment funds could be used for the Board's general corporate and religious purposes, as distinguished from benefit plan purposes. It is not believed that this is a proper function of government, or that Congress intended such a result. Accordingly, it is important that the statute be amended to make clear that The Ministers and Missionaries Benefit Board, and similar boards of the other denominations, may continue to operate as they have in the past without being subject to ERISA requirements that were designed for a different type of organization having no religious purposes.

Also, if ERISA applied to the ABC Retirement Plan, it is quite possible that substantial premiums ($13,000 in 1978) would be payable to the PBGC each year under the plan termination insurance program. Since the ABC Retirement Plan is fully funded, it is difficult to see how the participants in the Retirement Plan would benefit from such premium payments, which constitute, in effect, a tax levied by the Federal government on private pension plans.

3. Meeting the participation standards of ERISA could impose a burden upon some churches. The Ministers and Missionaries Benefit Board, of course, makes a strenuous effort to encourage all American Baptist local churches to cover all of their employees, both ordained and lay, under the Board's benefit plans. However, the Board has no power to compel a church to do this and some churches may lack the financial resources to do so. In such a situation a local church may decide, as a matter of priority, that it will cover its minister from the time he or she is first employed by the church, but it will not cover its lay employees until they have been employed for a number of years and thereby attained a "career" status. Such an arrangement might violate the ERISA participation standards, forcing the church to terminate the coverage of its minister because it is not financially able to provide coverage for all of its employees. It seems questionable whether the government should interfere in this manner with the freedom of a church to employ its minister and lay employees on such terms as it deems appropriate in the management of its own internal affairs.

4. Under the existing statute, it is possible that a church plan might lose its exemption under ERISA if it covers a minister who is not an employee of a church (or until December 31, 1982, an employee of a church agency). However, numerous Baptist ministers pursue their ministries from time to time by serving outside the formal denominational structure. Examples would be Baptist ministers employed as chaplains in hospitals, prisons or colleges, or teaching religious studies in an educational institution, or serving as self-employed evangelists. It is important to such ministers, and to the denomination, that their membership in the Board's benefit plans be maintained during

such period of service as a minister outside the denomination. The proposed bills would make clear that this can be done without jeopardizing the exempt status of the plans under ERISA.

A similar question exists under present law with respect to the coverage of Baptist ministers or lay employees who are not currently employed because they are disabled or in transition from one job to another. The proposed bills would eliminate this question and allow such coverage.

5. The present statute fails to recognize the fact that the American Baptist employee benefit plans, as well as most church plans of congregational denominations, have historically been administered by a corporate entity that is separate from, but controlled by, the denomination. The statute is not clear as to whether such a plan may qualify as an exempt church plan under ERISA. This question would be resolved by the proposed bills.

6. In its proposed regulations the Treasury Department took the position that if a church plan should ever, at any time or for whatever reason, fail to meet the requirements of a church plan it can never thereafter regain its exempt status under ERISA. This position is unnecessarily harsh because a failure to meet the requirements of a church plan may result from insignificant violations of rules that are not now clearly defined and will take years to resolve. The proposed bills would give a church plan which has violated the applicable rules an opportunity to correct the violation and thereby retain its exemption from ERISA. Such a provision seems essential to the orderly functioning of church plans.

7. The problem that is of the greatest concern to a number of the denominations is the so-called church agency problem. As previously mentioned, under present law a church plan cannot retain its ERISA exemption after December 31, 1982 if it continues to cover employees of church agencies. Examples of church agencies would be any of the following organizations which is affiliated with a church or a convention or association of churches: a hospital, a school or college, a nursing home, a retirement home, a drug-abuse center, or a children's home or camp.

The Church Alliance has taken the position that because of the close relationship that exists between churches and their affiliated agencies, it is essential that the employees of the agencies be eligible for coverage under the benfit plans of the church. If this is not permitted, the agencies will have only two alternatives; that is, either to establish ERISA plans for their employees or to terminate their plans on December 31, 1982. Because of the expense and redtape connected with establishing ERISA plans, it is feared that many agencies will choose to terminate their plans, thus depriving their employees of benefits which they are now receiving as members of the church plan. Also, it is believed that if agency employees are not allowed to participate in church plans, the mobility of church employees within the denomination will be greatly restricted. The proposed bills would permit the continued coverage of agency employees in church plans after December 31, 1982.

These are some of the problems that have led the members of the Church Alliance to attach so much importance to the enactment of the proposed bills.

It is not an overstatement to say that if the bills are not enacted, the consequences for all religious denominations will be very serious. The type of regulation mandated by ERISA is simply not appropriate for an organization with a religious history and purpose such as The Ministers and Missionaries Benefit Board and the pension boards of the other religious denominations.

It is important to emphasize that the desire of the Board, and the other members of the Church Alliance, to be exempt from ERISA is not based upon a view that the employees of churches and their agencies should be denied the protections of ERISA. In the case of the plans of The Ministers and Missionaries Benefit Board, most of these protections are already provided. The ABC Retirement Plan is fully funded, and members' benefits thereunder are fully vested at all times. The Board's investments are professionally managed in accordance with the highest fiduciary standards applicable to organizations of its type under New York law. The reports of the Board's operations, as audited by its independent certified public accountants, are regularly provided to the governing bodies of the denomination and are freely available to other interested persons. To the extent possible, the Board has encouraged all American Baptist churches and employing organizations to provide participation under the Board's benefit plans for all of their employees, both ordained and lay. And the Board has made a consistent effort to communicate the provisions of its benefit plans to all participants.

Accordingly, it would seem that there is little that ERISA would add to this picture, except increased administrative costs and unwarranted governmental involvement in the administration of an essential church function. It is therefore hoped that when called upon to do so, the members of the Board will help to communicate to the denomination-at-large, and to the Congress, the importance of the legislation that is being sought by the Board and the Church Alliance for Clarification of ERISA.

Prepared by John P. Persons, Attorney-at-Law, Patterson, Belknap, Webb & Tyler, for meeting of Board of Managers of The Ministers and Missionaries Benefit Board of American Baptist Churches, May 23, 1978.

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By Mr. TALMADGE (for himself and Mr. Bentsen):

S. 3132. A bill to amend the Internal Revenue Code of 1954 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan; to the Committee on Finance.

S. 3133. A bill to amend the Employee Retirement Income Security Act of 1974 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan; to the Committee on Finance and the Committee on Human Resources, jointly, by unanimous consent.

DEFINITION OF CHURCH PLAN

Mr. TALMADGE. Mr. President, with my colleague, Senator BENTSEN of the State of Texas, I am introducing bills to amend the definition of "church plan" found at section 414(e) of the Internal Revenue Code and section 3(33) of the Employee Retirement Income Security Act of 1974. All of the major church denominations in this country—Protestant, Catholic, and Jewish—are of one accord in this matter. They need and desire relief.

When we enacted ERISA in 1974, we set 1982 as the date beyond which a church plan could no longer provide retirement and welfare benefits for employees of church agencies. We also forbade the church plans to provide any new agency coverage after 1974. Moreover, as I will explain later, the church plan definition is so narrow that it almost completely fails to consider the way our church plans have for decades operated. At this moment our churches are justifiably concerned that their plans do not meet the church plan requirements and are, therefore, subject to ERISA. In 1974, we did not recognize the unique character and needs of our church plans.

The church plans in this country have historically covered both ministers and lay employees of churches and church agencies. These plans are some of the oldest retirement plans in the country. Several date back to the 1700's. The average age of a church plan is at least 40 years. To comply with ERISA by 1982, the churches must divide their plans into two so that one will cover church employees and the other, agency employees. It is no small task to break up a plan that has been in existence for decades, even centuries.

The estimated legal, actuarial, and accounting costs of the initial division of church plans and the additional continuing costs of maintaining two separate plans are so significant that reduced retirement and other benefits may result unless they can be assimilated. To offset these additional costs, the churches are confronted with a very large, and possibly not absorbable, economic burden, merely to provide pre-ERISA level of benefits. There is no imposition by ERISA of such moment on the plans of other organizations.

Church agencies are essential to the churches' mission. They care for the sick and needy and [illegible] religious instruction. They are [illegible] part of the churches. As a [illegible] matter, it is doubtful that the agency plans would survive subjection to ERISA. There is an essential difference between the plans of business and the plans of church institutions. If a business incurs increased plan maintenance costs, it merely passes these on to the consumer. The incomes of most church agencies, on the other hand, are dependent solely upon tithes and other offerings. There is virtually no way for them to compensate for the additional costs of complying with ERISA. The churches fear that many of the agencies would abandon their plans. We are concerned today that the requirements of ERISA has made the maintenance of plans too expensive and demanding even for businesses which have the capacity to absorb additional costs. The impact of ERISA on church agencies would be many times as serious as that on businesses.

Ministers and lay employees have a unique need to be covered by one plan. Employment is extremely fluid within our denominations. A minister will frequently move from church to agency, or wherever his services are most needed. If he cannot be covered by one plan, gaps in coverage may occur because the agency may not have a plan or may have a waiting period before participation. If the church plan definition is allowed to remain, ministers and lay employees will not be able to pursue their missions nearly as freely as they have in the past. It is inescapable that the way our churches have functioned will be directly affected.

As I mentioned earlier, the church plan definition is so narrowly drawn that it does not in many ways even approximate the way church plans are organized or operated. For example, this definition can be interpreted to require a minister or lay employee of a church to be a current employee. Many ministers serve their faith outside the denominational structure—as chaplains in prisons, hospitals, universities, and elsewhere. Evangelist ministers are usually self-employed and have no employer. There is no valid reason for denying these persons the benefits of retirement and welfare coverage.

This type of problem is less apt to occur in a hierarchical denomination because a minister may continue to be considered an employee even though he is serving outside the church structure.

Most church plans of congregational denominations are administered by a pension board. This is usually an organization separately incorporated from, but controlled by, the denomination. Under the church plan definition, there is a question whether the plan is established by a church, as it must be, or by a pension board. This requirement also points up the inapplicability of the church plan definition to congregational churches. In this type of church, the denomination has little, if any, control over the local churches. Some differences in plan provisions occur because the denomination cannot enforce uniformity, and the question whether the plan is maintained by the denomination or by the local churches is raised.

The inability of a congregational denomination to control its agencies makes it difficult to see how the church agency plan could meet the requirements of ERISA. In a corporate structure lines of authority are clear. One plan covering the employees of a parent and its subsidiaries can easily meet the requirements of law because of the control executed by the parent. As I have stated, a congregational denomination cannot force the agencies to observe the requirements of ERISA. Accordingly, there is little hope that a plan established by a congregational church for its agencies could comply with ERISA.

Mr. President, these and other problems over the church plan definition under present law confront the churches today. They are worried that their plans do not now meet the church plan requirements and concerned over the impending restructuring of their plans. It is time we remove the churches from this statutory cloud. If we have enacted a statute that may require the church plans to come under ERISA, file reports, be subject to the examination of books and records and possible foreclosure of church property to satisfy plan liabilities, it must be changed because we have clearly created an excessive government entanglement with religion.

Under the provisions of our bills, effective as of January 1, 1974, a church plan shall be able to continue to cover the employees of church-associated organizations. There will be no need to separate the employees of church agencies from the church plan. The bills retain the definition of church plan as a plan established and maintained for its employees by a church or by a convention or association of churches exempt from tax under section 501. However, to accommodate the differences in beliefs, structures, and practices among our religious denominations, all employees are deemed to be employed by the denomination. The term employee is also redefined to include: One, a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry; two, an employee of an organization which is exempt from tax and which is controlled by or associated with the church; and three certain former employees who participated in the church plan before separation from service.

Under the bill an organization is "associated" with a church if it shares common religious bonds and convictions with that church. Thus, by including an ordained minister as an employee without the requirement of an actual employment relationship, the church plan may continue to cover a minister who serves outside of the denominational structure, provided the service is in the exercise of his ministry. Accordingly, a minister serving as a prison chaplain or teaching religious studies at a university or an evangelist minister who has no employer would be entitled to participate in the church plan.

Under the bills a church plan will not have to remove from its rolls an employee who has left the denominational group but may retain his accrued benefit or account for the eventual payment of benefits under the plan. There is no real reason why a church plan should be forced to pay a former employee his accrued benefit in cash and, thus, destroy his retirement benefits. Some denominations continue to accept plan contributions for disabled employees and, temporarily, for employees who have separated from service. A minister or lay employee may reach a point in his career where he wants time to decide whether he will spend the rest of his life in the service of the church. During this period the denomination may permit the individual to continue to be covered by the church plan even though he is separated from service. Under the bills a church plan may continue to receive contributions for an individual who is a participant in the church plan at the time of his separation from service but only for a period of 5 years. A time limit is not placed upon employees who separated from service because of disability.

A plan or program funded or administered through a pension board, whether a civil law corporation or otherwise, will be considered a church plan, provided the principal purpose or function of the pension board is the administration or funding of a plan or program for the provision of retirement or welfare benefits for the employees of a church. The pension board must also be controlled by or associated with a church exempt from tax under section 501. No church plan administered or funded by a pension board would be disqualified merely because it is separately incorporated or merely because of variations in the plan provisions among the local employers.

The bill also corrects a very harsh position taken by the Treasury Department in its proposed regulations defining church plans. These proposed regulations provide that once a church plan fails to meet the requirements of church plan it can never thereafter be a church plan. This rule requires perpetual disqualification of church plan status for the smallest violation of rules that are not now clearly understood and that will take years to resolve.

Our bills provide a mechanism whereunder a church plan will be disqualified as such only after it receives appropriate notice that it has violated the church plan requirements and does not within a certain period of time correct its default. The term "correction" as used in the bill is not intended necessarily to require a church plan to undo the default completely or to put itself and other parties in precisely the same position they would have been in had the default never occurred. The degree of correction required should depend upon the equities of the situation.

For example, a possible violation of the church plan requirements would be the coverage of an impermissible number of individuals who are not defined as employees. A complete correction of this type of default would require the plan to refund to these individuals all contributions made on their behalf. Such a correction may cause the distributions to be included in the incomes of innocent persons and, hence, work a hardship on them.

In this type of situation, the default should be considered corrected if the church plan were permitted to retain the accrued benefits or accounts of these individuals for the eventual payment of benefits upon their death or retirement. But the plan should accept no further contributions with respect to them.

Therefore, Mr. President, I urge my distinguished colleagues to support these measures and I ask unanimous consent that the bills be printed in the RECORD.

There being no objection, the bill were ordered to be printed in the RECORD, as follows:

S. 3172

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

SECTION 1. Section 414(e) of the Internal Revenue Code of 1954 is amended to read, as follows:

"(e) CHURCH PLAN.—

"(1) IN GENERAL.—For purposes of this part the term 'church plan' means a plan established and maintained (to the extent required in paragraph (2)(B)) for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501.

"(2) CERTAIN PLANS EXCLUDED.—The term 'church plan' does not include a plan—

"(A) which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513); or

"(B) which includes individuals less than substantially all of whom are described in paragraphs (1), (3)(B), or (3)(E) (or their beneficiaries).

"(3) DEFINITIONS AND OTHER PROVISIONS.—For purposes of this subsection—

"(A) A plan established and maintained by a church or by a convention or association of churches shall include a plan established and maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both for the employees of a church or a convention or association of churches if such organization is controlled by or associated with a church or a convention or association of churches.

"(B) The term 'employee' of a church or a convention or association of churches shall include—

"(i) a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation;

"(ii) an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 and which is controlled by or associated with a church or a convention or association of churches, and

"(iii) an individual described in paragraph (3)(E).

"(C) A church or a convention or association of churches which is exempt from tax under section 501 shall be deemed the employer of any individual included as an employee under paragraph (3)(B).

"(D) An organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

"(E) If an employee who is included in a church plan separates from the service of a church or a convention or association of churches or an organization described in clause (ii) of paragraph (3)(D), the church plan shall not fail to meet the requirements of this subsection merely because it—

"(i) retains his accrued benefit or account [illegible] the payment of benefits to him or his [illegible]ficiaries pursuant to the terms of the [illegible], or

"(ii) receives contributions on his behalf after his separation from such service, but only for a period of five years after the employee's separation from service, unless the employee is disabled (within the meaning of the disability provisions of the church plan or, if there are no such provisions in the church plan, within the meaning of section 72(m)(7)) at the time of such separation from service.

"(4) CORRECTION OF FAILURE TO MEET CHURCH PLAN REQUIREMENTS.—If a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 fails to meet one or more of the requirements of this subsection and, corrects its failure to meet such requirements within the correction period, the plan shall be deemed to meet the requirements of this subsection for the year in which the correction was made and for all prior years. If a correction is not made within the correction period, the plan shall not be deemed to meet the requirements of this subsection beginning with the date on which the earliest failure to meet one or more of such requirements occurred. The term 'correction period' means the period ending with the later of the following: (1) 270 days after the date of mailing by the Secretary of a notice of default with respect to the plan's failure to meet one or more of the requirements of this subsection; (2) such period as may be set by a court of competent jurisdiction after a determination [illegible] has become final that the plan fails [illegible] meet such requirements, or, if the final court determination does not specify such period, a reasonable period depending upon all the facts and circumstances, but in any event not less than 270 days after the determination has become final; or (3) any additional period which the Secretary determines is reasonable or necessary for the correction of the default."

SEC. 2. The amendments made by this Act shall be effective as of January 1, 1974.

S. 3182

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

SECTION 1. Section 3(33), title I, of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"(33)(A) The term 'church plan' means a plan established and maintained (to the extent required in clause (ii) of subparagraph (B)) for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954.

"(B) The term 'church plan' does not include a plan—

"(i) which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513 of the Internal Revenue Code of 1954), or

"(ii) which includes individuals less than [illegible] [illegible] subparagraph (A) and in clauses (iii) and (iv) of subparagraph (C) (or their beneficiaries).

"(C) For purposes of this paragraph—

"(i) A plan established and maintained by a church or by a convention or association of churches shall include a plan established and maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.

"(ii) The term 'employee' of a church or a convention or association of churches shall include: a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation, an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of the Internal Revenue Code of 1954 and which is controlled by or associated with a church or a convention or association of churches; and an individual described in clause (v) of subparagraph (C).

"(iii) A church or a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954 shall be deemed the employer of any individual included as an employee under clause (ii) of subparagraph (C).

"(iv) An organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

"(v) If any employee who is included in a church plan separates from the service of a church or a convention or association of churches or an organization, whether a civil law corporation or otherwise, which is exempt from tax under s[illegible]ion 501 of the Internal Revenue Code of 1954 and which is controlled by or associated with a church or a convention or association of churches, the church plan shall not fail to meet the requirements of this paragraph merely because it: retains his accrued benefit or account for the payment of benefits to him or his beneficiaries pursuant to the terms of the plan; or receives contributions on his behalf after his separation from such service, but only for a period of 5 years after the employee's separation from service, unless the employee is disabled (within the meaning of the disability provisions of the church plan or, if there are no such provisions in the church plan, within the meaning of section 72(m)(7) of the Internal Revenue Code of 1954) at the time of such separation from service.

"(D) If a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954 fails to meet one or more of the requirements of this paragraph and corrects its failure to meet such requirements within the correction period, the plan shall be deemed to meet the requirements of this paragraph for the year in which the correction was made and for all prior years. If a correction is not made within the correction period, the plan shall not be deemed to meet the requirements of this paragraph beginning with the date on which the earliest failure to meet one or more of such requirements occurred. The term 'correction period' means the period ending with the later of the following: (i) 270 days after the date of mailing by the Secretary of a notice of default with respect to the plan's failure to meet one or more of the requirements of this paragraph; (ii) such period as may be set by a court of competent jurisdiction after a determination that has become final that the plan fails to meet such requirements, or, if the final court determination does not specify such period, a reasonable period depending upon all the facts and circumstances, but in any event not less than 270 days after the determination has become final; or (iii) any additional period which the Secretary determines is reasonable or necessary for the correction of the default."

SEC. 2. The amendments made by this Act shall be effective as of January 1, 1974.

Mr. ROBERT C. BYRD. Mr. President, I ask unanimous consent that S. 3182, to amend ERISA, one of the bills introduced by Mr. TALMADGE, be referred jointly to the Committee on Finance and the Committee on Human Resources.

The PRESIDING OFFICER. Without objection, it is so ordered.

PENSION PLANS OF CHURCHES AND CHURCH-RELATED ORGANIZATIONS

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from New York, (Mr. CONABLE) is recognized for 10 minutes.

● Mr. CONABLE. Madam Speaker, I wish to discuss a bill, H.R. 12172, which I recently introduced to amend the Internal Revenue Code of 1954 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan. The major church denominations of this country all agree that they are seriously affected by the definition of church plan we provided in section 414(e) of the Internal Revenue Code.

For many years our church plans have been operating responsibly and providing retirement coverage and benefits for the clergymen and lay employees of the churches and their agencies. Some of the church plans are extremely old, dating back to the 1700's. The median age of church plans is at least 40 years. Churches are among the first organizations to found retirement plans in the United States.

In 1974, when we enacted the Employee Retirement Income Security Act of 1974, popularly called ERISA, we exempted church plans from the provisions of the act to avoid excessive Government entanglement with religious [illegible] the first amendment to the Constitution. We provided that a church plan is a plan established and maintained for its employees by a church or by a convention or association of churches which is exempt from tax under section 501. At the same time we provided that a church plan, if it were to continue to be identified as such, could not provide coverage to employees of church agencies not participating in the plan in 1974 nor could it provide coverage for employees of any agencies after 1982.

Mr. Speaker, I believe that our definition of church plan should be revised. It does not take into account the special needs of our churches, ministers, and lay persons, or the structural differences of our denominations.

Under the existing definition of church plan, the churches must by 1982 divide their plans into two parts, one covering employees of the church and one covering employees of church agencies. Present law fails to recognize that the church agencies are parts of the church in its work of disseminating religious instruction and caring for the sick, needy, and underprivileged. Estimates of the initial costs of the division of church plans that have been in existence for many years and of the additional continuing costs of maintaining two separate plans are so significant that reduced benefits may result.

Some of these additional costs must of necessity be shifted to the local churches and agencies. Churches and church agencies are often very small and operate marginally, being staffed by two or three persons who work at a personal sacrifice. Plan contributions for churches and agencies are generally dependent upon tithes and offerings. There is virtually no way to pass on higher plan costs to the consumer as businesses can. If forced by the 1982 deadline to establish a retirement plan separate from the denominational plan and to comply with the paperwork and other requirements of ERISA, many of the agencies might decide to abandon their retirement plans.

Mr. Speaker, the division of the church plans will also hurt the work of our churches. The churches consider their agencies as an extension of their mission. A significant number of ministers and lay employees move frequently from church to agency and back in pursuance of their careers. A church may ask a rabbi to serve in an agency where his services are most needed. The rabbi may then return to pulpit work. The present definition of church plan does not satisfy the unique need of our churches to cover continuously their employees in one plan. If ministers and lay persons cannot be continuously covered by one plan, gaps in coverage will result, and they will not be free to pursue their work for the denomination as they should.

Also, many ministers serve their faith outside of the denominational structure as chaplains in prisons, universities, hospitals, and elsewhere. In some cases the employment relationship is not easily discernible or does not exist. For example, evangelist ministers may have no employer. The present definition of church plan could be interpreted to exclude them from coverage either now or in 1982.

One of the most important binding influences within a religious denomination is the pension and welfare benefits program. The division of the church plans may lessen the unity of the church. Some churches fear that division of their plans will destroy the sense of oneness within the church and weaken the dedication of agency employees to the denomination.

Moreover, in a congregational denomination, if the plan covering the agencies is required to comply with ERISA, the denomination would not be able to require an agency either to join in the plan or to observe the requirements of ERISA. In the congregational type of denomination, the local churches and agencies are self-governing. Unlike corporate structures, no lines of authority exist from the denomination.

The existing definition of church plan has also created many technical problems. The large majority of church plans of the congregational denominations are administered by a pension board, a unit separate from, but controlled by, the denomination. It is not clear whether a plan administered by a pension board of a congregational church is a plan established and maintained for its employees by a church. A pension board is usually incorporated because the church does not want the funds set aside for retirement purposes to be subject to the general creditors of the church.

This structure raises a question whether a plan maintained by a pension board is maintained by a church. In the congregational denominations, ministers and lay employees are considered employees of the local churches and other units, rather than of the denomination. As mentioned, congregational churches have little control over local churches and agencies. Some differences in plan provisions, therefore, necessarily occur, and the question is also raised whether the plan is maintained by the church (denomination) for its employees or by a local church for its employees.

Under section 1 of the bill, effective as of January 1, 1974 a church plan may continue after 1982 to cover the employees of its church-associated organizations, both those participating in 1974 and those that begin participation after 1974. This recognizes the special nature of church agencies and of their special problems in complying with ERISA. It also recognizes the unique needs of ministers and denominational employees to move about within the denominational structure and still stay within the church plan.

The bill achieves this result by retaining the basic definition of church plan as a plan established and maintained for its employees by a church or by a convention or association of churches exempt from tax under section 501. The term "employee", however, is redefined to include: first, a duly ordained, commissioned or licensed minister of a church in the exercise of his ministry; second, an employee of an organization which is exempt from tax and which is controlled by or associated with the church; and third, certain former employees who participated in a church plan before separation from service. Under the bill an organization is "associated" with a church if it shares common religious bonds and convictions with that church.

For purposes of section 414(e), all such employees are deemed to be employed by the denomination. The combined effect of these provisions is to treat both hierarchical and congregational denominations in the same manner for purposes of the church plan definition. The bill thus, accommodates the differences in beliefs, structures, and practices among our religious denominations.

By including ordained ministers within the definition of employee without requiring an employment relationship, the bill permits a church plan to continue to cover a minister who serves in the exercise of his ministry outside of the denominational structure. Thus, a minister serving as a prison chaplain or teaching religious studies in a university could receive coverage. An evangelist minister who has no employer would also be entitled to participate in the church plan.

The bill provides that a church plan will not have to remove from its rolls an employee who has left the denominational group but may retain his accrued benefit or account for the eventual payment of benefits under the plan. Some denominations continue to accept plan contributions for disabled employees and temporarily, [illegible] employees who have separated from se[illegible]e.

A typical example would be a minister or lay employee who reaches a point in his career where he wants time to decide whether he will spend the rest of his life in the service of the denomination. During such a transitional period the denomination may permit the individual to continue to be covered by the church plan for a time even though he has separated from service.

The bill would permit a church plan to continue to receive contributions for an individual who is a participant in a church plan at the time of his separation from service, but only for a period of 5 years. No such time limit is placed upon employees who are separated from service because of disability.

The bill also recognizes pension boards as acceptable funding media for church plans. A plan or program funded or administered through a pension board, whether a civil law corporation or otherwise, will be considered a church plan, provided the principal purpose or function of this organization is the administration or funding of a plan or program for the provision of retirement or welfare benefits for the employees of a church.

The organization must also be controlled by or associated with a church exempt from tax under section 501(a). It is intended that no church plan administered or funded by a pension board would be disqualified merely because it is separately incorporated or merely because of variations in plan provisions among the local employers.

The bill also corrects a very harsh paltion taken by the Treasury Department in its proposed regulations defining church plan which provide that once a church plan fails to meet the requirements of a church plan it can never thereafter be a church plan. This rule requires perpetual disqualification of church plan status for the smallest violation of rules that are not now clearly understood and that will take years to resolve.

My bill provides a mechanism whereunder a church plan will be disqualified as such only after it receives appropriate notice that it has violated the church plan requirements and does not within a certain period of time correct its default. The term "correction" as used in the bill is not intended necessarily to require a church plan to undo the default completely or to put itself and other parties in precisely the same position they would have been in had the default never occurred. The degree of correction required should depend upon the equities of the situation.

For example, a possible violation of the church plan requirements would be the coverage of an impermissible number of individuals who are not defined as employees. A complete correction of this type of default would require the plan to refund to these individuals all contributions made on their behalf. Such a correction may cause the distributions to be included in the incomes of innocent persons and, hence, work a hardship on them.

In this type of situation, the default should be considered corrected if the church plan were permitted to retain the accrued benefits or accounts of these individuals for the eventual payment of benefits upon their death or retirement. But the plan should accept no further contributions with respect to them.

Mr. Speaker, I believe that when we enacted ERISA, we required far more of our churches than we intended. We certainly did not in 1974 intend to draft a definition of church plan that fails to take into consideration the way our church plans are operated or that is disruptive of church affairs. Our 1974 legislation requires the church plans to reconstitute their plans after decades, even centuries, of responsible experience.

The problems the churches face are immediate. They are concerned today that their plans may be presently disqualified as church plans. This is a matter we must not put off until 1982.

Therefore, Mr. Speaker, I urge my distinguished colleagues to support this measure, and I ask unanimous consent that the bill be printed in the RECORD.

The bill follows:

H.R. 12172

A bill to amend the Internal Revenue Code of 1954 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan

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

SECTION 1. Section 414(e) of the Internal Revenue Code of 1954 is amended to read, as follows:

"(e) CHURCH PLAN.—

"(1) IN GENERAL.—For purposes of this part the term 'church plan' means a plan established and maintained (to the extent required in paragraph (2)(B)) for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501.

"(2) CERTAIN PLANS EXCLUDED.—The term 'church plan' does not include a plan—

"(A) which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513), or

"(B) which includes individuals less than substantially all of whom are described in paragraphs (1), (3)(B), or (3)(E) (or their beneficiaries).

"(3) DEFINITIONS AND OTHER PROVISIONS.—For purposes of this subsection—

"(A) A plan established and maintained by a church or by a convention or association of churches shall include a plan established and maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.

"(B) The term 'employee' of a church or a convention or association of churches shall include—

"(i) a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation,

"(ii) an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 and which is controlled by or associated with a church or a convention or association of churches, and

"(iii) an individual described in paragraph (3)(E).

"(C) A church or a convention or association of churches which is exempt from tax under section 501 shall be deemed the employer of any individual included as an employee under paragraph (3)(B).

"(D) An organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

"(E) If an employee who is included in a church plan separates from the service of a church or a convention or association of churches or an organization described in clause (ii) of paragraph (3)(B), the church plan shall not fail to meet the requirements of this subsection merely because it—

"(i) retains his accrued benefit or account for the payment of benefits to him or his beneficiaries pursuant to the terms of the plan, or

"(ii) receives contributions on his behalf after his separation from such service, but only for a period of five years after the employee's separation from service, unless the employee is disabled (within the meaning of the disability provisions of the church plan or, if there are no such provisions in the church plan, within the meaning of section 72(m)(7)) at the time of such separation from service.

"(4) CORRECTION OF FAILURE TO MEET CHURCH PLAN REQUIREMENTS.—If a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 fails to meet one or more of the requirements of this subsection and corrects its failure to meet such requirements within the correction period the plan shall be deemed to meet the requirements of this subsection for the year in which the correction was made and for all prior years. If a correction is not made within the correction period the plan shall not be deemed to meet the requirements of this subsection beginning with the date on which the earliest failure to meet one or more of such requirements occurred. The term 'correction period' means the period ending with the later of the following: (1) 270 days after the date of mailing by the Secretary of a notice of default with respect to the plan's failure to meet one or more of the requirements of this subsection; (2) such period as may be set by a court of competent jurisdiction after a determination that has become final that the plan fails to meet such requirements, or, if the final court determination does not specify such period, a reasonable period depending upon all the facts and circumstances but in any event not less than 270 days after the determination has become final; or (3) any additional period which the Secretary determines is reasonable or necessary for the correction of the default."

SEC. 2. The amendments made by this Act shall be effective as of January 1, 1974. ●

95TH CONGRESS
2D SESSION

S. 3182

IN THE SENATE OF THE UNITED STATES

JUNE 7 (legislative day, MAY 17), 1978

Mr. TALMADGE (for himself and Mr. BENTSEN) introduced the following bill; which was read twice and referred to the Committees on Finance and Human Resources jointly by unanimous consent

A BILL

To amend the Employee Retirement Income Security Act of 1974 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan.

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

SECTION 1. Section 3(33), title I, of the Employee Retirement Income Security Act of 1974 is amended to read, as follows:

"(33) (A) The term 'church plan' means a plan established and maintained (to the extent required in clause (ii) of subparagraph (B)) for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954.

"(B) The term 'church plan' does not include a plan—

"(i) which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513 of the Internal Revenue Code of 1954), or

"(ii) which includes individuals less than substantially all of whom are described in subparagraph (A) and in clauses (ii) and (v) of subparagraph (C) (or their beneficiaries).

"(C) For purposes of this paragraph—

"(i) A plan established and maintained by a church or by a convention or association of churches shall include a plan established and maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement bnefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.

"(ii) The term 'employee' of a church or a convention or association of churches shall include: a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation; an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of the Internal Revenue Code of 1954 and which is controlled by or associated with a church or a convention or association of churches; and an individual described in clause (v) of subparagraph (C).

"(iii) A church or a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954 shall be deemed the employer of any individual included as an employee under clause (ii) of subparagraph (C).

"(iv) An organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

"(v) If any employee who is included in a church plan separates from the service of a church or a convention or association of churches or an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of the Internal Revenue Code of 1954 and which is controlled by or associated with a church or a convention or association of churches, the church plan shall not fail to meet the requirements of this paragraph merely because it: retains his accrued benefit or account for the payment of benefits to him or his beneficiaries pursuant to the terms of the plan; or receives contributions on his behalf after his separation from such service, but only for a period of 5 years after the employee's separation from service, unless the employee is disabled (within the meaning of the disability provisions of the church plan or, if there are no such provisions in the church plan, within the meaning of section 72(m)(7) of the Internal Revenue Code of 1954) at the time of such separation from service.

"(D) If a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954 fails to meet one or more of the requirements of this paragraph and corrects its failure to meet such requirements within the correction period, the plan shall be deemed to meet the requirements of this paragraph for the year in which the correction was made and for all prior years. If a correction is not made within the correction period, the plan shall not be deemed to meet the requirements of this paragraph beginning with the date on which the earliest failure to meet one or more of such requirements occurred. The term 'correction period' means the period ending with the later of the following: (i) 270 days after the date of mailing by the Secretary of a notice of default with respect to the plan's failure to meet one or more of the requirements of this paragraph; (ii) such period as may be set by a court of competent jurisdiction after a determination that has become final that the plan fails to meet such requirements, or, if the final court determination does not specify such period, a reasonable period depending upon all the facts and circumstances, but in any event not less than 270 days after the determination has become final; or (iii) any additional period which the Secretary determines is reasonable or necessary for the correction of the default.".

SEC. 2. The amendments made by this Act shall be effective as of January 1, 1974.

Senator WILLIAMS. Our next witness is the Association of Private Pension and Welfare Plans, William N. Bret, Jr., president-elect.

STATEMENT OF WILLIAM N. BRET, JR., PRESIDENT-ELECT, ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.

Mr. BRET. As I approached this testimony, I heard a very funny story the other day, which seemed to exemplify this from a fellow lawyer.

He said when Moses went up the mountain to get the Ten Commandments, he came down with tablets, and the people said what are those, and he said those are the law. They looked at the mountain, and it was scattered with broken tablets, and the people said what are those. He said those are the regulations. [Laughter.]

Well, I think it expresses our problems with ERISA. The remarks that I am going to make today first are very complimentary to you and Senator Javits and your staff, for the attempts to simplify what has been a very difficult act for us.

We would like to be as helpful as we can. The association is testifying for the first time. As chairman of the Hansen, I have a dual interest in this. We are 1 of the 10 or 12 large consulting firms. I have dichotomy in what I am saying. They are not contradictory in that sense. There are 600 plan sponsors in the association, representing all facets of this business.

Let me quickly go through about seven points. I have written the testimony. There were some supplementary material that I hope you will find interesting, too.

Senator WILLIAMS. Thank you.

Mr. BRET. First, the paperwork on the small employer has to be simplified. There are too many reports. It is too costly.

It seems to me, as it has for sometime that these vesting funding fiduciary rules are sufficient by themselves to protect the small employer cases. I would like to see the definition of small employer to be 500 employees or less and up to $10 million in sales. That would be a standard I think we would adopt and live with.

Some people will say that is too large but it really is not; $510 million would be what I think small employer means in this country today. At least it is in our practice, and I think in most consulting firms. The association would look at it that way.

As to Employee Benefit Commission, in a sense I guess we would say we are not sure. We would like to see more thought to this. We know you cannot live with dual jurisdiction that ERISA imposes because it reminds you of a Chinese definition of a committee. It is a chair with four back legs. I do think that at the moment I probably favor a two-step move. I go with Senator Bentsen's bill, 901, in transferring vesting funding participation to Treasury, where it has always been in the past, and I concentrate fiduciary standards and prohibited transactions in Labor. That seems to make sense to me.

Then I continue to study this Benefit Commission, I guess, because the associations stresses privatization and private solutions.

I am somewhat concerned about a commission that would not be favorable to private benefits. I do not know who the commission would be. I suppose if I knew the people, I might favor the commission more. It is kind of how do you feel about it in your heart?

At the moment, certainly a two-step move toward 901, that separation would be most helpful—the problems of self-employers particularly are not related to dual jurisdiction. They are related to about seven related problems that we are going to cover with you in great detail, not today.

I do not think we can live with the joint and survivor option as it is in the act. I know it is attractive, but we have costed it out and it seems to us that it can cost out to 15 percent additional cost to employers. That might be low, but I think that is a fairly accurate figure.

So if a company is spending $10 million on pension contributions, we might add as much as $1½ million dollars to their annual costs. That worries me.

I would rather see mandatory group life insurance, and I would go that way.

My second argument is that tax lawyers favor group life more than they do joint and survivor out of pensions. The group life insurance payment is nontaxable to the beneficiary and it can be assigned out of the estate.

I would prefer to do what we have always done, and that is provide death benefits in that fashion. You might argue that at age 55, this could be more than an election, and that would be more acceptable.

I think we have found that the election at age 55 is a reasonably low-cost item. This would not be. I want to stress that 10 times. There would not be a low-cost item. It will receive a great deal of criticism. The cost-of-living question has always been a matter of great concern. We have studied it, we have looked at it for many employers. More often than not, we have backed away from cost of living. I do not feel that cost of living should be studied in this field. We would rather leave this baby to the Presidential Commission and a higher level to look at.

I do not think the private industry can afford cost-of-living adjustments. Even though this is just a study, studies have a way of becoming law. They particularly have a way of becoming law sometimes at great cost to the private sector.

TAX INCENTIVES

I have to applaud your efforts. The small employer field has been devastated by ERISA. We used to write two plans a week in our part of the world where I live, Southwestern area. Now, if we write two a year, I say it would be unusual, defined benefit plans. It has just ceased since 1974. The statistics that we have on this are overwhelming.

I think Commissioner Kurtz pointed out the other day that 150,000 terminations, most of them are probably related to ERISA. The studies all seem to say that. So relief is needed. I do not know whether five three one one one is correct or not. I guess if I had to express a choice, I would say ten six two two two would be twice as good and would provide twice the incentive.

You cannot install a pension plan for $2,000. I do not know whether it should be more or not.

I would like to see more study given to that, what should be done. No one has mentioned the 5 percent. I think that 5 percent on improved plans is a very substantial benefit.

I do not know whether the bill means present plans that are improved or whether it means plans that will be improved.

The language is somewhat ambiguous in my reading of it. Does it mean both?

If a company has 5-year vesting, let us say, another company has 10, and 10 goes to 5-year vesting, do they get the same 5-percent credit, or is it only the plan that is being improved? I read it that it means any plan that is improved to those standards.

I would like to see that confirmed.

The *Daniel* case, enough has been said about it. We think one last thing might have been overlooked. It did not cover thrift or savings plan, the exemption from *Daniel* did not.

I think the *Daniel* exception in your law should cover not only defined benefit, but defined contribution plans. It specifically does not cover voluntary plans like thrift and safety plans that are so prominent and have been so prominent since ERISA.

Let me conclude with a comment that the small employer committee of the APP has prepared, and I have seen the first draft, of one of the most interesting reports on small employer problems I have seen. We will complete this draft very shortly and would obviously want to send you a copy of our report on small employer problems. It is extremely well done.

I am very pleased with what the committee has done, and we will review this and shortly be turning this over to you for your own study and for any questions you might have.

Senator WILLIAMS. When can we expect that?

Mr. BRET. I would hope to do this—I will speed it up—let me say that. Two weeks perhaps?

Senator WILLIAMS. I am not putting any time limit or suggesting any time. I just want to know when to look forward to it.

Mr. BRET. I will say very shortly. I have the draft and it is very well done. We should be able to get agreement on that very shortly.

The second report is one of our own firm. We have prepared a report on the multiemployer field with specific attention to the two problems that bother us most. One is the personal liability of the trustees. And the second is the liability of the employer.

We will have specific recommendations for the PBGC within the next 2 weeks of this also.

We have given comprehensive study to the multiemployer field, and if you wanted to talk about it a bit, it would sound like this. I do not think we can continue to prosper with the personal liability of trustees. I think we can provide safely that if trustees selected a bank, an insurance company, or qualified investment counsel, they would no longer be subject to personal liability unless they took a direct part in the fiduciary activities of this institution.

Nevertheless, that is one other day.

Lastly, when we look at the problem of capital formation and the investment of pension funds and miserable returns of the last 10 years in common stocks, you must ask yourself what part ERISA has played in capital formation and the lack of it. I think we need to look at a number of things to loosen up investment activities of our pension funds. Too much of the money is concentrated in the top hundred stocks and not nearly enough in the rest of the market.

I suspect that personal liability trustees has a great deal to do with that. At one point we were moving toward some broader base of investments, 1974. They were coming from in-house investment groups, coming from trustees themselves and from investment counsel. Since then, that has substantially stopped. There is the risk, if you take any chance at all in these investments, the trustees feel this personal liability will eat them alive.

I failed to mention earlier we not only endorse, but strongly endorse and compliment you on this deduction of employee contributions. We thing nothing in the act, save the joint and survivor question is more important than 10 percent, $1,000 deduction.

We think that tax incentive is one of the most important advances the bill offers.

Senator WILLIAMS. Will you repeat that?

Mr. BRET. We think your employee contribution section of the 10 percent up to $1,000 is a magnificent step forward in this field. We strongly endorse this.

I would like to think it would apply to defined benefit and defined contribution plans both. I am not sure it does. It may only apply to defined contribution plans. I would like to see it maybe explicit that you can use it either way.

There would be accounts, but those moneys would be applied toward qualified defined benefit plan. We might elaborate on that point with you in some more written testimony.

Senator, that concludes my remarks this morning.

Senator WILLIAMS. On the apprehension of trustees that leads to investment in only those that carry the highest rating in the blue chips, there is a proposed regulation in this. It is out for comments, I guess.

Have you commented? Has your association commented?

Mr. BRET. No. But we should like to. We have not commented. This is a subject close to my heart.

I have been personally involved in this from the beginning. I find that we have had 1.6 return on the market from 1968–77 in common stocks as an average. With 1.6 return on common stocks, you have to ask yourself what is happening, not only on the level of return, and cost to companies, I mean of the pension fund, but what, in fact, is happening to the whole broad stock market. What can we do to help it?

There is no one thing. I do not mean to be naive and say personal liability is the whole issue. No, it is part of the issue. Perhaps a small part of the issue, but a very important part. People are being super cautious.

Senator WILLIAMS. Mr. Hills was here yesterday, and he addressed himself to this as one of our problems—or perhaps I should say, one of our opportunities——

Mr. BRET. That is right. We can be creative here. That is what I am saying, a chance for you and your committee to be creative in that field and extend yourself a bit further.

Senator WILLIAMS. We are moving into departmental reorganization, and this proposal comes from one of the departments. Your attention to this and comments to it, I would think, would be very helpful.

Mr. BRET. We will do that.

Senator WILLIAMS. Thank you very much.

We may have some questions after we have examined your material.

Mr. BRET. Thank you.

[The prepared statement of Mr. Bret follows:]

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APPWP

Statement of the

Association of Private Pension and Welfare Plans

on Pension Simplification

Before Joint Hearings of the

Committee on Finance and the

Committee on Human Resources

August 17, 1978

Good morning. My name is William Bret. I am Chairman of the Board of A. S. Hansen, Inc., one of the world's largest independent actuarial consulting firms. I am also President-Elect of the Association of Private Pension and Welfare Plans. I am appearing here today to testify before the Committees on behalf of the Association.

Appearing with me is John Smokevitch. John is General Counsel of my company, A. S. Hansen. He was formerly with the Private Pension Task Force of the House of Representatives where he worked with the Honorable John Erlenborn and John Dent assisting them in the initial work of the Task Force. John has assisted me in the preparation of this testimony on behalf of the Association.

The Association of Private Pension and Welfare Plans is a nonprofit organization which was founded in 1967. It is dedicated to the preservation of the private pension and welfare system. Accordingly, it stresses "privatization" as an approach to problem solving rather than government intervention.

The Association's approximately 600 members represent the full spectrum of employers, plan sponsors and professionals involved with the maintenance and continued well-being of every type of private pension or welfare plan being maintained in America today. Our nationwide membership includes employers, unions and other plan sponsors, as well as accounting firms, actuarial firms, attorneys, banks and bank trust departments, insurance companies, investment firms and counselors, and pension and welfare plan administrators and consultants. I am certain the Senators and their staffs are aware of the Association's educational activities on behalf of its members. We believe the Association's broad-based membership, philosophical approach, and educational activities offer the Committees a unique perspective on the pension simplification proposals being considered in these joint hearings.

The Various Pension Simplification Proposals

The purpose of the hearings is pension simplification. The Association applauds this recognition by the Committees that many of the administrative and reporting requirements under ERISA, as interpreted by the Labor and Treasury Departments, often have succeeded only in increasing the expenses of plan sponsors without providing participants any real benefit. We encourage the committees to press ahead in their efforts to identify and simplify all of the confusing, duplicative, expensive, and time-consuming administrative requirements under ERISA.

The members of the Association are firmly committed to the protections afforded participants under ERISA and to the principle that participants must be informed about their plans so that they fully understand the benefits being provided them. Our frustration has been over the needlessly complex and cumbersome requirements imposed on our members by the agencies in interpreting ERISA. The result has been that we often feel that, while we may have complied with what a particular agency may say ERISA requires, we really have not given our participants anything of real value for the time, money and effort we've spent on this compliance.

In general, the Association supports the simplification proposals and tax incentives found in S. 3017, the ERISA Improvements Act of 1978, as introduced by Senators Williams and Javits, and S. 901, the Pension Simplification Act, and S. 3193, the ERISA Paperwork Reduction Act, both as introduced by Senator Bentsen. However, certain of the proposals in these bills are either counterproductive or need further work to make them really effective in achieving pension simplification. Therefore, rather than spend the time available to us discussing the vast majority of the proposals which the Association can support, we intend to discuss those proposals which cause problems or require further work. In this way we believe the Committees will most benefit from our expertise and assistance in developing simplification proposals that not only ease the administrative burden on employers and other plan sponsors but, more importantly, provide real benefits for the participating employees covered under our private pension and welfare plans.

Establishing an Employee Benefit Commission
v.
Allocating Administrative Responsibilities Among Existing Agencies

We all agree that there is a problem with the administration of ERISA as that law was enacted by Congress. What is commonly referred to as the "dual jurisdiction" problem is actually a tripartite jurisdictional problem involving conflicts and inconsistencies among the Department of Labor, the Internal Revenue Service and the Pension Benefit Guaranty Corporation. The problem is serious enough that Senator Bentsen with S. 901 and Senators Williams and Javits with S. 3017 have introduced bills dealing with the problem, but proposing different solutions.

S. 901, the proposed Pension Simplification Act, as introduced by Senator Bentsen, would eliminate the dual Treasury and Labor Department jurisdiction over the administrative and enforcement provisions of ERISA and allocate these responsibilities individually among the Departments. In effect, S. 901 would render unto Caesar that which is Caesar's.

S. 3017, the ERISA Improvements Act of 1978, as introduced by Senators Williams and Javits, would establish a new Employee Benefits Commission and consolidate all ERISA administrative, regulatory and enforcement functions within that new commission.

The Association of Private Pension and Welfare Plans believes that this problem is too complex, and an informed enough consensus has not been reached, for the Committees to attempt to resolve the issue at this time. We understand that the Administration expects to shortly propose a reorganization and reallocation of responsibilities among the Labor and Treasury Departments. This should sufficiently resolve the current problems on a temporary basis, and thereby allow the Committees to continue studying the issue so that the best long-term solution may be reached. It would be a mistake to act precipatately.

Accordingly, while the Association recognizes the need to solve the jurisdictional problem, it can only recommend further study of the jurisdictional issues at this time. The Association itself has not reached a consensus on the best solution to the jurisdictional problem. I can advise you, however, that the Association will continue studying this matter and will assist the Committees and their staffs in resolving this complex and troubling issue.

Expansion of the Joint and Survivor Annuity Requirements

We are deeply troubled over Section 238 of S. 3017. This section expands the present joint and survivor annuity provisions of ERISA to require that a plan provide a joint and survivor annuity to the spouse of any participant who is 50 percent or more vested at the time of his death. Also, the participant's accrued benefit may not be charged for the cost of the death benefit paid the surviving spouse. In other words, this provision mandates a free death benefit for the surviving spouse of any participant who is 50 percent vested.

That is exactly the problem with the provision and why the Association must oppose it. The provision confuses an employer's providing death protection for employees with an employer's providing living protection for its employees through its pension plan. Let me explain. An employee faces many hazards from which his employer's benefit plans are designed to protect him. Medical plans are designed to protect the employee from excessive medical expenses arising from the hazards of sickness and ill health. Life insurance programs are designed to protect an employee and his family against the hazard of his dying. The pension plan is designed to protect the employee from the hazard of living. While we do not normally think of continued good health and a long life expectancy as a hazard, responsible employers realize their responsibility to provide an adequate replacement income to their career employees once they retire.

The plans which protect against these hazards are designed to provide the greatest protection on the most cost effective basis. An advance funded retirement plan is the best way, we feel, to provide the protection against living. It is not the best way to protect against the hazards of dying. The best way to provide death protection is through group term insurance arrangements--the way employers have traditionally provided death benefit protection.

Hansen's actuaries have estimated for me the cost impact of the joint and survivor annuity proposal in S. 3017. While the cost of the proposal on an individual pension plan car only be determined by analyzing the actual mortality and turnover experience of the particular plan involved, they would expect the proposal to increase pension costs for the overwhelming majority of our client's pension plans by about 15 percent per year.

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Gentlemen, we simply cannot add such a cost burden to employers maintaining retirement programs for their employees. Furthermore, we expect that most employers do maintain an adequate group life insurance program for their employees.

Actually, this proposal mandates free death protection for employees. Regardless of the cost of the proposal, therefore, the Association simply cannot support it. The Association would also hope that, as the Human Resources Committee considers our comments, it also will recoil from such federal interference with the collective bargaining process.

Study of Mandatory Cost-of-Living Adjustments

The Association of Private Pension and Welfare Plans stresses "privatization" as an approach to problem solving, rather than government intervention. For this reason, the Association rejects any attempt to require mandatory cost-of-living adjustments under private pension plans. Accordingly, the Association opposes Section 273 of S. 3017 which would require the Secretary of Labor to conduct a study on the feasibility of requiring private pension plans to provide mandatory cost-of-living adjustments.

Plan sponsors do recognize the need for having retirement benefits keep pace with inflation. This is one of the reasons why most pension plans today base their pension benefits on final average pay. The members of the Association do consider the effect of inflation on the pensions of their retirees. Many members have adopted cost-of-living supplements for their retirees. We believe it interesting and instructive for the Committees to note that in providing these supplements, most of our members have chosen to do so outside of their pension plans. That is, the supplements are paid directly by the employer rather than funded through the plan. This is largely due to the uncertainty and to the degree of the commitment involved in making available a cost-of-living supplement. Employers providing these supplemental pensions outside the plan are quite careful to explain to retirees that they cannot guarantee unlimited continuation of the supplement if business conditions should become adverse. The Association strongly believes this is a problem that is best dealt with in the private sector. Employers sponsoring plans are aware of the need for cost-of-living supplements and are responsible about providing such supplements to their retirees.

We believe there is no need for the Committees to provide for such a study. We certainly expect the Presidential Commission on Pension Policy, which has been announced by the White House, to consider the impact of inflation on retirement incomes. In fact, it would be ironic if a bill which has as its primary goal--simplification--was to authorize additional and duplicative studies of a problem which already will be studied.

Tax Incentives for the Establishment or Improvement of Qualified Retirement Plans and Deductions for Employee Contributions

The Association strongly supports all of the tax incentives found in Title III of S. 3017. However, the Association believes there is a problem with the proposed deduction for employee contributions to qualified retirement plans. We do not understand why the Committees would on the one hand propose to allow employees a limited deduction for contributions to a qualified retirement plan and then with the other hand take the deduction away from employees earning more than $30,000 per year.

In designing a retirement plan, the goal is to have the plan provide, when considered with all the other sources of retirement income available to the career employee, the best replacement possible in his retirement years of his pre-retirement income. Accordingly, employers generally take into account, in one fashion or another, the benefits provided under Social Security in determining the amount of replacement income to be provided under the employer's retirement plan. Under Social Security, however, the lower an employee's rate of earnings, the greater is the replacement of his pre-retirement income by Social Security benefits. The following table illustrates this:

Employee's final year's pay	Annual estimated "Social Security wages"*	Annual Social Security benefit	Percent of final year's pay
$ 5,000	$3,339	$3,012	60%
8,000	5,343	4,028	50
10,000	6,598	4,679	47
12,000	7,747	5,147	43
15,000	8,087	5,458	36
20,000	8,258	5,518	28
25,000	8,258	5,518	22
30,000	8,258	5,518	18
40,000	8,258	5,518	14
50,000	8,258	5,518	11

*These are Social Security-covered wages, assuming 5% pay increases over a working career. This is very close to the historical rate of increase in such earnings.

As we can see, an employee earning $5,000 in the year prior to retirement would receive Social Security benefits replacing approximately 60 percent of his final year's pay. This is 60 percent of his gross pay, not his net, after tax takehome pay. Likewise, the $12,000 per year employee can expect to receive 43 percent of his final year's gross pay from Social Security. However, if we now look at the employee earning $30,000 a year--the point at which he would start losing the proposed deduction for voluntary contributions to his retirement plan--we find that his Social Security benefits will only replace 18 percent of his final year's pay. For the $35,000 per year employee--the level at which the deduction for voluntary contributions for a qualified retirement plan would be completely denied--Social Security only replaces 15-3/4 percent of the employee's pre-retirement income. Ironically, these are the very employees who may need to save for retirement in order to supplement the replacement income they receive in retirement from the combination of Social Security and their employer's retirement plan. Yet the Committees' proposal would deny them the deduction that it grants to so many of their fellow workers.

One of the biggest problems the members of the Association face is providing an adequate retirement income for their managers in comparison to the total replacement income that rank and file employees receive from the combination of Social Security and their employer's private pension plan. Accordingly, the Association urges the Committees to eliminate the $30,000 phase out in the deduction S. 3017 makes available for employee contributions to qualified retirement plans.

Federal Preemption and the Daniel Case

The Association applauds the Human Resources Committee's decision to broaden the preemption provisions of ERISA to, in effect, legislatively overrule the Daniel case.

– There is an exception to Sections 271 and 274 of S. 3017, however, whereby the Daniel decision is not overruled for "eligible individual account plans" in which participation is voluntary. We do not understand the reason for this exception and find the voluntary concept quite troubling. Let me explain.

A very desirable form of employee benefit plan is the so-called thrift or savings plan. Under such a plan, for example, an employee may save from 1 to 6 percent of his compensation on a voluntary basis. If he does so, the employer will match his savings at a rate specified in the plan. These matching rates typically vary from 1/2 of the employee's savings up to twice the employee's savings. These plans have proven to be very popular. They allow the employee to augment his Social Security benefits and his pension plan benefits in providing for his retirement needs. Most often, these plans will be invested in stock of the employer sponsoring the plan, but this stock is usually publicly traded so it is registered under the Securities Laws and the employees participating in the savings plan usually receive prospectuses.

However, under sections 271 and 274 of S. 3017, this is a voluntary individual account plan and the Daniel decision is not overruled. But there is no need for the exception. ERISA's fiduciary provisions and the prudent man rule apply to the investment in employer securities so that participants are fully protected. Accordingly, the Association recommends that the exception be deleted and the Daniel decision be overruled across-the-board for all defined benefit and defined contribution pension plans covered under ERISA.

* * * * *

Thank you for the opportunity to have testified on behalf of the Association of Private Pension and Welfare Plans.

While our testimony concentrated on what we felt were problem areas in the bills, please do not let this obscure the fact that the Association supports the simplification proposals of S. 3017, S. 901 and S. 3193. Furthermore, the Association would especially like to compliment Senators Bentsen, Williams and Javits and their staffs for the work they've done in pressing ahead on pension simplification.

If there are any questions about what I have said, I will be happy to answer them. John or I also will be pleased to answer any other questions you may have on the bills you are considering, but our answers would reflect our own independent views and not necessarily the views of the Association.

Senator WILLIAMS. Next we have Mr. Lawrence Walner.

Mr. Walner, we will recess for a couple of minutes. I want to see if Senator Javits will be available.

[Short recess.]

Senator WILLIAMS. Senator Javits has been alerted. I know he wanted to be here to hear your testimony, Mr. Walner. He is right in the middle of a presentation at another committee that is very critical, and so he will do his best to get here.

Why don't you proceed.

STATEMENT OF LAWRENCE WALNER, ATTORNEY, CHICAGO, ILL.

Mr. WALNER. Thank you very much for your consideration in trying to arrange for his presence, Mr. Chairman.

I appreciate the opportunity of being able to address you.

I am counsel for John Daniel. I would like to say in beginning that my remarks are not intended, and should not be construed as any comment or discussion on the merits of the *Daniel* case. The position of *Daniel* on the merits have been pretty widely discussed, and reasonably set out at length in our brief, which was filed last week with the Supreme Court.

I have given a copy of the brief to your staff. I ask that the brief be made a part of the record.

To the extent that there is interest in a discussion of the merits of the case, I respectfully suggest that the brief should be consulted.

My remarks today are directed solely to the desirability of that portion of the proposed legislation that attempts to deal with the Daniel situation, but not to comment on the *Daniel* merits itself.

Although my statement is brief, my prepared statement, I will read only portions of it, and ask that the full statement be included in the record.

Senator WILLIAMS. It will be.

[The brief of respondent John Daniel before the U.S. Supreme Court *IBT* v. *Daniel* is being held in files of the Human Resources Committee, 4230 Dirksen Senate Office Building, Washington, D.C. 20510.]

Mr. WALNER. Lest I not properly build up to the point I would like to make in the course of the statement, I would like to emphasize it in the beginning, that we feel many of the reported discussions of the liability that would emanate from the *Daniel* decision are grossly overstated. They greatly overlook the requirements of the *Hochfelder* case, which require before an omission or misrepresentation can constitute a 10(b) violation that there must be present scienter, something close to intention to defraud.

We do not believe for a minute that the intention to defraud is so widespread throughout the pension industry that it would result in the calamitous liability that some of the proponents of that theory would suggest.

If the concern, gentlemen, is the addition of another agency, because of possible SEC participation, we respectfully suggest that the 10(b)(5) provisions be codified as part of ERISA, rather than eliminate it by legislation, which would cancel the rights of people involved.

Senator JAVITS. Could I ask you one question?

Mr. WALNER. Yes, sir.

Senator JAVITS. If we pass this bill in the form in which we introduced it on *Daniel*, and assuming its constitutionality, which you have every right to contest, will Daniel, or a plaintiff like Daniel still have left a fraud count, straight common law fraud?

Mr. WALNER. Well, Senator, to get into the situation that is discussed in *Daniel*, which goes, by the way, beyond his personal identical facts, I feel really deals with the merits of the case.

Senator JAVITS. I do not want to get into the merits. I am only asking a question. Is there anything in our bill which eliminates common law fraud as a cause of action, in whatever court it needs to be pursued? I am not passing on it. Would the bill cut off your common law fraud count?

Mr. WALNER. Under the Securities Act?

Senator JAVITS. Under anything. Do we cut you off from a fraud count?

Mr. WALNER. I have not read the bill with that in mind, but my offhand guess would be that it probably would not, Senator. But we feel that the rights under 10(b) are important rights to be maintained, and have been there all along, as we recite in our brief.

This bill, if I can focus on two points, deals in a substantive fashion with the matters now pending before the Supreme Court in *Daniel*. It does so by excluding interest in voluntary noncontributory employee pension plans from the definition of "security" in the act of 1933 and 1934.

It thereby excludes the purchasers of such interests, so-called employee investors, from the protection of fraud, and provides no substitute remedy under any other statute.

This approach we believe is wrong, for the purchasers of such securities need this protection whether afforded by the securities laws or transferred to the labor laws by statutory enactment preserving these valuable rights. In either case, the employee should be afforded all of his rights. It is not important which Government agency is given any special jurisdiction. Such employee-investors are, indeed, within the scope of those investors that the Federal securities laws are designed to protect. It is, therefore, not surprising that a similar bill, H.R. 5065, introduced 37 years ago, in 1941, by Congressman Paddock, was never enacted, and this proposed portion of the ERISA Improvement Act of 1978 should be similarly rejected.

This portion of S. 3017 is, moreover, deficient in two other respects.

First, Congress by this bill is attempting to legislate on this question when the matter has been fully briefed, and is on the threshhold of being heard before the Supreme Court.

In fact, a reversal by the Court would moot the issue, and, even in affirmance, would help guide Congress to a more refined legislative approach to any problems remaining in the area.

Second, this portion of S. 3017 is deficient because, while removing the protections afforded by the Federal securities law, it adds no similar protection to ERISA.

ERISA has no provision affording employees rights against the makers of intentionally false, misleading representations to induce the employee to invest in a pension fund. Neither does ERISA have any general antifraud provisions of the sort found in the securities laws.

Consequently, to amend ERISA to preempt any fraud provisions of the Federal securities laws without adding similar protections to ERISA would be to deny relief to persons intentionally induced to invest in an employee pension plan on the basis of fraudulent misrepresentation.

We would be satisfied with this portion of the legislation if it would codify in the labor laws a provision correspondent to 10(b) (5) of the securities law, without watering down rights or eliminating existing claims.

The second point which I wish to make deals with the effect that the ERISA Improvement Act of 1978 will have on the *Daniel* case itself. Not only does one portion of S. 3017 exclude an interest in a voluntary noncontributory pension plan from the definition of "security" from the Federal securities laws, it also does so retroactively. Not only does it so change the definition of "security" retroactively, it also divests the Federal courts from hearing any case based upon an alleged fraudulent sale of such securities in the past, and not only does it divest the Federal courts from hearing any such case, it also divests the Federal courts of any jurisdiction to continue hearing any such case already pending.

That last provision seems directed principally, if not solely, to the *Daniel* case. It is directed to deprive Mr. Daniel of a remedy that four Federal judges have already said that he had.

In fact, it is a legislative provision that will have the effect, even though perhaps not so intended, of insulating the Teamsters from liability in any court of law for intentional securities fraud. In other words, intentional or not, the result is to get the Teamsters legislatively "off the hook."

We ask that you should not change the rules of the game for Mr. Daniel in the bottom of the ninth inning while he is ahead. It is, furthermore, unnecessary. To the extent that Congress is concerned about possible pension fund liability resulting from *Daniel*, S. 3017 could be made only prospective, and not retroactive. And, to the extent that Congress is concerned about retroactive pension fund liability resulting from *Daniel*, Congress concern is misplaced because liability is limited solely to those pension fund securities sold by means of an intentional securities fraud.

The estimates of potential liability stemming from the *Daniel* case have been monstrously overstated. Surely, the suggestion that some or all, or even most, other pension funds are sold by means of intentional securities fraud, simply has no basis in fact. In any event, even if Congress seeks to limit the extent of retroactive pension fund liability resulting from *Daniel*, it can do so without excluding from its scope those cases already pending.

It was the U.S. Supreme Court decision in *Hochfelder* that established the existence of the scienter requirement (akin to intention to defraud) as an essential element to constitute a securities violation. Mere omission or misrepresentation, without scienter, is not enough to establish a violation. Therefore, the honest pension fund trustee and manager has ample protection. Even the dishonest pension fund has substantial insulation in most cases by the statute of limitations in securities cases which does not exceed 3 years in any but a handful of States.

Senator JAVITS. Is that 3 years from the time he discovered, or should have discovered——

Mr. WALNER. That is correct.

Many people have been cut off a long time ago, I may add.

I would think at least that is one of the areas that could be considered a possibel basis of running of the time, although not exclusively.

We ask is it really the intent and position of Congress that an employee investor in a pension plan who has been intentionally defrauded by omissions or misstatements have no cause of action either under the Federal securities laws or ERISA, the statute supposedly designed to cure pension abuses?

We, therefore, would urge this subcommittee to reconsider those portions of S. 3017, the ERISA Improvement Act of 1978, which retroactively exclude from the definition of "security" under the Federal securities law an interest in voluntary noncontributory pension plans without adding comparable antifraud provisions to ERISA, and deny Daniel his day in court by divesting the Federal court of jurisdiction to continue hearing his case, a case at the threshold of hearing before the Supreme Court of the United States.

Senator WILLIAMS. Mr. Walner, your cause of action under the securities laws is based on the theory that an interest in an involuntary, noncontributory pension plan is a security, and entering employment where there is such a plan, is a sale; is that right?

Mr. WALNER. The sale could take place at a number of events, but I am concerned that to get into detailed discussion of when the sale takes place is really dealing substantially with the merits of the case.

Senator WILLIAMS. The theory, though, is that there is a sale, and it is a sale of a security?

Mr. WALNER. The theory is, there is a sale, and it is a sale of a security.

Senator WILLIAMS. On page 2 you say you would be satisfied with this portion of the legislation if it would codify in the labor laws a provision corresponding to 10(b)(5) of the securities law, without watering down rights or eliminating existing claims.

Now, if we took that route, and took the substance of rule 10(b)(5), and put it in labor law, that would moot that question of sale of a security; would it not?

Mr. WALNER. You were talking about in the pending case?

Senator WILLIAMS. No.

Mr. WALNER. Generally?

Senator WILLIAMS. Generally, and prospectively.

Mr. WALNER. If in codifying it in the labor law, you at the same time eliminated it statutorily in the securities law, it would, by definition, moot it in the securities law, assuming the constitutionality of it. Only I would hate to see it done in a fashion that would cut off existing rights of the people.

Senator WILLIAMS. Again, thinking prospectively, if our bill included the substance of rule 10(b)(5) in labor law, and we made it clear that we are making a policy judgment that an interest in this and other kinds of pension plans is not a security, that would be all right, as long as the substance is included under labor law; is that right?

Mr. WALNER. As long as rights are preserved, Senator. We do not care if they are preserved and enforced under labor laws or securities laws. If there is some concern, where they are adding SEC, would create administrative or other problems, we do not feel that concern——

Senator WILLIAMS. You do not, but everybody else does.

Mr. WALNER. I am sorry, what I intended to say was whether it was given to SEC, or given to Labor, we do not think is the important distinction. We feel the important distinction is the preservation of the right. We do not feel that even if it is left with the SEC, it has to become a nightmare of any sort.

There is no registration requirement resulting from this. There are no regular papers that have to be filed with the SEC. There are no forms. All it requires, as I understand it, is that when the person is advised of his rights, he be given a correct statement of what his rights are, and no more than that.

Not only that, even if he is not properly advised of his rights, even if there is omission or misstatement, even that will not create a right, if it does not have the concomitant scienter. We feel that right should not be compromised. Whether you desire to leave the right in the securities area, which is where we believe it presently exists, or whether you say let us take it out of securities and transfer the exact same right to the labor statute, I do not feel is material from my point of view, from the point of view of the people who need to prosecute their rights.

Senator WILLIAMS. I do not believe you were in the room when Mr. Cummings testified.

Mr. WALNER. No, sir.

Senator WILLIAMS. We will have to review all of his statement in connection with your statement. I have a feeling that this can come together.

We have no desire to deny a remedy to anybody in a plan covered by ERISA where there has been an intentionally fraudulent statement. We thought we took care of that when we passed ERISA, with all of its standards, fiduciary, disclosure, and so forth. So, one question before us is the form of the remedy and the law to be applied.

We have been of the view that if the employee's interest is deemed to be a security, there is so much law that may be applicable under the Federal securities acts that we would be seriously affecting the opportunities for people to be covered under ERISA pension plans. Many have told us that characterizing this interest as a security—which brings retroactive application and prospective involvement of the SEC—will give plan sponsors strong incentives to terminate existing plans and not start new plans. They are very concerned about unforeseen liabilities arising out of the past, and about the confusion of regulation by a third agency—the SEC—on top of the Labor Department and the IRS. And so are we.

Mr. WALNER. We do not care which agency has the jurisdiction, as long as the rights are maintained, Senator.

We feel that so much has been said over whether it is a security or not, that the notion has been lost as to how limited the liability probably would be because of the scienter requirement. Even Mr. Daniel, without getting into the merits, if you believe his case was unfair, would not be the——

Senator WILLIAMS. This question of scienter in the *Daniel* case, that has not even been heard.

Mr. WALNER. It has been lost. It has been lost in the litigation. We have taken it up in our briefs.

Senator WILLIAMS. The briefs are strictly on pleadings right now. There has been no trial of the facts in the *Daniel* case.

Mr. WALNER. That is correct. But even Mr. Daniel's case, if he could not prove scienter to the satisfaction of the jury, he would not have an action under the securities laws.

Senator WILLIAMS. We are involved in a very difficult question here—it is a matter of some confusion as to what the law regarding scienter is under an SEC enforcement proceeding.

I am told by counsel, who used to work over there some time ago, that——

Mr. PARADISE. The SEC takes the position that scienter does not apply when it brings an action.

Mr. WALNER. I cannot speak to the SEC position, but if the concern is that scienter does not apply to SEC, and you are concerned that they may invade pension area because of that, I would think the statute could be narrowly drafted to require scienter to apply to the SEC in the pension area, and that would put them under the same constraint that the private litigants have.

Senator WILLIAMS. Yes, that could be done, the point here is that we see another problem with applying the securities laws, and that is that there may be a difference of law, depending on whether the fraud action is privately brought, or SEC brought.

Mr. WALNER. I am not prepared to address myself to the SEC requirements. It seems to me to be a matter susceptible of resolution without causing a lot of people to lose their rights.

Senator WILLIAMS. Your basic objective here is the individual and his opportunity——

Mr. WALNER. Opportunity to preserve the private right of action, yes, Senator.

Senator WILLIAMS. Well, there is a difference between preserving a specific right of action which many people believe does not exist, and making sure that employee benefit plan participants who are protected by ERISA are fully protected. But I think we have had some very helpful clarification today.

Senator Javits opened it up 2 days ago, and then Frank Cummings gave us his views, and now Mr. Walner. I think I see a path for us to follow. We are in the woods, but I can see the path. We will head down the path.

Senator JAVITS. Mr. Walner, I am not going to go into detail on what my colleague has already said and on what I raised earlier because I do not think there is any light you would cast on that without getting into a discussion of your case, which you are quite properly not doing.

I, too, am trying to think of what we can do to preserve what I feel needs to be preserved without perpetuating the present situation, which to us has many analogies to why we did not get into retroactivity in ERISA generally.

There are moral questions. The issue is can we handle those questions without dealing with the securities laws.

We will wrestle with that, and I think you have given us all the help that you can.

I did wish to ask the following, Mr. Chairman. Two men who were on this staff by my appointment and who took a very active role in the drafting and ultimate enactment of ERISA were Frank Cummings, who testified this morning for the ABA and who took a position opposite to that of Mr. Walner and others who have testified——

Senator WILLIAMS. Now, that is my point, Senator Javits. I have a feeling that there is a kernel of similarity here.

Mr. Cummings, of course, extended *Daniel* to its ultimate possibility. Mr. Walner is limiting his presentation to the individual in the *Daniel* kind of situation.

Mr. WALNER. That is correct.

Senator WILLIAMS. On that, in the limited frame of *Daniel*, I think there was some similarity. Did I see somtthing that was not there? I think we have a patch of common ground here.

Senator JAVITS. The other thing I want to mention is that the other man is named Michael Gordon, who literally gave a piece of his life in the ultimate resolution of ERISA; he gave months of unbelievable service. He is now a practicing lawyer with another lawyer who was also minority counsel here, Gene Mittelman.

Mr. Gordon, who is very well informed, is handling some cases which are like *Daniel*. He has asked permission to introduce a statement, which generally, I think, will track the position taken by Mr. Walner.

He was a very active participant in the finalization of the conference report that came into law, and I feel justified after the disclosure which I have just made, in asking unanimous consent that his statement appear in the record following that of Mr. Walner.

Senator WILLIAMS. Hearing no objection, that will be included.

I will be reviewing it, and we will put Mike in the same position of everyone else, we might have written questions. How is that?

Senator JAVITS. Fine.

Senator WILLIAMS. One final thing, Mr. Walner.

You came to us from New Hampshire——

Mr. WALNER. No, my colleague, Mr. Barrack is in New Hampshire. He is co-counsel on the case with us.

Senator WILLIAMS. As an old New Hampshire lawyer from way back, I wonder what part of the beautiful State you were in. It is your partner who is there.

Mr. WALNER. Yes; in this case.

Senator WILLIAMS. He stayed there?

Mr. WALNER. Yes.

Senator WILLIAMS. I do not blame him.

[The prepared statements of Mr. Walner and Mr. Gordon follow:]

TESTIMONY FOR THE SUB-COMMITTEE ON LABOR OF THE SENATE COMMITTEE ON HUMAN RESOURCES

My name is Lawrence Walner. I am a practicing attorney in Chicago, Illinois. I wish at the start to thank Senator Williams, his staff and the sub-committee, for allowing me to testify at these hearings.

I am one of the counsel in the somewhat celebrated case of John Daniel vs. International Brotherhood of Teamsters now pending before the Supreme Court of the United States. These remarks are not intended and should not be construed as any comment or discussion on the merits of the Daniel case. The position of the plaintiff on the merits in Daniel have been widely discussed and have recently been set out at length in our Brief filed last week with the Supreme Court. Therefore, to the extent that any of you are interested in the merits, I would like you to read this Brief which we have recently filed. These remarks are solely limited to the desirability of one portion of the proposed legislation.

At least one of the bills presently pending before you today - S-3017 - known as the ERISA Improvement Act of 1978 - deals in part both with the substance of matters now pending before the Supreme Court in the Daniel case and, more ominously, with the Daniel case itself. Indeed, a portion of this legislation is expressly designed to deprive Mr. Daniel of a remedy which all four judges who have now heard the case to-date say that he has.

My comment will, in any event, be brief to focus on two major points. First, the proposed ERISA Improvement Act of 1978 deals in a substantive fashion with those matters now pending before the Supreme Court in Daniel. It does so by excluding interest in voluntary non-contributory employee pension plans from the definition of "security" in the Securities Act of 1933 and the Securities Exchange Act of 1934; it thereby excludes the purchasers of such interests - so-called employee investors, from the protection of fraud and provides no substitute remedy under any other statute. This approach we believe is wrong for the purchasers of such securities need this protection whether afforded by the securities laws or transferred to the Labor Laws by statutory enactment preserving these valuable rights. In either case, the employee should be afforded all of his rights. It is not important which government agency is given any special jurisdiction. Such employee-investors are, indeed, within the scope of those investors that the federal securities laws are designed to protect. It is, therefore, not surprising that a similar bill (HR 5065) introduced 37 years ago (in 1941) by Congressman Paddock was never enacted, and, this proposed portion of the ERISA Improvement Act of 1978 should be similarly rejected.

This portion of S 3017 is, moreover, deficient in two other respects. First, it is clearly untimely in the sense that it is somewhat untoward for Congress now to attempt to legislate on this question when the matter has been fully briefed and is on the threshhold of being heard before the Supreme Court. In fact, a reversal by the Court would moot the issue and, even in affirmance, would help guide Congress to a more refined legislative approach to any problems remaining in the area. Second, this portion of S 3017 is deficient because, while removing the protections afforded by the Federal Securities Law, it adds no similar protection to ERISA.

ERISA has no provision affording employees rights against the makers of intentionally false, misleading representations to induce the employee to invest in a pension fund. Neither does ERISA have any general anti-fraud provisions of the sort found in the securities law. Consequently, to amend ERISA to preempt any fraud provisions of the federal securities laws without adding similar protections to ERISA would be to deny relief to persons intentionally induced to invest in an employee pension plan on the basis of fraudulent misrepresentation. We would be satisfied with this portion of the legislation if it would codify in the Labor laws a provision corresponding to 10(b)5 of the securities law, without watering down rights or eliminating existing claims.

The second point which I wish to make in my testimony today deals with the effect that the ERISA Improvement Act of 1978 will have on the Daniel case itself. Not only does one portion of S 3017 exclude an interest in a voluntary non-contributory pension plan from the definition of "security" from the federal securities laws, it also does so retroactively. Not only does it so change the definition of "security" retroactively, it also divests the federal courts from hearing any case based upon an alleged fraudulent sale of such securities in the past, and, not only does it divest the federal courts from hearing any such case, it also divests the federal courts of any jurisdiction to continue hearing any such case already pending. Such a legislative provision is unique, if not outrageous. It is directed principally, if not solely, to the Daniel case. It is directed to deprive Mr. Daniel of a remedy that four federal judges have already said that he had. In fact, it is a legislative provision that will have the effect, even though perhaps not so intended, of insulating the Teamsters from liability in any court of law for intentional securities fraud. In other words, intentional or not, the result is to get the Teamsters legislatively "off the hook."

You should not change the rules of the game for Mr. Daniel in the bottom of the ninth inning while he is ahead. It is, furthermore, unnecessary. To the extent that Congress is concerned about possible pension fund liability resulting from Daniel, S 3017 could be made only prospective, and not retroactive. And, to the extent that Congress is concerned about retroactive pension fund liability resulting from Daniel, Congress's concern is misplaced because liability is limited solely to those pension fund securities sold by means of an <u>intentional</u> securities fraud.

The estimates of potential liability stemming from the Daniel case have been monstrously overstated. Surely, the suggestion that some or all, or even most, other pension funds are sold by means of intentional securities fraud, simply has no basis in fact. In any event, even if Congress seeks to limit the extent of retroactive pension fund liability resulting from Daniel, it can do so without excluding from its scope those cases already pending.

It was the United States Supreme Court decision in Ernst and Ernst v. Hochfelder, 425 U.S. 185 (1976) that established the existence of the <u>scienter</u> requirement (akin to intention to defraud) as an essential element to constitute a securities violation. Mere omission or misrepresentation, without scienter, is not enough to establish a violation. Therefore, the honest pension fund trustee and manager has ample protection. Even the dishonest pension fund has substantial insulation in most cases by the statute of limitations in securities cases which does not exceed three years in any but a handful of states.

Is it really the intent and position of Congress that an employee-investor in a pension plan who has been intentionally defrauded by material omissions or misstatements have no cause of action either under the federal securities laws or ERISA, the statute supposedly designed to cure pension abuses?

I, therefore, would urge this subcommittee to reconsider those portions of S 3017, the ERISA Improvement Act of 1978, which (retroactively) exclude from the definition of "security" under the federal securities law an interest in voluntary non-contributory pension plans without adding comparable anti-fraud provisions to ERISA, and deny Daniel his day in court by divesting the federal court of jurisdiction to continue hearing his case, a case at the threshhold of hearing before the Supreme Court of the United States. Your consideration of our position is very much appreciated.

STATEMENT OF
Michael S. Gordon
MITTELMAN AND GORDON

Before the

SUBCOMMITTEE ON LABOR
COMMITTEE ON HUMAN RESOURCES

and the

SUBCOMMITTEE ON PRIVATE PENSIONS
and EMPLOYEE FRINGE BENEFITS,
COMMITTEE ON FINANCE

UNITED STATES SENATE

on

"THE ERISA IMPROVEMENTS ACT OF 1978"
(S. 3017)

August 15, 1978

The following statement is being submitted on behalf of the Washington, D. C. law firm of Mittelman and Gordon by Michael S. Gordon, a partner in the firm. During the period 1970-1975, Mr. Gordon served on the professional staff of the Senate Human Resources Committee and participated in the drafting of ERISA.

The purpose of this statement is to comment on Section 274 of S. 3017, the "ERISA Improvements Act of 1978," which is intended to reverse the holding of the Seventh Circuit Court of Appeals in the Daniel case, currently on appeal to the U. S. Supreme Court. Since this legislative action is proposed to be taken without awaiting the decision of the Supreme Court, this statement will describe the implications of Section 274 in light of the interests of litigants represented by Mittelman & Gordon who have alleged violations of the securities laws with respect to certain pension plans in which they participated.

Section 274 and the Daniel Case

Before dealing with the merits of Section 274, it should be observed that it is public knowledge that a zealous campaign has been conducted on behalf of a broad coalition of interested groups to extirpate the Daniel decision from the annals of American jurisprudence. Whatever the deficiencies in Daniel--and I do not deny that there are some--I urge that due consideration be given to curbing any hasty effort to foreclose the Supreme Court from ruling meaningfully on the case. The failure to abate legislation to overrule Daniel before the Court decides will be interpreted by a large number of working people--regardless of what they think or know about the technicalities of Daniel--as a turning away from the sympathetic leadership which distinguished the Congress and, especially, the Committee on Human Resources, when it gave birth to ERISA.

The central issue presented by Section 274 is not whether Daniel is correct as a matter of law, but whether the social policy created by that decision, in whole or in part, is sound. If the Daniel policy (or any part of it) is worth keeping, then the flaws of logic or legislative history which are embedded in Daniel (or in the assertions of the S.E.C.) need not unduly disturb us. They are worthy of concern only to the extent that they reflect unsatisfactory aspects of an otherwise sensible social policy which can be improved by curing the deficiencies, or taking steps to minimize them.

Section 274 reflects a decision that coverage of defined-benefit plans under the antifraud provisions of the securities laws is bad. However, if Section 274 is examined very closely, certain inconsistencies come to the surface which weaken considerably the vitality as well as the rationale of this judgment. For example, Section 274 continues undisturbed securities fraud coverage of voluntary profit-sharing plans. This leads to two dissonant results: first, that there will be a certain duplication of enforcement effort between the S.E.C. and the Department of Labor with respect to fraudulent communications by fiduciaries of profit-sharing plans (a presumed evil to be avoided in connection with defined-benefit pension plans); second, if the Daniel decision is upheld, voluntary profit-sharing plans, but not defined-benefit pension plans, may be compelled to disclose to their members the statistical probabilities of forfeiture in order to avoid potential liability under the antifraud provisions, even though "actuarial" calculations of this sort are irrelevant to the functioning of such plans. This is an item not without significance since most profit-sharing plans (such as the so-called "class-year" plans) do not provide immediate vesting.

The foregoing demonstrates that the real purpose of the draftsman of Section 274 is to more or less restore the Daniel status quo ante without regard to whether in present circumstances that is an adequate legislative policy. Doubtless, the origin of this approach stems from the displays of apocalyptic concern voiced by opponents of Daniel. In fact, both pro-Daniel as well as anti-Daniel forces have been guilty of some extremism in their pronouncements. On the one hand, the anti-Daniel adherents project ruinous liabilities for private plans if Daniel is upheld, as if somehow statutes of limitations and the doctrine of laches, as well as the requirements of proving scienter,[1/] had ceased to apply to the antifraud provisions of the securities laws. On the other hand, the pro-Daniel forces appear to regard the rule requiring communications to participants of the actuarially-projected rates of forfeiture as some sort of sacred purification rite which not only will bring truth and understanding to hordes of hapless workers, but will also cleanse the private pension system of its allegedly great sin of not providing everyone with a vested right.

If this matter is to be approached in manageable terms, the place to begin is with the circumstances of Daniel itself. Stated

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1/ In Ernst & Ernst v. Hochfelder, 425 U. S. 185 (1976), the Supreme Court sharply restricted the scope of private actions for civil damages that can be brought based on section 10(b) of the Exchange Act and rule 10b-5 thereunder by holding that "scienter" is a necessary element of such a cause of action. "Scienter" was interpreted by the Court to mean intent to deceive, manipulate or defraud. By ruling that section 10(b) proscribed only knowing or intentional misconduct, the Court overrode the S.E.C.'s assertion that, since the dominant purpose of the securities laws was remedial, its provisions should be interpreted to proscribe any conduct which would have the effect of injuring investors.

succinctly, they are that Mr. Daniel was denied a pension by the Central States Teamsters Pension Fund despite over 22 years of covered employment under the plan prior to ERISA, because of a three-month break in service. The important point to note is that Mr. Daniel is not unique. There are, literally, millions of former pension plan participants who stand in exactly his shoes although the particular facts pertinent to each such participant may vary.

The possibility, really, the probability, that most of these millions of former participants would never get a pension was well-known to the Congress both prior to and during the deliberations that immediately preceded passage of ERISA in 1974. The Human Resources Committee sat through hearing after hearing during 1971-1973 listening to one "horror story" after another quite similar to the Daniel case, and, indeed, authorized a statistical survey of the degree of forfeiture in private plans,[2/] (which incidentally, was cited with approval but misapplied in the Daniel case),[3/] that

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2/ See S. Rept. No. 92-634, 92d Cong., 2d Sess., Feb. 22, 1972, at 121.

3/ The Daniel court failed to understand the background of the 1971 Senate forfeiture study. The so-called "P-1" study was the first to ever elicit historical forfeiture data from private pension plans. This technique was previously unused, and aroused a storm of controversy when its results were projected prospectively in order to draw attention to the need for pension reform legislation. (This statement can be verified by consulting news stories of the period.) In addition, because historical forfeiture data had not been maintained by most plans, out of some 1500 plans forming the study sample, only 87 provided sufficient data to permit analysis of forfeiture rates to be made.

It is clear that in the pre-ERISA period, a staggering number of pension plans used actuarial turnover assumptions that rarely corresponded to actual experience (because, legally, they were not required to take account of experience). In many instances, their assumptions were simply borrowed from tables appearing in some actuarial text. All this was par for the course and is one of the factors that led to the evolution and enactment of ERISA's funding and actuarial standards.

Given these circumstances, it seems totally implausible to have expected pre-ERISA plans to furnish actuarial projections of benefit qualification to participants; such a concept was completely alien to plans in the pre-ERISA environment and, besides, plan records were so shabbily maintained (by post-ERISA standards) that projections based on such records (or other sources) would have been worthless. See further discussion, p. 9, infra.

confirmed the wide-spread lack of adequate vesting protection in most plans at that time. Nevertheless, the very painful but necessary decision was made not to apply ERISA's vesting standards retroactively. Aside from the constitutional problems presented by such an approach, the practical and political obstacles were insurmountable. Accordingly, while I do not believe that Daniel would result in exposing plans to enormous pre-ERISA liabilities, there is a certain intellectual evasiveness about Daniel which does create uneasiness, and that uneasiness stems from the sense that the Daniel court seems to be using a previously unknown theory of securities fraud to undermine a consciously formulated Congressional policy, a policy, I may add, which was, and is, essential to ERISA's viability.

It is, therefore, not so much the specific holding of the 7th Circuit Court of Appeals which gives rise to concern among the anti-Daniel forces, but rather the intuitive awareness that an unfettered movement in the federal courts to rectify pre-ERISA injustices in private pension plans under the securities laws might result in cumulative economic problems of epic proportions. In order to combat this possibility, it is felt necessary to send the judiciary (and the S.E.C.) a signal and, apparently, Section 274 of S. 3017 is supposed to be that signal. The question presented is whether it is the right one. My answer to that is "no." Section 274 is a classic case of legislative overkill.

The Problem with Section 274

In order to see why Section 274 goes too far, it is necessary to revisit briefly the state of the law prior to ERISA. Based on a broad survey of all relevant statutes and regulations, the Senate Human Resources Committee concluded in 1972 that: "regulation of the private system's scope and operations has been minimal and its effectiveness a matter of debate . . . the assets of private plans . . . constitute the only large private accumulation of funds which have escaped the imprimateur of effective federal regulation." (S. Rept. No. 92-1150, 92d Cong. 2d Sess., Sept. 18, 1972, at 3-4.)

The foregoing conclusion was not challenged by the S.E.C. or any other federal agency. The Senate Report mentions the limited application of the federal securities laws but it is clear that the role played by the antifraud provisions was given cursory attention and only dimly perceived. Much has been made of this legislative history by those who wish to demonstrate that until Daniel was decided the S.E.C. never held the pro-Daniel position and are now, hypocritically, asserting it. However, as Judge Tone observed in his concurring 7th Circuit opinion, the S.E.C. is not infallible and in any event, in the present legislative context the argument misses the point.

Although in the absence of formal legislative history conjecture is always hazardous, nonetheless, if, in fact, the S.E.C. had voiced anything like the Daniel position to the Committee on Human Resources in 1972, it may be surmised that the Committee and its staff would not have resisted. The Committee had become inundated with thousands of complaints from bitter and angry participants all over the United States who claimed they were misled and cheated out of their pensions. After surveying the legal remedies available and finding the outlook rather bleak, it would certainly have been regarded as significant by the Committee to discover that at least one federal agency--the S.E.C.--had an enforcement procedure which, under certain circumstances, would enable some pension plan victims to retrieve their retirement benefits. Moreover, I don't think the Committee would have engaged in any legal haggle over whether defined benefit plans were "securities" and an employee's participation in a plan a "sale": if anything, the Committee would have welcomed such a position because it would have reinforced the Committee's view that employee pensions were a form of deferred compensation and not a gratuity to be bestowed or withheld at the whim of the employer. No--I think that if the Committee had learned in 1972 that the S.E.C. held the Daniel position, it would have expended its effort attempting to truck the mass of pension complaints it had received over to that agency.

However, that would not have been the end of the matter. The fact that there might be a federal remedy for misrepresentations or omissions with respect to pension plan communications in no way would have diminished the need for comprehensive pension reforms, such as vesting, funding, fiduciary standards, termination insurance and more systematic and precise disclosure requirements. With the benefit of hindsight, it now seems clear that the problem instead would have been to determine to what extent, if any, ERISA should displace or logically absorb the antifraud protections.

Whatever may have been the solution to this problem in 1972, in 1978 it seems fairly obvious that the jurisdictional overlapping between ERISA's fiduciary provisions and the antifraud provisions, as well as the more elaborate disclosure provisions in ERISA, argue in favor of explicitly shifting the enforcement of the antifraud provisions pertaining to employee benefit plans to ERISA, or making it clear that ERISA supercedes the securities laws in this regard. I believe such a solution is warranted on both theoretical and practical grounds. As to the former, it is difficult to see what the antifraud remedy adds that is not and cannot be handled under ERISA's fiduciary provisions. In fact, ERISA's fiduciary provisions are superior from a plaintiff's standpoint because it is not necessary to prove scienter under the fiduciary provisions. On practical grounds, the S.E.C.'s action in the Shenker case[4/] seems to me to create sufficient concern over potentially burdensome SEC-Depart-

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4/ S.E.C. v. Shenker, et al., D.D.C., Civ. Action No. 77-1787. This action concerned allegations of securities fraud involving inter alia the loaning of assets of the Pipefitters welfare and pension funds (approximately 65% of the combined funds' assets) to thinly-capitalized, highly speculative companies of Mr. Shenker. This part of the case was settled by a consent decree entered into with the S.E.C. It is clear that the allegations relating to the Pipefitter's funds were actionable under ERISA's fiduciary standards. It is also clear that the S.E.C. failed to consult effectively with the Department of Labor concerning the Shenker case in violation of the spirit, if not the letter, of Section 506 of ERISA.

ment of Labor conflict in enforcement philosophy to warrant centralizing all such enforcement activity in the Department of Labor.

I believe, therefore, that there is, or should be, a decisive difference between the post-ERISA application of the antifraud provisions to benefit plans as contrasted with any pre-ERISA application. A post-ERISA need for the antifraud provisions is de minimus; the pre-ERISA need for these provisions, however, is still great.

Why Pre-ERISA Application of the Securities Anti-Fraud Provisions Should not be Upset

Without the right to proceed under the antifraud provisions, participants will have no meaningful access to the federal courts to seek reparation for fraudulent conduct by pension plan sponsors and fiduciaries. Such access is critical because:

1. The class action device available under the federal rules is the only mechanism which will permit these actions to be brought from a practical standpoint. The procedural codes of many states would not permit such class actions to be maintained.

2. The common-law fraud doctrine, as applied in many states, is considerably more restrictive than the concept of fraud as developed under Rule 10b-5 of the Securities Exchange Act which includes the omission to state a material fact.

3. Application of state common-law fiduciary principles is still highly uncertain or non-existent. This was the conclusion reached by both the Executive Branch and the Congress in the 1970's (see e.g., Senate Report No. 92-634, 92d Cong., 2d Sess., Feb. 22, 1972, at 26) and is the reason why the federal fiduciary provisions in Title I of ERISA were enacted.

One of the principal purposes of ERISA was to assure participants access to the federal courts to pursue all of their rights under their plan. See ERISA § 502. It would be ironic, indeed, if the enactment of ERISA was used as a pretext for depriving participants of the limited access they might otherwise have for pre-ERISA claims.

Even though the federal concept of fraud under Rule 10b-5 is more liberal than the common-law doctrine as applied in many states, in order to succeed in a Rule 10b-5 action plaintiff must still show "scienter," i.e., that the defendant intended to deceive the plaintiff concerning material facts. Ernst & Ernst v. Hochfelder, supra. As indicated previously, the availability of recovery under Rule 10b-5 only if intentional deception can be proven surely belies any notion that numerous pension plans will be subject to enormous liability for unintentional conduct which may have misled plan participants during pre-ERISA years. At the same time, there is no reason why those fiduciaries or plan sponsors who deliberately engaged in deceptive practices during pre-ERISA years should now be exonerated.

Unfortunately, the limited dimensions of federal antifraud actions were obscured by the Seventh Circuit holding that the alleged failure of Daniel's union to disclose the actuarial likelihood of his receiving a pension would, if proved, constitute an omission of material information and entitle Daniel to relief. Viewed historically, it is inconceivable that any pre-ERISA plan sponsor or fiduciary could be found responsible for intentionally withholding actuarial projections in the sense of wishing to practice deception since no one could have had the slightest idea at the time that these projections were material information. This is, concededly, the most troubling aspect of Daniel and doubtless is what has caused most of the furor because even the most scrupulous and fair-minded of plan sponsors and fiduciaries could be found liable for fraud if this aspect of Daniel was applied mindlessly.

Since the theory of requiring actuarial projections is essentially a "gimmick" and its usefulness highly questionable--at least in terms of relating it to the kind of information that pre-ERISA plans could reasonably have been expected to furnish or make available--there should be no serious objections to legislation eliminating this element as a viable theory of securities fraud. This can be accomplished by simply stating legislatively that failure to furnish actuarial probabilities to plan participants shall not be considered an omission of a material fact or words to that effect.[5] However, it should be made abundantly clear that such legislative relief in no way implies exoneration of other pre-ERISA intentional misrepresentations or omissions of material information involving pension plan participants.[6]

To contrast the type of ersatz fraud created by the theory pertaining to actuarial projections with the genuine article, the following illustration from litigation handled by Mittelman and Gordon will suffice:

> The plaintiff worked a total of 29 years with Company X, but 15 of those years was actually worked for Company Y, which X acquired by merger in 1961. The complaint alleged that at the time of the merger, when plaintiff was considering employment with Company X, he was orally advised that his years of service with Y would count toward pension benefits under Company X's pension plan. Upon being formally employed by Company X, he was provided with a Plan booklet which merely stated that prior service with subsidiary corporations counted for benefit accrual purposes. Plaintiff was sent various statements relating to promotion, recognition of outstanding service, and qualification for vacation benefits, all of which stated or recognized explicitly his prior years of service with the predecessor subsidiary corporation. The pension plan provided for vesting

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5/ The question of whether statistical probabilities of collecting retirement benefits should be furnished to post-ERISA participants as a matter of affirmative disclosure under ERISA is an altogether different issue than whether the failure to furnish such information is fraud. Nothing asserted in my statement should be interpreted to preclude legislative consideration of affirmative disclosure of statistic probabilities, etc., under ERISA. I have no specific recommendations on this matter at this time.

6/ If the Supreme Court should overrule the Seventh Circuit in Daniel, the Committee should consider special legislation that would permit the bringing of actions that involve such intentional pre-ERISA misrepresentations or omissions.

after attainment of age 50 and 25 years of service. Contrary to the previous impressions plaintiff had received, he was told when he was discharged that even though he had attained age 50 he was not entitled to any pension benefits because he only had fourteen years of service with Company X, the fifteen years of service with Company Y did not count because the pension plan specifically credited service only with respect to defendant's subsidiaries during periods when 50% or more of the subsidiary's voting stock was owned by Company X. The Plan provision relating to the 50% or more ownership requirement was written in such incredible legalese that an untutored layman could not possibly penetrate it.

Can there be any doubt that in a situation like this a worker deserves the protection of the antifraud provisions? These cases are by no means unique. Conversations with other attorneys and actuaries convince me that while there may not have been widespread abuses of this nature, abuses there have been and they should not be condoned or consigned to the twilight zone of doubtful legal remedies.

Of course, the argument will be made that leaving application of the antifraud provisions intact as to pre-ERISA abuses will still expose employers, unions and others to potentially massive liabilities owing to the fact that what constitutes misrepresentations or omissions of material information must be determined on a case-by-case basis. Thus, even if the theory of actuarial projections is discarded, federal courts may invent equally novel theories which could lead to financial ruin.

This argument is somewhat reminiscent of the huge corporate liabilities that were predicted in the wake of the Texas Gulf Sulphur case where the company was held liable under Section 10(b) of the Exchange Act for issuing an inaccurate press release which affected the market price of its stock to the detriment of tens of thousands of investors. Despite the fact that many thought the consequences of Texas Gulf Sulphur were frightening, the courts have found ways to structure the development of subsequent Section 10(b) actions in such a manner as to permit individuals to seek redress for such economic wrongs without creating corporate havoc. Despite the somewhat aberrational content of the Daniel decision, most courts are able to size up dishonest disclosure when they see it and will take steps to provide a remedy for the resulting injuries to participants without inflicting unreasonable burdens on plans or their sponsors.

Conclusion

In enacting ERISA, Congress sought to establish a difficult but necessary balance between the needs of workers for minimum standards of protection in their pension plans and the needs of plan sponsors for immunity from the kind of governmental regulation that would disrupt the continued growth and stability of private retirement programs. Obviously, perceptions as to how that balance should be maintained will differ but it is submitted that Section 274 shifts the balance too much in favor of the plan sponsors and deprives plan participants of a highly desirable form of protection. I further believe that the meat-axe approach underlying Section 274 should be dropped and that using more surgically precise methods in dealing with the problems presented by Daniel would result in leaving intact the basic Daniel ruling with respect to pre-ERISA communications while allowing ERISA to absorb the Daniel doctrine for communications made after January 1, 1975.

In sum, there are important protections for workers established by Daniel which ought to be preserved; there are also problems stemming from Daniel that can or should be handled without capitulating to those who would compel the Congress to abandon victims of intentional fraud in order to vindicate their position.

Senator WILLIAMS. I think that concludes our hearings. Excellent 3 days. Very stimulating and thought provoking.

Thank you.

[Whereupon, at 12:23 p.m., the subcommittee adjourned, subject to the call of the Chair.]

APPENDIX

Additional Statements Submitted for the Record

STATEMENT OF SENATOR FRANK CHURCH, CHAIRMAN
SENATE SPECIAL COMMITTEE ON AGING
before
JOINT HEARINGS ON PENSION SIMPLIFICATION
held by
SUBCOMMITTEE ON LABOR, SENATE HUMAN RESOURCES COMMITTEE
and
SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS
SENATE COMMITTEE ON FINANCE

Mr. Chairman, and members of the Subcommittees on Labor and on Private Pension Plans and Employee Fringe Benefits.

The subject which these joint hearings address - pension plan simplification - is one of the most important on the national agenda.

The increased longevity of the American population, the national trend toward earlier retirement, fiscal strains on the Social Security System, and the recent enactment of the Age Discrimination Employment Amendments of 1978, point up the need for a strong and equitable private pension system.

The Employee Retirement Income Security Act of 1974, ERISA, was enacted in response to the overwhelming need for adequate pension protection and disclosure by America's workers. Yet, while ERISA's safeguards were clearly necessary, it has become clear that ERISA's administrative framework is in need of improvement.

Continued delays in the publication of essential regulations; the unwieldiness inherent in the present dual jurisdiction scheme: and paperwork requirements and other "red tape" problems have caused extensive concern.

We must not retreat from ERISA's protections. We must instead recognize that this necessarily complex bill can instill new confidence in American workers as they regard the certainty of retirement benefits. ERISA, by pruning the weakest and most inequitable pension plans, can help develop a fundamentally healthier private retirement system.

On the other hand, despite good faith efforts by the Departments of Labor and the Treasury, and reforms instituted at the suggestion of the Commission on Federal Paperwork, it has become clear that ERISA needs legislative overhaul. You will be considering a variety of legislative proposals during these three days of hearing, as well as the President's Reorganization Proposal. All of these schemes have merit; and I have full confidence that, through the cooperative efforts of the Committees on Finance and Human Resources, ERISA's dual jurisdiction problems can be substantially reduced and uniform accounting and actuarial standards for essential pension plan reporting can be established.

The Committees are to be congratulated on their joint initiative in addressing these difficult issues. This same spirit will be required in the future, as ERISA undergoes further necessary fine-tuning, and the Congress deals with many of the unfinished items on the private pension agenda -- such as better integration with the Social Security System, portability, and adequacy of retirement benefits in the face of inflation. The Special Committee on Aging, which I chair, will contribute fully to this effort and work with the authorizing

Committees in every way possible. Last month we held three days of opening hearings on "Retirement, Work, and Lifelong Learning," focusing on the adjustments that will be required of society in response to the demographic, biomedical, and economic changes related to the "aging" of the Nation's population. The Committee on Aging stands ready to make its contribution to the Congressional consideration of pension issues by supplying data on the broad societal transformations which must necessarily impact on the form and adequacy of the private pension system. The soundness of the private pension system is second only to the fiscal integrity of Social Security in our joint objectives of guaranteeing security in retirement and expanding work and retirement options, for all Americans.

* * * * * * *

33-549 O - 78 - 66

United States Senate

COMMITTEE ON THE JUDICIARY
WASHINGTON, D.C. 20510

August 31, 1978

Senator Harrison A. Williams, Jr.
Chairman
Senate Committee on Human Resources
352 Russell Senate Office Building
Washington, D.C. 20510

Dear Pete:

Enclosed is a copy of comments I received from Actuarial and Administrative Services of Phoenix, Arizona, a division of Investment and Retirement Systems, Inc., concerning the Employee and Retirement Income Act of 1974. I would appreciate it if you would include these views in the hearing record on S. 3017.

With best wishes, I remain

Sincerely,

Dennis

DENNIS DeCONCINI
United States Senator

DDC/JMT
enclosure

ACTUARIAL REQUIREMENTS

I. Enrollment: Prior to ERISA Defined Benefit costs for small (less than 25) participants were typically calculated by an actuarial assistant. Plans of this size are too small to warrent the use of funding assumptions more complicated than an interest growth rate for the fund and an annuity cost at retirement for benefits payable. Payouts in a plan of this size are almost always made by lump-sum or through the purchase of a single premium commercial annuity contract. Costs can thus be calculated by any person familiar with basic funding methodology who has access to interest and annuity tables.

The Joint Board for the Enrollment of Actuaries, however, took the position that there should only be one classification for Enrolled Actuaries and that to be enrolled, an actuary must be capable of handling the most complex plans and of generating his own rate tables for each calculation. What's good for General Motors is good for Joe's Used Car Lot. The small plan must now locate an enrolled Actuary and pay his fees for work that is still being done either by a computer or a clerk but now has an expensive signature attached.

II. Reporting: Form 5500 Schedule B must now be signed by an Enrolled Actuary and filed each year even though the Act itself [Section 1033; Code Section 6059(a)] requires filing a signed Actuarial Report once every three years "unless the Secretary or his delegate determines that more frequent reports are necessary". The only change that has been proposed by IRS and DOL on this Form is to require all plans to adopt the same actuarial methods so that all Forms will provide the same data. No importance was placed on the fact that Accrued Benefit is much more complicated than Aggregate Level and therefore much more expensive to the sponsor.

Adding a lower level of classification of actuaries and cutting filing back to the three year requirement would bring costs back to what they were previously and still remain within both the spirit and the letter of the law.

INITIAL QUALIFICATION PROCESS

Although the IRS portion of this process remains essentially the same as before E.R.I.S.A., it is far more costly and time consuming than before. The forms themselves are slightly more difficult to complete but most of the additional expense comes in after receipt by IRS. In the Phoenix district (with one to two exceptions) the quality of the IRS staff responsible for qualifying plans is far below previous standards. On a typical submission, the plan sponsor will receive a list of changes to be made six to eight months after IRS receipt. This list is designed to show deficiencies in the trust document but more often than not it shows deficiencies in the review of this document. An example of requested changes we receive continually is the treatment of Voluntary Contributions in Defined Contribution plans. Our trust document states in the accounting and allocation section that all contributions will be placed in Account A if Employer Contributions and Account B if Voluntary Employee Contributions and under Vested Benefits that all amounts in Account B will be 100% vested at all times. Approximately half of the reviewers fail to spot these sections and send out a notice that the trust does not provide for segregation and full vesting. Apparently they did not check Form 5301 which indicates the Section and Page where the provisions can be found. These changes seem trivial but involve determining what the reviewer thinks was left out and whether it actually was and then either composing a lengthy explanation as to where it is included or rewriting another Section to duplicate the original. Changing what wasn't wrong is usually less expensive in the long run than explaining why it's right.

If the reviewer is really careless, it can take as much time to amend the amendment as it did to draft it in the first place.

For some plans, the paperwork doesn't stop there. In an effort to get all qualifications submitted, IRS mass mailed a questionaire to all plans that their computer showed as outstanding. We received approximately 20 of these - all on plans that were pending at IRS - and returned them promptly. Of these, 10 or so received a second questionaire asking when they intended to submit (most had Determination Letters by this time) and again they were returned promptly. One of these ten has now received a third letter - this time requesting a completed submission package, using a totally different format than originally and threatening loss of qualified status. The final letter contained for the first time the name of a human being in Los Angeles and a phone number. We called and got the computer record corrected. At the end of the conversation, the reviewer stated that since phone calls were expensive we should have simply checked the appropriate space and returned the form as requested. The phone call was less costly than duplication and postage costs would have been, let alone time spent in composing a response.

Adequate staffing and training of the IRS regional review would probably do more to reduce qualification costs than any further revision of Forms and/or procedures.

FORM 5500 SCHEDULE A

(Copy Attached)

The intended purpose of this form is to provide Sponsors, Trustees, Participants and IRS/DOL with information useful in evaluating insurance and annuity products providing plan benefits. 'Information to be included for life contracts is limited to contract numbers, policy year dates, paid and unpaid premium amounts, commissions paid, expenses incurred and actuarial rate bases used in premium calculation. It is extremely unlikely that the average Sponsor, Trustee or Participant is able to evaluate an insurance contract on the basis that premiums paid were \$X, commissions paid were \$Y, and rates were based 90% of 1958CSO Basic 3% calculated to mature at the later of 25 years or age 65. It would probably be more meaningful to all concerned to provide instead a summary of benefit coverage (i.e. death only, death & disability, settlement options available, etc.).

SCHEDULE A
(Form 5500)
Department of the Treasury
Internal Revenue Service
Department of Labor
Pension and Welfare Benefit Programs
Pension Benefit Guaranty Corporation

Insurance Information

This schedule is required to be filed under section 104 of the Employee Retirement Income Security Act of 1974.

▶ File as an Attachment to Forms 5500, 5500-C and 5500-K

1977

This Form Is Open to Public Inspection

For plan year beginning , 1977 and ending , 19

▶ Part I must be completed for all plans required to file this schedule.
▶ Part II must be completed for all insured pension plans.
▶ Part III must be completed for all insured welfare plans.

▶ Please complete all applicable items on this Form. If an item does not apply, enter "N/A".
▶ Round off money amounts to nearest dollar.

Name of plan sponsor as shown on line 1(a) of Form 5500, 5500-C or 5500-K | Employer identification number

Name of plan | Enter three digit plan number ▶

Part I Summary of All Insurance Contracts Included in Parts II and III

Group all contracts in the same manner as in Parts II and III.

1 Check appropriate box:
(a) ☐ Welfare plan (b) ☐ Pension plan (c) ☐ Combination pension and welfare plan

2 Coverage:

(a) Name of insurance carrier	(b) Contract number or identification	(c) Approximate number of persons covered at end of policy or contract year	Policy or contract year (d) From	(e) To

3 Payments to soliciting agents and brokers:

(a) Contract number or identification	(b) Name and address of each soliciting agent or broker receiving compensation	(c) Amount of sales commissions paid to soliciting agent or broker: First year	Renewal	(d) If soliciting agent or broker is compensated by a method other than as a percentage of premiums, explain that method of compensation

4 Premiums due and unpaid at end of the plan year ▶ $, contract number, or identification ▶

Part II Insured Pension Plans

Provide information for each contract on a separate Part II. Where individual contracts are provided, the entire group of such individual contracts with each carrier may be treated as a unit for purposes of this report.

▶ Contract number or identification ▶

5 Contracts with allocated funds, for example, individual policies or group deferred annuity contracts:
(a) State the basis of premium rates ▶
(b) Total premiums paid to carrier
(c) If the carrier, service or other organization incurred any specific costs in connection with the acquisition or retention of the contract or policy, other than reported in 3 above, enter amount
Specify nature of costs ▶

6 Contracts with unallocated funds, for example, deposit administration or immediate participation guarantee contracts. Do not include portions of these contracts maintained in separate accounts:
(a) Balance at end of previous policy year
(b) Additions: (i) Contributions deposited during year
(ii) Dividends and credits
(iii) Interest credited during year
(iv) Transferred from separate account
(v) Other (specify) ▶
(vi) Total additions
(c) Total of balance and additions, (a) plus (b)(vi)
(d) Deductions:
(i) Disbursed from fund to pay benefits or purchase annuities during year
(ii) Administration charge made by carrier
(iii) Transferred to separate account
(iv) Other (specify) ▶
(v) Total deductions
(e) Balance at end of current policy year, (c) less (d)(v)

7 Separate accounts: Current value of plan's interest in separate accounts at year end

Part III **Insured Welfare Plans**
Provide information for each contract on a separate Part III. If more than one contract covers the same group of employees of the same employer(s) or members of the same employee organization(s), the information may be combined for reporting purposes if such contracts are experience-rated as a unit. Where individual contracts are provided, the entire group of such individual contracts with each carrier may be treated as a unit for purposes of this report.

8 (a) Contract number or identification	(b) Type of benefit	(c) List gross premium for each contract	(d) Premium rate or subscription charge

9 Experience rated contracts:
(a) Premiums:
(i) Amount received . . . . .
(ii) Increase (decrease) in amount due but unpaid . . . . .
(iii) Increase (decrease) in unearned premium reserve . . . . .
(iv) Premiums earned, (i) plus (ii), minus (iii) . . . . .
(b) Benefit charges:
(i) Claims paid . . . . .
(ii) Increase (decrease) in claim reserves . . . . .
(iii) Incurred claims (i) plus (ii) . . . . .
(iv) Claims charged . . . . .
(c) Remainder of premium:
(i) Retention charges (on an accrual basis)—
(A) Commissions . . . . .
(B) Administrative service or other fees . . . . .
(C) Other specific acquisition costs . . . . .
(D) Other expenses . . . . .
(E) Taxes . . . . .
(F) Charges for risks or contingencies . . . . .
(G) Other retention charges . . . . .
(H) Total retention . . . . .
(ii) Dividends or retroactive rate refunds. (Such amounts were ☐ paid in cash or ☐ credited.) . . .
(d) Status of policyholder reserves at end of year:
(i) Amount held to provide benefits after retirement . . . . .
(ii) Claim reserves . . . . .
(iii) Other reserves . . . . .
(e) Dividends or retroactive rate refunds due (do not include amount entered in (c)(ii)) . . . . .
10 Non experience rated contracts:
(a) Total premiums or subscription charges paid to carrier . . . . .
(b) If the carrier, service or other organization incurred any specific costs in connection with the acquisition or retention of the contract or policy, other than reported in 3 above, report amount . . . . .
Specify nature of costs ▶ ____________

If additional space is required for any item, attach additional sheets the same size as this form.

General Instructions

This schedule must be attached to Form 5500, 5500–C or 5500–K, for every defined benefit, defined contribution and welfare benefit plan where any benefits under the plan are provided by an insurance company, insurance service or other similar organization.

Specific Instructions

(References are to the line items on the form.)

Include only contracts with policy or contract years ending with or within the plan year. Data on Schedule A should be reported only for such policy or contract years. Exception: If the insurance company maintains records on the basis of a plan year rather than policy or contract year, data on Schedule A (Form 5500) may be reported for the plan year.

Include only the contracts issued to the plan for which this return/report is being filed.

2(c).—Since the plan coverage may fluctuate during the year, the number of persons entered should be that which the administrator determines will most reasonably reflect the number covered by the plan at the end of the policy or contract year.

Where contracts covering individual employees are grouped, entries should be determined as of the end of the plan year.

2(d) and (e).—Enter the beginning and ending dates of the policy year for each contract listed under column (b). Where separate contracts covering individual employees are grouped, enter "N/A" in column (d).

5(a).—The rate information called for here may be furnished by attachment of appropriate schedules of current rates filed with appropriate state insurance departments or by a statement as to the basis of the rates.

6.—Show deposit fund amounts rather than experience credit records when both are maintained.

8(d).—The rate information called for here may be furnished by attachment of appropriate schedules of current rates or by a statement as to the basis of the rates.

9(b)(iv).—The amount in 9(b)(iii) will not necessarily agree with the amount in 9(b)(iv).

United States Senate

COMMITTEE ON APPROPRIATIONS

WASHINGTON, D.C. 20510

August 17, 1978

The Honorable Harrison A. Williams, Jr.
United States Senate
Room 352, Russell Senate Office Building
Washington, D.C. 20510

Dear Pete:

Enclosed please find a copy of a telegram I received from Mr. Julius Brecht, Director of Alaska Division of Banking, Securities, and Corporations. I would appreciate your including Mr. Brecht's comments in the hearing record on S. 3017, the ERISA Improvement Act of 1978.

Thank you for your consideration.

With best wishes,

Cordially,

TED STEVENS
United States Senator

Enclosure

western union Telegram

IPMPOMU HSB
1-012337A227 08/15/78
ICS IPMAFUA ANG
01009 A TDA JUNEAU ALASKA 50 08-15 840A ADT AUG 15 4 54 PM '78
PMS SENATOR TED STEVENS OF ALASKA

CAPITOL HILL DC

UNDERSTAND SENATE FINANCE AND HUMAN RESOURCE SUBCOMMITTEES START HEARINGS ON S,3017 TODAY. WE ARE OPPOSED TO PRE-EMPTION LANGUAGE CONTAINED IN SUBSECTION 3 OF SECTION 274 AND URGE THAT SUCH EXEMPTION FROM REGULATION BE DELETED, WE SUPORT POSITION TAKEN BY NATIONAL ASSOCIATION OF SECURITIES ADMINISTRATORS,

JULIUS J BRECHT, DIRECTOR/ADMINISTRATOR OF SECURITIES
POUCH D
JUNEAU, AK, 99811

15:10 EST

IPMPOMU HSB

United States Senate
COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

August 23, 1978

Mike Stern
Staff Director
Senate Finance Committee
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mike:

Would you please include this in the hearing record for the ERISA Improvement Act of 1978, S. 3017.

Thanks very much.

Cordially,

Bob

BOB PACKWOOD

BP/tbb

western union **Telegram**

IPMPOMU HSB
1-012337A227 08/15/78
ICS IPMAFUA AHG
 01009 A TDA JUNEAU ALASKA 50 08-15 840A ADT Aug 15 4 54 PM '78
PMS SENATOR TED STEVENS OF ALASKA

CAPITOL HILL DC

UNDERSTAND SENATE FINANCE AND HUMAN RESOURCE SUBCOMMITTEES START HEARINGS ON S,3017 TODAY. WE ARE OPPOSED TO PRE-EMPTION LANGUAGE CONTAINED IN SUBSECTION 3 OF SECTION 27A AND URGE THAT SUCH EXEMPTION FROM REGULATION BE DELETED. WE SUPORT POSITION TAKEN BY NATIONAL ASSOCIATION OF SECURITIES ADMINISTRATORS.

JULIUS J BRECHT, DIRECTOR/ADMINISTRATOR OF SECURITIES
POUCH D
JUNEAU, AK. 99811

13:10 EST

IPMPOMU HSB

Testimony by Congressman John F. Seiberling on HR 13446, before the Subcommittee on Private Pension Plans of the Senate Finance Committee and the Labor Subcommittee of the Senate Human Resources Committee, August 15, 1978.

Messrs. Chairmen and members of the Subcommittees, I appreciate this opportunity to bring to your attention legislation I have introduced to amend the Employee Retirement Income Security Act of 1974. My bill, HR 13446, would provide that pensions covered by ERISA can be assigned or alienated by court order for alimony or child support.

My interest in this subject began when I received a letter from a constituent whose husband left her and their two children, and retired at the age of 53. Because ERISA section 206(d)(1) provides that "benefits provided under the plan may not be assigned or alienated," and because ERISA preempts state law, the husband's pension plan has ignored a state court order attaching his pension for the support of his two children. My constituent has had to turn to welfare for subsistence.

Prior to 1975, there were a number of such non-alienation provisions in federal law. They covered civil service pensions (5 USC 8346(a)), foreign service pensions (22 USC 1004(c)), armed forces survivors' pensions (10 USC 1450(i)), lighthouse attendants' pensions (33 USC 775), longshoremen's and harbor workers' pensions (33 USC 916), railroad workers' pensions (45 USC 231m), private pensions (29 USC 1056(d)), veterans' benefits (38 USC 3101(a)), social security benefits (42 USC 407), and supplemental security income benefits (42 USC 1383(d). In 1975, as part of PL 93-647, Congress established the Child Support Enforcement Program, a joint federal-state effort to collect support payments from absent parents. Recognizing the inconsistency of the government on the one hand attempting to enforce support payments and on the other shielding federal retirees from these efforts, Congress voided almost all these non-alienation provisions. Only one remains in force today--the provision in ERISA prohibiting the attachment of private pensions.

Virtually all private pension plans covered by ERISA--that is, virtually all private pension plans--have enacted what are commonly called "spendthrift" clauses. The public interest in requiring these non-alienation clauses is clear, and reflected in the name "spendthrift." They prevent retirement funds from being spent for other purposes. A retiree often has only his pension and his social security to rely on. Permitting him to use his pension rights as collateral on a loan, or allowing creditors to attach his pension to satisfy his debts, could easily leave him unable to afford the necessities of life and force him to turn to welfare.

But no conceivable public interest is served if the spendthrift clause, instead of shielding a retiree's pension from business creditors, is used to shield him from his moral and legal obligation to provide for the support of his dependents. There is little reason to believe that the courts would uphold this interpretation of ERISA. Indeed, those court cases which have come to my attention emphatically deny that Congress intended this effect. The Court of Appeals for New York State, in Wanamaker v. Wanamaker, said it is "against the public interest to permit the pensioner, a husband, or former husband, or father to reap all of the benefits of his pension while his dependents have to seek support from other sources." In Cogollos v. Cogollos, the New York County Supreme Court said, "The court does not believe Congress intended to create a privileged sanctuary, behind which a delinquent husband or father can thumb his nose at concededly valid and outstanding support orders. It is inconceivable that Congress meant to authorize use of a pension fund as a barrier behind which a husband could shed all his assets and income, live on the pension arrangements, and leave his wife--or, in other cases, infant children --to go begging for welfare."

Even though the courts are rejecting this application of ERISA, the Congress itself must make clear that private pensions can be attached for support payments. Dependent spouses and children being denied pension benefits for support are hardly in a financial position to sue. If we leave the issue to the courts, each pension plan will have to be sued individually. Enactment of HR 13446 would remove from both the petitioners and the courts this burden of litigation, since those pension plans which ignored court orders for support payments could be cited for contempt.

I would like to briefly describe the provisions of the bill. It creates a new subparagraph B which is an exception to 206(d)(1). Since the purpose of the bill is to prohibit the "use of a pension fund as a barrier behind which a husband [can] shed all his assets and income, [and] live on the pension arrangements" to the detriment of his dependents, the bill specifically limits the court orders to "any participant or beneficiary <u>who is receiving benefits</u>." A court thus cannot use this provision to order an early payout of pension benefits to satisfy a community property settlement. This intent is further emphasized in (ii), which specifically prohibits the court order itself from affecting the time when benefits are payable to the pensioner. Finally, I think Congress ought to have some way of knowing how many pensions are being attached pursuant to this provision, and for what amount, and for that reason I have included a provision requiring that the Secretary of Labor be sent a copy of the court order.

I have requested the opinions of the Internal Revenue Service, the Department of Health, Education, and Welfare, and the Labor Department on this bill, and I will submit them for your hearing record when I have received them.

In closing, I want to point out that the child support enforcement program I mentioned earlier has been so successful that HEW Secretary Joseph Califano recently announced the formation of Project Responsibility, a departmental initiative to more than double the $423 million in child support collected from absent parents in 1977. I commend Secretary Califano for his efforts, and I urge this Congress to do its part in this effort, by enacting HR 13446 and bringing non-alienation provisions for private pensions into line with those for federal pensions and with public policy and interests. Thank you.

33-549 O - 78 - 67

95TH CONGRESS
2D SESSION

H. R. 13446

IN THE HOUSE OF REPRESENTATIVES

JULY 12, 1978

Mr. SEIBERLING introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 and the Employee Retirement Income Security Act of 1974 to permit assignments or alienations of rights under pension plans which are pursuant to certain court orders.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (13) of section 401 (a) of the Internal Revenue Code of 1954 (relating to requirements for qualification of pension plans, etc.) is amended—

(1) by striking out "(13) A trust" and inserting in lieu thereof "(13) (A) A trust";

(2) by striking out "This paragraph" in the last sentence and inserting in lieu thereof "This subparagraph"; and

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(3) by adding at the end thereof the following new subparagraph:

"(B) Subparagraph (A) shall not apply to any assignment or alienation of benefits payable to any participant or beneficiary who is receiving benefits under the plan if—

"(i) such assignment or alienation is pursuant to a decree of divorce or separate maintenance, or any other order of a court which requires an individual to contribute to the support of his children;

"(ii) such decree or order does not affect the time when benefits are payable under the plan; and

"(iii) a copy of such decree or order is submitted to the Secretary of Labor at such time and in such manner as he may by regulations prescribe."

(b) Subsection (d) of section 206 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new paragraph:

"(3) Paragraph (1) shall not apply to any assignment or alienation of benefits payable to any participant or beneficiary who is receiving benefits under the plan if—

"(A) such assignment or alienation is pursuant to a decree of divorce or separate maintenance, or any other order of a court which requires an individual to contribute to the support of his children;

"(B) such decree or order does not affect the time when benefits are payable under the plan; and

"(C) a copy of such decree or order is submitted to the Secretary at such time and in such manner as he may by regulations prescribe."

(c) The amendments made by this section shall take effect on the date of the enactment of this Act.

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Record Statement, ERISA Hearings

COMMENTS AND RECOMMENDATIONS

ON S. 3017

ERISA IMPROVEMENTS ACT OF 1978

SUBMITTED TO:

SUBCOMMITTEE ON LABOR OF THE SENATE COMMITTEE ON HUMAN RESOURCES

SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS

OF THE SENATE COMMITTEE ON FINANCE

BY:

AMERICAN PAPER INSTITUTE

SEPTEMBER 15, 1978

API is the national trade association of the pulp, paper and paperboard industry; its two hundred member companies provide more than 90% of the nation's output of these products. The paper industry ranks among the ten largest in the United States and operates throughout the nation. Last year the industry employed approximately 700,000 people and its outlay in wages, salaries and benefits amounted to more than $12 billion.

LEGISLATIVE PROBLEMS AND RECOMMENDATIONS

S. 3017 ERISA IMPROVEMENTS ACT OF 1978

SUBTITLE B - EMPLOYEE BENEFITS COMMISSION

The proposal to consolidate the ERISA functions of the Labor Department, Pension Benefit Guaranty Corporation, and the Internal Revenue Service under a new agency, the Employee Benefits Commission, is unnecessary since the three agencies have fairly well defined their responsibilities. Jurisdictional problems that arose immediately after passage of ERISA have considerably eased. Moreover, establishment of a single agency will not eliminate the need to develop and maintain close coordination and cooperation between the Treasury and Labor Departments. Further, if a single agency concept is expanded to include control of the Social Security system, with total responsibility for providing retirement income, this could result in a weakening of the private pension plan system.

RECOMMENDATION

We urge that Sec. 122 and Sec. 123 be deleted from this legislation. We support the efforts of Treasury and Department of Labor to develop closer coordination and cooperation in the regulation of pension and welfare plans.

Sec. 201. MULTIEMPLOYER PLANS

A plan will be a multiemployer plan under ERISA if it is collectively bargained and has 10 or more contributing employers.

RECOMMENDATION

We support this new definition of a "multiemployer plan". We support the principle that multiemployer plans should be subject to the same regulations as single employer plans. If an employer withdraws from a multiemployer trust, the employer should be held responsible only for the liabilities pertaining to its employees.

SUBTITLE B PART 1 - REPORTING AND DISCLOSURE

These provisions would simplify annual reporting, consolidate Form EBS - 1 and the Form 5300 series, eliminate the summary annual report, and simplify reporting of participants' benefits rights.

RECOMMENDATION

We strongly support these proposals. These revisions would reduce costly and unnecessary requirements, and facilitate more efficient administration of plans without reducing ERISA protection.

Sec. 238. JOINT AND SURVIVOR ANNUITY

This provision would expand joint and survivor annuity coverage by requiring that the plan provide a survivor's annuity for the spouse of a participant who has not less than a 50% vested benefit and who dies before the annuity starting date.

RECOMMENDATION

We oppose this provision. This proposal would increase plan costs, lead to reduced benefits, and conflict with existing life insurance programs. It may also contribute to further plan terminations and strengthen the reluctance of some companies to initiate pension plans. We urge reinstatement of Sec. 205 (h); cost of this coverage should be charged to plan participants in any equitable fashion.

Sec. 251. FUNDING TO TAKE ACCOUNT OF FUTURE AMENDMENTS

This provision would take into account provisions of a plan which are not yet effective, for plan years beginning after Dec. 31, 1980. The proposal could significantly alter customary collective bargaining practices, could accelerate the cost of funding plans, result in significant and unnecessary complexity, and could lead to additional plan terminations.

RECOMMENDATION

We oppose the mandatory requirement that after 1980 a plan's funding method must take into account provisions of a plan which are not yet effective.

Sec. 264. COFIDUCIARY RESPONSIBILITY

This provision would add a new subsection 405 (e) (1) which provides that in the case of a fiduciary who is not an individual, "knowledge" shall mean knowledge actually communicated to the fiduciary's officer or employee who is authorized to carry out the fiduciary's responsibilities.

RECOMMENDATION

We support this proposal to more accurately and realistically clarify the concept of "knowledge".

Sec. 273. IMPACT OF INFLATION ON RETIREMENT BENEFITS

Section 273 provides for a study to be made of the feasibility of requiring pension plans to provide cost of living adjustments to benefits payable under such plans. Cost of living adjustments would represent a major cost item over which plan sponsors would have little control.

The proposal to study this topic now would be a duplication of the work being done by the National Commission on Social Security, Commission on Pension Policy, and the Advisory Council on Social Security. All are studying issues relating to a national retirement policy.

RECOMMENDATION

The study proposed in Sec. 273 should be deferred until the above listed committees and study groups have completed their reports.

Sec. 274. PREEMPTION

Securities Laws This proposal provides that ERISA supercedes federal and state securities laws. This proposed change makes it clear that the interest of an employee in an employee benefit plan is not a security within the meaning of federal or state securities laws.

RECOMMENDATION

We strongly support this provision and urge that the proposal cover profit sharing and thrift plans as well, except for voluntary employee investments in employer securities.

ERISA Preemption

ERISA clearly preempts state laws relating to employee benefit plans. However, recent court decisions have seriously eroded this preemption with respect to state mandated benefits and coverage.

RECOMMENDATION

Although S. 3017 does not specifically address the ERISA preemption problem, we urge that amendatory language be included in final legislation to reaffirm the principle that ERISA preempts any state from regulating employee benefit plans. The preemption provisions of ERISA must be affirmed or multi-state employers will lose the ability to maintain uniform and equitable employee welfare benefit plans. They must be upheld to avoid increases in the complexity and the cost of administering such plans on a state by state basis. The language of ERISA specifically and explicitly preempts any state or state agency from regulating any employee benefit plan regardless of whether the plan is insured or self-insured. It was Congress' aim to provide federal regulation in this area at the time of the enactment of ERISA in order to avoid burdensome and overlapping State laws. Accordingly, we urge that Congressional intent be reaffirmed.

Sec. 303 DEDUCTIONS FOR EMPLOYEE CONTRIBUTIONS TO QUALIFIED PLANS

This section would permit a deduction from taxable income for contributions made by employees to qualified retirement plans.

RECOMMENDATION

We support the concept of providing an incentive to expand the private pension plan system, subject to the following modifications.

We recommend that the reduction in allowable tax deduction of 20% of the amount of gross income in excess of $30,000 be deleted. This is a discriminatory limitation. We also propose that plans be given an option, but not be required, to accept employee contributions.

The substantial administrative costs associated with employee contributions make such an arrangement better suited to defined contribution plans (rather than defined benefit plans), because individual participant accounts are already required for defined contribution plans. For example, under defined contribution plans, contributions require separate accounts for company and employee contributions on an individual employee basis, and, thus, already entail additional costs. Once a contribution is made, an account must be maintained until the employee's entire interest is terminated. These administrative costs, therefore, would be incurred indefinitely, even though a particular employee might make only a single contribution.

However, under this proposal administrative costs would be increased if a company maintained more than one qualified plan for the same group of employees. For example, some of our member companies maintain a defined benefit plan as the primary pension plan, as well as a savings plan, and/or a stock bonus plan. The amendment would apply equally to all such plans. We recommend that Sec. 303 not apply to a plan if the company maintains another plan into which the employees may make contributions.

Sec. 304. CREDIT FOR ESTABLISHMENT OF SMALL PLANS

This provision would provide a tax credit for small employers who establish retirement plans that meet ERISA requirements. The credit would phase downward over a period of five years from the year in which the employer establishes a plan.

RECOMMENDATION

We support the concept of a tax credit to encourage the establishment of more private pension plans, but we object to this proposal because it is discriminatory.

This provision clearly discriminates against employers who have already established retirement plans that meet ERISA requirements.

Sec. 305. CREDIT FOR THE IMPROVEMENT OF QUALIFIED PLANS

This section would provide a tax credit of 5% of an employer's allowable deduction for contributions to a qualified plan for any year in which the proposed Employee Benefits Commission determines that the plan is an improved plan.

RECOMMENDATION

We oppose this provision.

This proposal would clearly discriminate against those companies which have in the past maintained plans which meet or exceed the requirements of ERISA by rewarding other companies (including competitors) which have previously maintained minimally qualified plans. In addition, as currently written the proposal would be difficult, if not impossible to administer without clear guidelines as to how earlier participation, more rapid vesting or other benefit improvements would be measured.

Sec. 307. RETROACTIVE DISQUALIFICATION OF PLANS

This provision prohibits the retroactive disqualification of a plan which is subject to ERISA unless the proposed Employee Benefits Commission determines that the past failure to meet the qualification standards was a result of intentional failure or willful neglect on the part of the plan sponsor.

RECOMMENDATION

We support this provision. This proposal will eliminate or at least sharply decrease the need for determination letters.

LW/cj

STATEMENT OF H. WESTON CLARKE, JR.

VICE PRESIDENT, HUMAN RESOURCES

AMERICAN TELEPHONE AND TELEGRAPH COMPANY

ON S. 3017

BEFORE THE HUMAN RESOURCES SUBCOMMITTEE ON LABOR

AND

THE FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS

AND EMPLOYEE FRINGE BENEFITS

OF THE UNITED STATES SENATE

August 18, 1978

This statement is submitted in my capacity as Vice President, Human Resources of the American Telephone and Telegraph Company, on behalf of the 24 Bell System companies, the names of which are attached to this statement. In this position I am responsible for benefit administration, compensation planning, job performance, equal employment opportunity, human resources research, training and development, as well as the other usual personnel duties.

I appreciate this opportunity to comment on S. 3017 and the other bills before this Committee. We are vitally interested in pensions and the federal pension law which was passed in September, 1974. The Bell System submitted testimony on various aspects of pension legislation in 1970 and 1973. My comments will relate primarily to S. 3017, the "ERISA Improvements Act of 1978," but I will also give a few general observations regarding other issues that have been before these Subcommittees.

BACKGROUND

Each of the Bell System Companies has a similarly worded pension plan and its own pension fund. However, in the aggregate, nearly a million active employees and 200,000 pensioners are currently covered by our Plans. Since 1913 when we established the pension plan, each Bell Company has always had one non-contributory Plan covering both management and non-management employees.

We started pre-funding for pensions in 1927. The aggregate Bell Funds now amount to approximately $13 billion in irrevocable trust funds administered by over 100 professional investment managers throughout the country. In 1977 about $2.6 billion was paid into the funds and approximately $800 million was paid out of the funds.

The Bell System strongly favors sound financing of pension plans. We strongly favor disclosure of relevant and meaningful information regarding the annual operation of the plan to employees and the federal agencies. We have been reporting annually to employees for fifty years. We support fair minimum standards for vesting and participation. Since large sums of money and the future expectations of many employees are involved, we have always believed that pension and benefit plans should be administered under high fiduciary standards.

At the time of the enactment of the Employee Retirement Income Security Act, September, 1974, the Bell System was already using one of the acceptable funding methods (the Aggregate method) specified by ERISA. We provided a vested benefit to employees who terminated employment after age 40 with 15 years of service. We provided a 50% survivor annuity option. We issued plan booklets and annual reports to our employees. And of course we submitted the required pre-ERISA reports to the federal agencies.

ERISA did require us to liberalize our vesting requirements. We selected the method in the law that provides a vested benefit at age 65 for employees who had 10 years of service after age 22. We started paying premiums to the Pension Benefit Guaranty Corporation. We submitted the EBS-1's and 5500 Annual Report/Return to the government and provided Summary Annual Reports, and "Notices to Interested Parties" to participants. You can appreciate that the additional paperwork and detail was found to be administratively burdensome in that we were dealing with such large numbers of active and retired employees. What was even more frustrating at times was that many of our employees and pensioners were confused and therefore irritated by all the new detailed and technical information that we were forced to send them. Additional time had to be spent explaining the statutory requirements because some participants thought that the Bell Company was taking something away from them.

S. 3017 OFFERS SOME IMPORTANT IMPROVEMENTS

We endorse the general purpose of the ERISA amendments in S. 3017 which is aimed at refining communications with participants to a more meaningful level as well as reducing the administrative paperwork burdens and related compliance costs without jeopardizing the interest of plan participants and adversely affecting the financial viability of plans. Such administrative and compliance reductions are essential for those of us who are charged unning employee benefit plans. In general, the bill seems to be   the right direction.

SPECIFIC ENDORSEMENTS

We concur that Summary Annual Reports should be eliminated. The consolidation of the plan description (EBS-1) and the determination letter application forms (forms 5300, 5301, and 5303) is also endorsed. Merging these reports would eliminate the filing of duplicative information.

Adding the elapsed time method as a permissible way to credit service is a definite improvement, as it permits employers the alternative of recognizing overall periods of service for pension credit without the costly record-keeping of exact numbers of hours worked.

The relaxation of the requirement to furnish an updated summary plan description every five years to at least once every ten years is also endorsed. Here again administrative expense decreases when an amendment to a benefit plan can be publicized without the printing and distribution of the entire summary plan description.

The administration and enforcement section of the bill which would make the anti-fraud provisions of the Federal securities laws inapplicable to employee benefit plans is a very necessary improvement.

Section 307 dealing with retroactive disqualification of plans is strongly endorsed as is the proposal to narrow the definition of a party-in-interest.

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The bill will require accountants to rely on the correctness of any actuarial matter certified to by an enrolled actuary. Similarly, an actuary will be required to rely on the correctness of matters on which a certified accountant has expressed an opinion. Thus, duplication of efforts by actuaries and accountants should be eliminated. This is a decided improvement.

We are encouraged by the current approach being taken by the Department of Labor and Internal Revenue Service regarding the division of regulatory responsibility under ERISA. Therefore, we would recommend that the new entity not be set up at this time. The progress of the Department of Labor and Internal Revenue Service in resolving their problems in this area should be evaluated after a one- or two-year trial period. We are hopeful for continued improvement in coordination between the two agencies.

We would expect that these improvements would reduce the number of employers who are currently terminating their plans and perhaps help those who are considering the adoption of new pension plans to make the positive decision to go ahead with them.

RECOMMENDATIONS FOR CHANGES IN S. 3017: MERGERS AND CONSOLIDATIONS OF PLANS OR TRANSFERS OF PLAN ASSETS (SECTION 208 of ERISA) AND RECIPROCAL AGREEMENTS (SECTION 231 of S. 3017)

We believe that while it has been the intent of Congress to promote the transfer of full pension rights for individuals who transfer from one pension plan to another in private industry, viable ways and means of so doing across all industry have not yet been found.

Section 231 of S. 3017 is a helpful step in this direction, although unnecessarily limited in scope. There is no reason why this section should be limited to "collectively bargained plans." Employers that do not have "collectively bargained plans" have entered into agreements that have provided for the full and complete transfer of pension rights between related plans. Limiting such transfers to "collectively bargained plans" would not be helpful.

Within industries there have been developments toward this objective, some of them very successful, through reciprocal agreements between the participating plans. The Bell System for example has had "interchange" agreements among the associated companies and certain other companies in the industry, now covering almost a million employees, since the inception of the plans in 1913. These agreements provide complete transferability of pension rights for individuals who move from the plan of one participating company to that of another. Many such transfers back and forth among the companies occur daily. No transfer of assets is made since the net effect of the estimated liabilities transferred is immaterial in relation to the total estimated liabilities of the plans. No employee has ever suffered a loss of pension benefits because of such transfer nor have there been either financial windfalls or hardships to any of the companies because of them.

Surely it is not the intent of Congress to discourage the development of such interchange arrangements or to cause the abandonment of existing ones by placing such onerous restrictions on their operation that they are no longer practical.

Section 231 (amending ERISA Section 209) of S. 3017 is indicative of Congressional intent regarding the transfer of full pension rights. It provides that the Secretary may establish additional conditions, variences and exemptions in order to facilitate such transfer arrangements. This concept, without the "limitation to collectively bargained" plans, is to be encouraged in light of IRS regulations that were proposed in July, 1977.

Proposed IRS regulations (Proposed Regulations Relating to Mergers and Consolidation of Plans and Transfers of Plan Assets or Liabilities, 42 Fed. Reg. 33770. (July, 1977)) would place onerous restrictions on the interchange agreements. The proposed regulations would require that if even one employee is transferred from one plan to another, the event must be treated as a spin-off of a portion of the old plan to a new one-person plan and the subsequent merger of that one-person plan with the plan of the receiving company, with all the regulations concerning spin-offs and mergers being applicable. As such, these regulations require many elaborate calculations for each individual in the old plan as of the date of transfer (under the Section 4044 rules for terminations) and the transfer of a calculated number of dollars for each transferred individual from the old plan to the new. In lieu of Section 4044 calculations, the proposed IRS regulations permit plans to maintain data regarding individual transfers for a specific period of time. However, the data maintenance alternative is based upon the assumption that there will be no further transfer of assets or liabilities within five years of the very first individual transfer. A subsequent individual transfer nullifies this alternative. In an industry with successful reciprocal agreements (e.g., the Bell System) there are several thousands of such individual transfers back and forth between the plans each year without any significant net effect on any one of the plans.

These proposed regulations contain De minimis provisions which reduce the calculations somewhat so long as there is no subsequent merger or spin-off within 5 years, but such provisions are of no help at all if even one employee is transferred from the receiving plan within the next 5 years. Furthermore, there is absolutely no relief from the requirement for asset transfer.

In the case of small plans where the transfer of even one employee may involve a significant proportion of the liabilities of the plans, such regulation may be necessary to protect the pension rights of the employees, but it should not apply where it accomplishes nothing but to impose onerous administrative burdens.

In light of the concerns addressed in the proposed IRS regulations it would be highly desirable to provide in the Act itself clearer enunciation of Congressional intent to promote the ability of employees to transfer from one plan to another without loss of pension benefit. This might be done by amending Sections 208 and 1015 (1) to say:

> "The transfer of the liability for individual employees between plans without loss of any accrued benefits shall not constitute a spin-off, merger or consolidation."

In such cases all employees involved would be as well protected immediately after the transfer as before in accordance with the statutory intent and the transfer of benefits would not be hampered.

COMMENTS AND RECOMMENDATIONS CONCERNING THE ANNUITY FOR THE SPOUSE OF A DECEASED PARTICIPANT (SECTION 238) JOINT AND SURVIVOR ANNUITY AMENDING SECTION 205(b) OF ERISA

Under the proposed wording of Section 238 of S. 3017 it would appear to require that the amount of the spouse's annuity must be based, not on the amount of the decedent's vested benefit at the date of death, but on the amount that would have been vested if the participant had continued in service to his or her earliest retirement date.

As it stands this is a highly inequitable proposal. If it applies to separated employees with vested rights (and there is no statement to the contrary), it can represent a reward for job changing. For example, consider an employee who starts with Company A at age 22 and works 10 years achieving a vested pension; the employee then resigns from Company A and goes to work for Company B for 10 years acquiring another vested pension. The same employee then goes to Company C where the employee works for 20 years, obtaining eligibility for retirement and a third vested pension. If the employee dies at age 62 after 20 years with Company C, the employee's spouse would then receive three pensions computed on the basis of 40 years of service, 30 years of service and 20 years of service respectively, a total of 90 years of service. The spouse of another employee who had worked for the last employer for the entire 40 years would get one pension based on only 40 years of service.

If the proposed language is modified so that it applies only to the survivor annuity of an active employee who dies while in active service with vested rights (and not to individuals who leave with vested rights), the provision of a pension based on service and salary in a final pay plan as if the employee had worked to early retirement age is inequitable since the employee might have left the company before then if he or she had lived.

The language should clearly state that the pension payable to the spouse should be based only on the vested amount of pension to preserve equity.

Another aspect of the survivor annuity issue merits your consideration. Many companies provide benefits for spouses through other plans paid for by the employer. Group life insurance plans fall into this category. Such programs usually provide insurance benefits based on salary alone, with benefits payable without regard to whether or not there is a vested pension. These plans often make payments without regard to length of employment. Consequently, the spouse of a person separated from one company but working for another might well receive the same value benefit from the new company as would have been received from the former one.

To require duplication of benefits through the pension plan of either a single employer or of two or more employers is wasteful and would tend to curtail the expansion of private pension plans.

We would suggest that at the very least this section should be revised to provide 1) that separated employees with vested pensions shall not be considered as participants for the purposes of this section and 2) that a pension plan shall not be considered as not qualified if the requirement for the actuarial equivalent of the spouse's pension is met by other plans paid for by the employer.

We submit that the proposed language in Section 238 would impact upon two very important areas. When benefits are congressionally legislated they are removed from the realm of collective bargaining with two types of effects. Unions may not recognize the cost of such improvements as being an offset to the cost of other benefits they may be seeking (for example, increased wages) since this is something the employer has to pay for anyway. Such an effect is inflationary since cost must be recovered in price if the firm is to remain healthy and continue to provide the employees with jobs. Or, if in some cases the cost is recognized, it precludes the union's obtaining some other benefit that the membership would prefer, thus restricting the right to bargain collectively for what is wanted.

The additional funding required to support this mandated benefit improvement would also cause a reduction in government tax income.

SECTION 303 COMMENTS - DEDUCTION FOR CERTAIN EMPLOYEE CONTRIBUTIONS TO QUALIFIED RETIREMENT PLAN (PROPOSING A NEW SECTION 221 OF ERISA CONCERNING ACCEPTANCE OF EMPLOYEE CONTRIBUTIONS)

We agree with the apparent intent of the proposed new Section 221 to allow employees to make limited voluntary tax deductible contributions to an individual account retirement plan. However, we oppose the requirement that it must be done through the trust fund of a non-contributory defined benefit plan if that is the kind of pension plan the employer has. It should be permissible to accomplish the same result through another plan of the employer.

The Bell System and many other companies have both defined benefit plans and defined contribution plans. Bell employees can contribute up to 10% of their pay to the defined contribution plans (management now and non-management as of 1/1/79). Such contributions could be made tax-deductible to the employee.

If the employer has no such other plan, the employee should be permitted to contribute to an Individual Retirement Account (IRA). To burden the trust of the non-contributory defined benefit plan with the acceptance of voluntary contributions creditable to individual accounts is unnecessary when other suitable vehicles for the acceptance of such contributions already exist and all that is necessary is to provide for the tax-deductibility of the contribution.

OTHER ISSUES THAT HAVE BEEN ADDRESSED BY THE SUB-COMMITTEES

As an employer with administrative responsibility for pension plans covering over a million participants, we appreciate the principal objectives of improved pension plan administration of several of the other bills being considered in addition to S. 3017; and we are in accord with their aim of reducing the paperwork burden of ERISA.

We believe that the guiding principle to be used in approaching the problem should be to require the minimum reporting necessary to meet the needs and interests of the users of the various reports without additional confusing detail.

With regard to reporting to participants, in general it has been our experience that participants have been perplexed by many of the pieces of information the law requires us to furnish. The provision of information to participants should be limited to that which is likely to prove meaningful to the average plan participant. Clearly, the concept of summary plan descriptions meets the test of meaningfulness.

In the case of individual-account defined contribution plans, each participant should receive annually a statement of his account balance and a summary statement of the transactions that produced the change from the previous year.

In the case of defined benefit plans, the amount of benefit that has vested should be reported to active participants if they want to know; retired participants already know what they are getting; separated former employees with vested pensions have received statements of vested benefits on leaving. Statements showing unvested accrued benefits would be meaningless. Should a participant wish to know the amount to which he or she would be entitled at some specific date in the future, assuming continuation of present salary and continuous service to that date, it should be available on request, but not more than one request per year. To require the provision of such information when the employees are not interested in it, as the majority are not until they begin to approach retirement age, is not very meaningful (e.g., telling a 25 year old what his or her pension will be in 40 years based on today's pay).

Participants are interested in whether or not they will be able to collect their pensions when they become due, but most have no notion of the meaning of various actuarial concepts. For an ongoing plan, there should be reported to the participant:

1. A financial statement of the Trust Fund certified by a qualified accountant engaged on behalf of the participants,

2. A statement by the administrator that the plan is not expected to terminate in the forseeable future, supported by the quotation of a representation statement to that effect from a responsible employer official,

3. A certification by the enrolled actuary that the minimum funding standard has been met,

4. A statement by the administrator that there is no reason to believe that the employer will be unable to meet the minimum funding standard in the forseeable future, supported by a statement to that effect from the accountant engaged by the employer to certify his financial report. Such statements would provide dependable, useful information without confusing detail. If such statements cannot be made, termination is probably imminent and the estimated results of such termination should be furnished to participants on a total plan basis.

For corporate reporting purposes for an ongoing plan these statements should also be adequate to eliminate any need to show a pension liability on the corporate balance sheet. The contribution that will be required is no more a liability than is the payroll that will be required. There is no current liability for any pension contributions until such contributions become due in the ordinary course of the business, just as there is no current liability for future wage payments until they become due.

Again, should termination be imminent, any expected resulting employer liability should be reflected on the balance sheet.

As for reporting the actuarial assumptions used, these should be reported along with Schedule B by the Enrolled Actuary to the Government official responsible for accepting them as reasonable.

Should the employer accrue and/or contribute amounts significantly different from the minimum funding requirement, this should be footnoted on the financial statements of the employer with an appropriate explanation.

Should the government official responsible under ERISA require additional information upon review of any particular case in carrying out his oversight responsibility, he can request it. But there is no reason why all plans should be burdened with routine furnishing of information that is needed only in a few specific cases.

We believe that such reporting and disclosure would satisfy the needs of all concerned -- participants, shareowners, creditors, financial analysts and government officials -- without confusion or misunderstanding.

In conclusion, we are concerned about the three sections of S. 3017 dealing with transfer of assets through reciprocal agreements, the calculation of annuities provided for spouses of deceased former employees, and employee contributions as related to non-contributory plans, as well as aspects of the other bills that we believe should be discarded or modified. As one of many employers with a vital interest in this legislation, we welcome this opportunity to present our views to this Committee.

BELL SYSTEM COMPANIES

American Telephone and Telegraph Company

The Bell Telephone Company of Pennsylvania

Bell Telephone Company of Nevada

Bell Telephone Laboratories, Incorporated

The Chesapeake and Potomac Telephone Companies

Cincinnati Bell Incorporated

The Diamond State Telephone Company

Illinois Bell Telephone Company, Incorporated

Indiana Bell Telephone Company, Incorporated

Michigan Bell Telephone Company

The Mountain States Telephone and Telegraph Company

New England Telephone and Telegraph Company

New Jersey Bell Telephone Company

New York Telephone Company

Northwestern Bell Telephone Company

The Ohio Bell Telephone Company

Pacific Northwest Bell Telephone Company

The Pacific Telephone and Telegraph Company

South Central Bell Telephone Company

Southern Bell Telephone and Telegraph Company

The Southern New England Telephone Company

Southwestern Bell Telephone Company

Western Electric Company, Incorporated

Wisconsin Telephone Company

AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.

CHARLOTTE
WASHINGTON
NEW YORK

1101 CONNECTICUT AVENUE, N.W., SUITE 300, WASHINGTON, D.C. 20036

August 29, 1978

Honorable Harrison A. Williams
Chairman
Senate Committee on Human Resources
Washington, D.C. 20510

Dear Mr. Chairman:

We respectfully request that the enclosed statement be included in the record of the Labor Subcommittee's hearings on S. 3017.

Sincerely,

W. R. Shockley

W. Ray Shockley
Executive Vice President

Enclosures

WRS:tew

STATEMENT OF
AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.
ON
S. 3017
"ERISA IMPROVEMENTS ACT OF 1978"

The American Textile Manufacturers Institute, Inc. is pleased to take this opportunity to comment on S. 3017, the "ERISA Improvements Act of 1978."

Employers and employees in the textile industry have been perhaps proportionately more affected than many other industries by the additional costs and administrative burdens which have resulted from ERISA.

We have now had four full years of experience with ERISA. We agree wholeheartedly with the sponsors of S. 3017 that the time has come to examine whether legislative changes should be made to more effectively carry out the purposes of ERISA. We hope that the following comments will be helpful.

(1) Dual Jurisdiction.

S. 3017 would establish a new Employee Benefits Commission as a separate governmental agency to handle many of the functions now performed by the Department of Labor and the Internal Revenue Service. We have serious doubts whether establishment of such a commission will substantially improve the administration of ERISA. Under the separate agency approach, the Internal Revenue Service would still retain an important interest in many qualified plan matters so that much of the same kind of coordination which is now required by the Department of Labor and the Internal Revenue Service would remain.

Many significant steps have been taken to date by the Department of Labor and the Internal Revenue Service to reduce the problems of dual jurisdiction spawned by ERISA. Considerable progress has been made in this regard. Furthermore, the President has announced this month a reorganization proposal which may well be a major step toward administrative resolution of most of the remaining problems of dual jurisdiction. We therefore urge that you take no action which will cause a major shift in jurisdiction, with its attendant disruptions, at least until this recently announced reorganization proposal has been in effect for a sufficiently long period to assess its effectiveness.

(2) Reporting and Disclosure.

ATMI strongly supports efforts to reduce the paperwork burden on employee plans and plan sponsors. Foremost among the improvements in this regard proposed by S. 3017 is the proposal to eliminate the requirement that plan administrators automatically furnish a summary annual report to each participant and beneficiary. It has been the experience of members of ATMI that this requirement of a summary annual

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report is not only unnecessary but counterproductive to the extent that it provides employees with information they have not requested and do not want. The objectives of ERISA can be amply fulfilled by requiring that plan administrators provide employees upon request with a copy of the latest annual report. We also strongly support the other paperwork reduction measures proposed in S. 3017:

(a) the grant of administrative authority to exempt plans from various requirements or to modify these requirements;

(b) consolidation of reporting forms;

(c) relaxation of the requirements for updating summary plan descriptions;

(d) requirement that accountants rely on the correctness of certified actuarial matter and vice versa.

(3) Joint and Survivor Rules.

ATMI is generally opposed to any major change in the joint and survivor requirements of ERISA. These requirements have proved to be perhaps the most far-reaching provisions of ERISA in terms of impact on plan design and benefit levels. The analysis and professional services required to adapt the plans to the present rules has been extensive and enormous effort has been required to notify employees of these provisions and to properly educate them concerning the coverage which is now provided and the elections which are available. The changes proposed by S. 3017 would fully revive the confusion and expense in this area even before the dust has settled.

(4) Lapsed Time.

Many of the plans which have been adopted by companies which are members of ATMI have taken the approach to counting service permitted by proposed regulations approving an elapsed time method. These plans have received Internal Revenue Service approval. However, some legal experts continue to express concern that the elapsed time method as outlined in proposed regulations is not clearly authorized by ERISA, leaving open the possibility that employees who can demonstrate compliance with ERISA's basic service counting rules but who fail to qualify under the plan's elapsed time method could successfully maintain an action for benefits, thereby effectively nullifying the important simplification which has been achieved by using an elapsed time method. Accordingly, ATMI urges that legislation be enacted as proposed by S. 3017 to make it clear that an elapsed time method is permissible under ERISA.

(5) Application of Securities Laws to Retirement Plans.

ATMI strongly endorses the proposal embodied in S. 3017 to eliminate any uncertainty concerning the application of the securities laws to an employee's interest in a noncontributory defined benefit pension plan. Much has been said and written on this point and we need not dwell in detail on the basis for our position except to say that any simplification, paperwork reduction, streamlined administration, and/or incentives to the establishment of plans which might be accomplished by other provisions of S. 3017 would experience a serious setback if the decision in the Daniel case is upheld by the Supreme Court and not overturned by Congress. There is obviously no justification whatever in superimposing another layer of regulations on this already overburdened area.

(6) Deduction for Employee Contributions to Qualified Plans.

ATMI is generally favorable to a provision which would permit a limited deduction for employee contributions to qualified plans.

In some cases under current law employees may find that they would be in a better position if they could withdraw from plan coverage and establish an individual retirement account. However, because of the risk of disqualification on the basis of insufficient coverage, most plans do not permit such voluntary withdrawal from participation. It appears to ATMI that the proposals for a limited deduction for employee contributions would go a long way toward solving this problem.

Respectfully submitted,

STATEMENT OF JOHN L. ASLING

2638 N. FLORIDA ST.
ARLINGTON, VIRGINIA
22207
8-13-78

SENATOR HARRISON WILLIAMS JR.-CHAIRMAN
COMMITTEE ON HUMAN RESOURCES
WASHINGTON, D.C.
20510

SENATOR HARRISON WILLIAMS JR.

I REQUEST THAT ALL OF THIS MATERIAL BE INCLUDED IN THE "RECORD" ON YOUR HEARINGS ON S.3017 AND "ERISA IMPROVEMENT ACT OF 1978" REGARDING MY COMPLAINTS WITH MY OWN EMPLOYEERS PENSION PLAN AND RELATED TAX LAWS.

I AM A EMPLOYEE OF A LARGE CORPORATION, AND A UNION MEMBER. I JOINED THE COMPANY "DEFINED BENEFIT PLAN" IN 1952, AND LATER JOINED THE COMPANY "VARIABLE BENEFIT PLAN" IN 1965.

THE PROBLEM THAT EXISTS WITH THE "DEFINED BENEFIT PLAN" IS SEX DISCRIMINATION BETWEEN MALE AND FEMALE EMPLOYEES. "FEMALES" WHO WERE A MEMBER OF THE PLAN PRIOR TO 1956 MAY RETIRE AS EARLY AS AGE 50. "MALES" WHO WERE A MEMBER OF THE PLAN MAY RETIRE AS EARLY AS AGE 55, REGARDLESS OF WHEN THEY BECAME A MEMBER OF THE PLAN. THE COMPANY PERMITS A CERTAIN GROUP OF "MALE" EMPLOYEES TO RETIRE AS EARLY AS AGE 50, WHILE OTHER "MALE" EMPLOYEES ARE NOT PERMITTED TO RETIRE UNTIL AGE 55.

THIS IS SEX DISCRIMINATION AND IN VIOLATION OF THE "CIVIL RIGHTS ACT OF 1964", YET THIS POLICY IS STILL IN EFFECT TODAY.

THE COMPANY ALSO DISCRIMINATES BETWEEN VARIOUS GROUPS OF "MALE" EMPLOYEES WHO WISH TO RETIRE EARLY AND RECEIVE A ACTUARIAL REDUCTION IN PENSION BENEFITS.

AGE	GROUP 1 MALES	GROUP 2 MALES
62	100%	100%
61	100%	97%
60	100%	94%
59	97%	91%
58	94%	88%
57	91%	85%
56	88%	82%
55	85%	79%
54	80%	0
53	75%	0
52	70%	0
51	65%	0
50	60%	0

BOTH GROUPS OF "MALE" EMPLOYEES ARE REPRESENTED BY UNIONS. GROUP 1 MALES MAY RETIRE BETWEEN THE AGES OF 50-55, WHILE GROUP2 MALESMAY NOT RETIRE UNTIL AGE 55! GROUP 1 MALES ALSO RECEIVE GREATER PENSION BENEFITS THAN GROUP 2 MALES AT THE SAME AGE. THIS PRACTICE SHOULD BE OUTLAWED!

THE "DEFINED BENEFIT PLAN" HAS A "LEVEL INCOME OPTION" FEATURE FOR THOSE EMPLOYEES WHO WISH TO RETIRE PRIOR TO AGE 62, WHICH IS COMBINED WITH SOCIAL SECURITY.

THE FOLLOWING IS A EXAMPLE OF HOW THE "LEVEL INCOME OPTION" WORKS AND HOW IT CAN BE A DISADVANTAGE TO EMPLOYEES, WITHOUT THE EMPLOYEE REALIZING IT, IF THE EMPLOYEE LIVES TOO LONG AFTER AGE 62!

A EMPLOYEE RETIRES AT AGE 61, RECEIVING $348 PER MONTH FROM THE PENSION PLAN TO AGE 62. THE EMPLOYEES PENSION PLAN BENEFITS ARE REDUCED AT AGE 62 FROM $348 TO $148 PER MONTH FOR THE REST OF THE EMPLOYEES LIFE. THE EMPLOYEE BEGINS TO COLLECT $200 PER MONTH FROM SOCIAL SECURITY AT AGE 62 FOR THE REST OF THE EMPLOYEES LIFE, SO THIS IS THE REASON THAT THE PENSION BENEFITS ARE REDUCED TO $200 PER MONTH AT AGE 62. THE EMPLOYEE STILL HAS A COMBINED TOTAL "LEVEL INCOME" OF $348 PER MONTH FOR LIFE. $148 PENSION PLUS$200 PER MONTH SOCIAL SECURITY=$348.

THE CATCH TO THE "LEVEL INCOME OPTION" IS THAT AT AGE 62, THE COMPANY PENSION IS REDUCED BY $200 PER MONTH FOR THE REST OF THE EMPLOYEES LIFE! IF THE EMPLOYEE DIES PRIOR TO AGE 63, THEN THE "LEVEL INCOME OPTION" WAS A ADVANTAGE TO THE EMPLOYEE. IF THE EMPLOYEE LIVES BEYOND AGE 63, THEN THE EMPLOYEE WILL LOOSE $200 PER MONTH FOR THE REST OF HIS LIFE, IN WHICH CASE THE LEVEL INCOME OPTION" WAS A DISADVANTAGE TO THE EMPLOYEE!

THE BASIC PROBLEM WITH THE "VARIABLE BENEFIT PLAN" HAS BEEN POOR MANAGEMENT BY THE SAME BANK TRUSTEE SINCE 1965! THE "VBP" WAS FIRST OFFERED TO EMPLOYEES AS A SUPPLEMENTAL PENSION PLAN, IN ORDER TO PERMIT A EMPLOYEE TO SUPPLEMENT HIS RETIREMENT INCOME THRU INVESTMENTS IN THE STOCK MARKET. INVESTMENTS IN THIS "VBP" HAVE PROVEN TO BE A POOR INVESTMENT.

I WAS PLEASED WHEN THE COMPANY OFFERED THE "VBP" IN 1965 AS I WAS ALLOWED TO INVEST UP TO 10% OR $2500 ANNUALLY IN THE "VBP" WHICHEVER WAS THE LESSER, AND TO DEFER TAXES ON MY INVESTMENTS IN THE "VBP" UNTIL I RETIRE, IN WHICH CASE IT WAS ASSUMED THAT I WOULD BE IN A LOWER TAX BRACKET AND PAY A LOWER TAX RATE.

I AUTHORIZED THE COMPANY TO DEDUCT 10% FROM MY SALARY FOR INVESTMENT IN THE "VBP" IN 1965. THE "NEW YORK TIMES" REPORTED IN A EDITORIAL BACK IN 1966 ABOUT THE POOR INVESTMENT PERFORMANCE OF THE NATIONS 25 AIRLINE PILOTS PENSION PLANS PRIOR TO 1966. I WAS HAVING SECOND THOUGHTS ABOUT THE "VBP" AND ITS INVESTMENT PERFORMANCE AS THE STOCK MARKET WAS EXPERICING A SEVERE DECLINE IN 1966! I CONTACTED THE COMPANY ABOUT THIS EDITORIAL AND MY CONCERN OVER THIS REPORT. THE COMPANY RESPONDED THAT THEY HAD CAREFULLY SELECTED THE BANK TRUSTEE ON THE BASIS OF HIS PAST PERFORMANCE RECORD WHICH WAS VERY GOOD.

I READ SEVERAL OTHER REPORTS ABOUT POOR MANAGEMENT BY BANK TRUSTEE IN 1967. I BECAME SO DISSASTIFIED WITH THE INVESTMENT PERFORMANCE OF THE BANK TRUSTEE THAT I NOTIFIED THE COMPANY THATI WANTED TO WITHDRAW ALL OF MY OPTIONAL CONTRIBUTIONS FROM THE "VBP" FROM 1965-1967 DUE TO POOR MANAGEMENT!

I REALIZED A SMALL CAPITAL GAINS WHEN I WITHDREW ALL OF MY OPTIONAL CONTRIBUTIONS, HOWEVER I WAS PENALIZED IN 2 WAYS!

1. I HAD TO PAY TAXES ON LONG TERM CAPITAL GAINS AT ORDINARY INCOME TAX RATES! HOW UNFAIR CAN TAX LAWS GET!

2, I HAD TO PAY A 10% TAX PENALITY FOR EARLY WITHDRAWAL OF MY CONTRIBUTIONS PRIOR TO RETIREMENT!

I LOST MY TAX SHELTERED PENSION PLAN, WHICH HAS PROVEN TO BE A WORTHLESS PENSION PLAN AND TAX SHELTER DUE TO POOR MANAGEMENT! I COULD NO LONGER MAKE INVESTMENTS UNDER A TAX SHELTERED PENSION PLAN, AS I DID NOT QUALIFY FOR "KEOGH" AND "IRA" DID NOT EXIST IN 1967!

THE FOLLOWING IS THE INVESTMENT PERFORMANCE RECORD OF THE "VARIABLE BENEFIT PLAN" FROM 1965-1978, WITH ALL DIVIDENDS, INTEREST, CAPITAL GAINS AND LOSSES REINVESTED.

YEAR	PRICE PER SHARE	ANNUAL GAIN OR LOSS
1-1-65	$10.00	5.6% GAIN
1-1-66	$10.56	.2.0% LOSS
1-1-67	$10.35	16.8% GAIN
1-1-68	$12.09	1.1% GAIN
1-1-69	$12.22	2.8% LOSS
1-1-70	$11.88	4.7% LOSS
1-1-71	$11.32	13.2% GAIN
1-1-72	$12.81	13.7% GAIN
1-1-73	$14.56	19.4% LOSS
1-1-74	$11.73	30.3% LOSS
1-1-75	$8.18	20.4% GAIN
1-1-76	$9.85	12.5% GAIN
1-1-77	$11.08	10.2% LOSS
1-1-78	$9.94	

THIS PENSION PLAN HAS BEEN VERY POORLY MANAGED BY THE SAME BANK TRUSTEE SINCE 1965, AND HAS FAILED TO EVEN COME CLOSE TO KEEPING UP WITH INFLATION! I HAVE BEEN COMPLAINING ABOUT THE INVESTMENT PERFORMANCE OF THEIS PENSION PLAN SINCE 1966 TO THE COMPANY, THE UNION, AND TO VARIOUS MEMBERS OF CONGRESS WITH NO RESULTS!

I BELIEVE THAT THE TIME HAS COME FOR CONGRESS TO REALIZE THATTHERE ARE MANY EMPLOYEES THAT ARE STUCK WITH POORLY MANAGED PENSION PLANS, AND EMPLOYEES ARE HELPLESS TO PROTECT THEMSELVES AGAINST POOR MANAGEMENT OF THEIR PENSION PLANS!

THE BASIC FAULT BEHIND THE POOR MANAGEMENT OF THE "VBP" IS THE FACT THAT THE "TRUSTEE"DOES NOT TAKE TAKE DEFENSIVE ACTION BY SELLING SECURITIES DURING MARKET DECLINES TO PRESERVE CAPITAL! THE NUMBER ONE RULE OF WALL STREET IS "CUT YOUR LOSSES SHORT".

I CONTACTED THE COMPANY REGARDING THE TRUSTEES LACK OF ACTION BY NOT TAKING DEFENSIVE ACTION DURING MARKET DECLINES. THE COMPANY STATED THAT THE TRUSTEE WAS INVESTING FOR THE "LONG TERM"!

THE BASIC FLAW WITH THIS INVESTMENT CONCEPT IS THE FACT THAT THERE ARE EMPLOYEES WHO ARE RETIRING EVERY WEEK IN THE YEAR, REGARDLESS OF WHETHER THE STOCK MARKET IS "UP" PR "DOWN"!

THOSE EMPLOYEES WHO RETIRED ON 1-1-73 MADE A SMALL PROFIT ON THEIR INVESTMENT, BUT NOT ENOUGH TO KEEP UP WITH INFLATION FROM 1965-1973, HOWEVER AFTER THEY PAID TAXES ON THE CAPITAL GAINS AT ORDINARY INCOME TAX RATES , ITS REAL RATE OF RETURN WAS POOR!

THOSE EMPLOYEES WHO RETIRED ON 1-1-74,1-1-75, 1-1-76, 1-1-77, AND 1-1-78 LOST THEIR SHIRTS IN THE "VBP", DUE TO LOSS OF CAPITAL AND INFLATION!

THE TRUSTEES DECISION TO INVEST MOSTLY IN COMMON STOCKS HAS PROVEN TO BE A DISASTER FROM A INVESTMENT POINT OF VIEW! I CAN SEE NO REASON FOR ANY TRUSTEE TO INVEST IN STOCKS WITH CAPITAL GAINS AS THE INVESTMENT OBJECTIVE, DUE TO THE UNFAVORABLE TAX TREATMENT ON CAPITAL GAINS PAID TO THE BENEFICIARY WHICH IS TAXED AT ORDINARY INCOME TAX RATES, INSTEAD OF LONG TERM CAPITAL GAINS TAX RATES! THE TRUSTEE SHOULD HAVE INVESTED ONLY IN CORPORATE BONDS AND PREFERRED STOCKS WHICH CARRY A LOT LESS RISK AND RECEIVE THE SAME TAX TREATMENT!

I UNDERSTAND THAT IN GENERAL, BANK TRUST DEPTS. HAVE DONE A POOR JOB OF MANAGING PENSION PLANS, TRUST ACCOUNTS, ETC. I HAVE ALWAYS WONDERED WHY CORPORATIONS USUALLY SELECT A BANK TRUST DEPT. TO MANAGE THE COMPANY PENSION PLAN? I UNDERSTAND THAT ONE OF THE REASONS IS THE LOW TRUSTEE FEES OF THE BANK. I WONDER IF THERE ISNT A BUSSINESS RELATIONSHIP BETWEEN THE BANK AND THE CORPORATION? BANKS AND CORPORATIONS NEED EACH OTHER TO SURVIVE. CORPORATIONS NEED MONEY FROM THE BANK TO FINANCE THEIRBUSINESS, AND THE BANKS NEED THE CORPORATIONS IN ORDER TO MAKE LOANS. I WONDER IF SOME CORPORATIONS MAY BE INFLUENCED BY WHICH BANK THAT THEY SELECT TO BE THE TRUSTEE TO THE PENSION PLAN ON THE BASIS OF THE TERMS THAT THE BANK IS WILLING TO GIVE THE CORPORATION A LINE OF CREDIT? THIS MAY NOT BE IN THE BEST INTEREST OF THE EMPLOYEES PENSION PLAN IF THE BANK HAS A RECORD OF POOR MANAGEMENT.

I DO NOT BELIEVE THAT MANY CORPORATIONS HAVE USED "MUTUAL FUNDS" AS TRUSTEE TO THEIR PENSION PLAN WHICH I FIND STRANGE TO BELIEVE.

I BELIEVE THAT CONGRESS SHOULD LOOK INTO THIS TO SEE IF ANY "CONFLICT OF INTEREST" SITUATIONS EXIST BETWEEN THE BANKS, CORPORATIONS, AND THE EMPLOYEES PENSION PLAN WHICH IS TO BE MANAGED IN THE BEST INTEREST OF THE EMPLOYEES!

THERE WAS A RECENT CASE OF A BANK TRUST DEPT. THAT WOULD PURCHASE STOCK AND HOLD THEM FOR A COUPLE OF WEEKS, PRIOR TO DECIDING WHICH STOCKS TO PUT IN WHICH TRUST ACCOUNT. THE STOCKS THAT HAD INCREASED IN VALUE WERE PUT INTO THE ACCOUNTS THAT WERE NOT PERFORMING VERY WELL. THE STOCKS THAT HAD DECREASED IN VALUE WERE PUT INTO THE ACCOUNTS THAT WERE PERFORMING WELL. THE REASON FOR THIS TYPE OF CONDUCT BY THE TRUST DEPT. WAS TO TRY TO KEEP ALL OF THEIR TRUST ACCOUNT CUSTOMERS HAPPY WITHOUT LOOSING ANY ACCOUNTS. I WONDER IF THIS IS A COMMON PRACTICE IN BANK TRUST DEPTS. WHICH COULD ALSO APPLY TO "MUTUAL FUNDS", ETC. I CAN READILY SEE A LOT OF ABUSE IN THIS AREA DUE TO VARIOUS "CONFLICTS OF INTEREST" SITUATIONS.

I BELIEVE THAT CONGRESS SHOULD TAKE STEPS TO SEE HOW WELL THE BANKS OWN INDIVIDUAL ACCOUNT HAS PERFORMED IN COMPARISON TO THE BANKS CUSTOMERS TRUST ACCOUNTS. THIS MAY UNCOVER THE NEED FOR NEW FEDERAL REGULATIONS TO ELEMINATE ANY "CONFLICT OF INTEREST" BETWEEN THE BANKS OWN ACCOUNT AND THE BANKS CUSTOMERS TRUST ACCOUNTS!

THE "VBP" BOOKLET MAKES THE FOLLOWING STATEMENT "YOU WILL HAVE ALL OF THE ADVANTAGES OF A MUTUAL FUND WITH NONE OF ITS COSTS OR LOADING CHARGES". THIS IS A DISCRIPTION OF A "NO-LOAD MUTUAL FUND", WHICH IS A SECURITY, WHICH IS REQUIRED TO REGISTER WITH THE S.E.C. AS A INVESTMENT COMPANY.

I AM OF THE OPINION THAT THIS STATEMENT IS FALSE FOR THE FOLLOWING REASONS.

1. I AM NOT PERMITTED TO VOTE, ELECT OFFICERS, ATTENT ANNUAL MEETINGS, AND DO SOMETHING ABOUT THE POOR MANAGEMENT OF THE "VBP".

2. I WOULD HAVE SUBMITTED A PROXY FOR STOCKHOLDERS VOTE TO TERMINATE THE BANK TRUSTEE BACK IN 1967!

3. THE CORPORATIONS BOARD OF DIRECTORS ARE ALSO ON THE BOARD OF DIRECTORS OF THE "VBP"! THIS PRESENTS A VERY SERIOUS "CONFLICT OF INTEREST" SITUATION BETWEEN THE SAME BOARD OF DIRECTORS WHO REPRESENT THE STOCKHOLDERS AND THE EMPLOYEES OF THE CORPORATION.

HOW CAN THE SAME BOARD OF DIRECTORS LOOK AFTER THE STOCKHOLDERS AND THE EMPLOYEES INTEREST AT THE SAME TIME WITHOUT A "CONFLICT OF INTEREST"?

I DO NOT BELIEVE THAT THE BOARD OF DIRECTORS OF THE "VBP" HAVEBEEN LOOKINGOUT FOR THE EMPLOYEES BEST INTEREST FOR THE LAST 13 YEARS, DUE TO POOR MANAGEMENT BY THE SAME BANK TRUSTEE!

I BELIEVE THAT CONGRESS SHOULD REQUEST THE "LABOR DEPT", JUSTICE DEPT", "S.E.C.","FEDERAL RESERVE BOARD", AND THE "I.R.S." TO CONDUCT A INVESTIGATION AS TO THE REASON FOR POOR MANAGEMENT, AND REASONS FOR THE COMPANY NOT TERMINATING THE BANK TRUSTEE FOR THE LAST 13 YEARS!

THE "VBP" WAS FIRST OFFERED TO EMPLOYEES IN 1965. EACH EMPLOYEE HAD THE RIGHT TO ACCEPT OR REJECT THE PENSION PLAN. THIS OFFERING WAS LIMITED TO THE EMPLOYEES OF THE COMPANY.

THE COMPANY AND EACH EMPLOYEE WERE BOTH REQUIRED TO CONTRIBUTE 1% OF THE EMPLOYEES ANNUAL SALARY, IF THE EMPLOYEE ACCEPTED THE "VBP". EACH EMPLOYEE HAD THE OPTION TO MAKE ADDITIONAL CONTRIBUTIONS TO THE "VBP" OF UP TO 10% PER YEAR. EACH EMPLOYEE COULD CHANGE HIS OPTIONAL CONTRIBUTIONS ONLY ONCE A YEAR. EACH OF THE EMPLOYEES MAY WITHDRAW ALL OF HIS OPTIONAL CONTRIBUTIONS PRIOR TO RETIREMENT.

THE "JUSTICE DEPT" HAS FILED A BRIEF WITH THE SUPREME COURT INDICATING THAT THEY FEEL THAT THE "INTERNATIONAL BROTHERHOOD OF TEAMSTERS UNION PENSION PLAN" IS NOT A SECURITY, HOWEVER THE STATEMENTS THAT THE JUSTICE DEPT MAKES IN ITS BRIEF WOULD INDICATE TO ME THAT THE "VBP" WOULD BE A SECURITY! THE "VBP" BOOKLET STATES "YOU WILL HAVE ALL OF THE ADVANTAGES OF A MUTUAL FUND, WITH NONE OF ITS COSTS OR LOADING CHARGES". THIS IS A DISCRIPTION OF A "NO-LOAD MUTUAL FUND".

I HAD THE OPTION TO ACCEPT (BUY SHARES OF THE "VBP") OR REJECT IT. I REDEMMED (SOLD SHARES OF THE "VBP") ALL OF MY OPTIONAL CONTRIBUTIONS IN 1967 DUE TO POOR MANAGEMENT. I PAID TAXES ON THE SMALL CAPITAL GAINS IN 1967 AT ORDINARY INCOME TAX RATES. THE "VBP" WAS MANAGED BY A BANK TRUSTEE WHICH I HAD NO CONTROL OVER THE TRUSTEES INVESTMENT DECISIONS. THE ONLY THING THAT WAS MISLEADING ABOUT THE "VBP" WAS THE FACT THAT I DID NOT HAVE ALL OF THE ADVANTAGES OF A "MUTUAL FUND"! I COULD NOT VOTE, ELECT OFFICERS, ETC. WHICH MAY HAVE VIOLATED BOTH FEDERAL AND STATE SECURITIES REGULATIONS, "ERISA", ETC.

THE UNION HAS NEGOATED WITH THE COMPANY TO TERMINATE THE "VBP" FOR ITS UNION MEMBERS! THE UNION SHOULD HAVE NEGOATED WITH THE COMPANY TO TERMINATE THE BANK TRUSTEE, WHO WAS RESPONSIBLE FOR POOR MANAGEMENT.

I DO NOT BELIEVE THAT THE UNION AND THE COMPANY HAVE THE RIGHT TO TERMINATE THE "VBP" IF THIS IS A SECURITY! THIS SHOULD BE VOTED ON BY THE EMPLOYEES OF THE COMPANY.

THE FACT THAT THE "VBP" IS TO BE TERMINATED IN 1978 HAS CREATED ADDITIONAL PROBLEMS FOR THE EMPLOYEES!

1. I CAN TAKE A LUMP SUM DISTRIBUTION. THE ONLY PROBLEM IS THAT MY CONTRIBUTIONS ARE PROBLY WORTH LESS TODAY THAN THE MONEY THAT I PUT INTO THE "VBP" FOR THE LAST 13 YEARS.

2. I WILL RECEIVE THE COMPANYS CONTRIBUTIONS ALSO, BUT I WILL HAVE TO PAY TAXES ON THE COMPANY CONTRIBUTIONS AT ORDINARY INCOME TAX RATES, PLUS A 10% TAX PENALITY, AND I WILL BE IN THE 50% TAX BRACKET, SO 50% OF IT WILL GO TO TAXES!

4. I CAN ELECT A "IRA ROLLOVER", BUT I CANNOT MAKE ANY ADDITIONAL CONTRIBUTIONS.

5. I COULD RECEIVE MY MONEY FROM THE "VBP" AT AGE 55 WITHOUT THE 10% TAX PENALITY, HOWEVER IF I ELECT THE "IRA ROLLOVER", I CANNOT ELECT TO RECEIVE MY CONTRIBUTIONS PRIOR TO 59.5 WITHOUT A 10% TAX PENALITY!

I BELIEVE THAT IT IS ABOUT TIME THAT CONGRESS REALIZE SOME OF THE STUPID LAWS THAT EXIST WITH VARIOUS TYPES OF PENSION PLANS!

THE COMPANY HAS (3) SEPERATE "VBP" FOR (3) SEPERATE INDIVIDUAL GROUPS OF EMPLOYEES. THE COMPANY CONTRIBUTES 11% TO ONE GROUPS "VBP", 5.5% TO ANOTHER GROUPS "VBP", AND ONLY 1% TO ANOTHER GROUPS "VBP". THIS ALLOWS THE COMPANY TO DISCRIMINATE BETWEEN VARIOUS GROUPS OF EMPLOYEES IN REGARDS TO COMPANY CONTRIBUTIONS TO VARIOUS GROUPS OF EMPLOYEE "VBP"! I BELIEVE THAT THIS PRACTICE SHOULD BE BANNED BY CONGRESS!

THE PROBLEM WITH THE "VBP" AND OTHER PENSIONPLANS LIKE IT IS THE FACT THAT THERE ARE EMPLOYEES WHO ARE RETIRING EVERY DAY OF THE WEEK REGARDLESS OF WHETHER THE STOCK MARKET IS UP OR DOWN! THE TRYSTEE HAS NO WAY OF KNOWING WHEN A EMPLOYEE INTENDS TO RETIRE, SO THE TRUSTEE INVESTS FOR THE LONG TERM WHICH MAY AND HAS PROVEN TO BE A DISADVANTAGE FOR THOSE EMPLOYEES WHO RETIRED WHEN THE STOCK MARKET WAS DOWN! THIS PUTS EACH EMPLOYEE AT THE MERCY OF THE TRUSTEE AND THE STOCK MARKET!

THERE IS NEVER A SINGLE TYPE OF INVESTMENT THAT IS A GOOD INVESTMENT 365 DAY OF THE YEAR! I BELIEVE THAT CONGRESS SHOULD PASS LEGSILATION TO REQUIRE ALL PENSION PLAN TO GIVE EMPLOYEES A CHOICE AS TO WHICH TYPE OF INVESTMENTS THAT THEY WISH TO INVEST IN AT A PARTICULAR TIME SUCH AS STOCKS, BONDS, MUTUAL FUNDS, CREDIT UNION, SAVINGS ACCOUNT, PREFERRED STOCKS,ETC. SO THATEMPLOYEES HAS A CHOICE AS TO THEIR INVESTMENT OBJECTIVE AT ANY TIME WHICH MAY BE CHANGED AT ANY TIME BY THE EMPLOYEE.

THE "FIDELITY MANAGEMENT AND RESEARCH CO" OF BOSTON, MASS. MANAGES SEVERAL NO-LOAD MUTUAL FUNDS WITH VARIOUS INVESTMENT OBJECTIVES. "FIDELITY" HAS SET UP A "MONEY PURCHASE PENSION PLAN" WHICH PERMITS EACH EMPLOYEE TO SELECT ONE OR MORE OF THE "FIDELITY FUNDS" TO INVEST IN AT ANY TIME, AND TO SWITCH THEIR INVESTMENTS FROM ONE FUND TO ANOTHER AT ANY TIME! I CONSIDER THIS THE IDEAL PENSION PLAN, SO THAT EMPLOYEES DO HAVE SOME CONTROL OVER THEIR INVESTMENTS AND IF THEY ARE DISSASTIFIED THEY CAN DO SOMETHING ABOUT IT. MR. ROGER HARRIS IS THE MARKET DEVELOPMENT MANAGER FOR "FIDELITY" WHO MAY BE REACHED AT 800-225-6197, ext 412 IF YOU WOULD LIKE MORE INFORMATION.

I AM ALSO ENCLOSING A LETTER FROM THE "NO-LOAD MUTUAL FUND ASSN. VALLEY FORGE, PA. 19481 INDICATING THAT THEY WOULD BE WILLING TO WORK WITH ANY CORPORATION TO SET UP A "VBP" USING "NO-LOAD MUTUAL FUNDS WITH DIFFERENT INVESTMENT OBJECTIVES TO SUIT EVER INDIVIDUAL EMPLOYEES INVESTMENT OBJECTIVE. I BELIEVE THAT THIS WOULD BE THE IDEAL PENSION PLAN ARANGEMENT, AND CONGRESS SHOULD REQUIRE CORPORATIONS TO GRANT EMPLOYEES A CHOICE IN THEIR INVESTMENT OBJECTIVES AT ALL TIMES. "I.R.S." REVENUE RULING NO. 70-370 PERMITS EMPLOYEES TO DIRECT THEIR OWN INVESTMENTS IN A PENSION PLAN IF THE COMPANY PERMITS THIS. THE PROBLEM IS THAT MOST COMPANIES DO NOT PERMIT EMPLOYEES TO DIRECT THEIR INVESTMENTS!

CONGRESS SHOULD PASS LAWS WHICH WOULD PERMIT EMPLOYEES TO ELECT "SEMI-RETIREMENT" IF A EMPLOYEE DOES NOT WISH TO RETIRE COMPLETELY, FOR EXAMPLE-A EMPLOYEE MAY BE MAKING $2000 PER MONTH SALARY AT AGE 55. IF THE EMPLOYEE WERE TO COMPLETELY RETIRE AT AGE 55 HE WOULD RECEIVE A PENSION OF $500 A MONTH, WHICH WOULD BE HARD TO LIVE ON TODAY. THE EMPLOYEE ELECTS "SEMI -RETIREMENT" BY WORKING 20 HOURS A WEEK AND RECEIVING $1000 A MONTH IN SALARY, PLUS $250 PER MONTH PENSION WHICH WOULD PROVIDE THE EMPLOYEE WITH A TOTAL MONTHLY INCOME OF $1250 INSTEAD OF ONLY $500 PER MONTH. I BELIEVE THAT MANY EMPLOYEES AND CORPORATIONS WOULD ADOPT A "SEMI-RETIREMENT" PROGRAM, BUT I BELIEVE THAT CONGRESS IS GOING TO HAVE TO DEVELOPE THIS IDEA. THIS WOULD PROVIDE CORPORATIONS WITH PART TIME HELP, AND WOULD PROVIDE THE EMPLOYEES WITH MORE TIME OFF DUTY WITHOUT THE USUAL FINANCIAL HARDSHIP ASSOCIATED WITH EARLY RETIREMENT!

EMPLOYEE PENSION PLANS SHOULD BE REQUIRED BY LAW TO GRANT RETIRED EMPLOYEES A ANNUAL "COST OF LIVING"INCREASE DUE TO INFLATION IN ORDER TO PROTECT THE RETIRED EMPLOYEES FROM INFLATION, IN ORDER TO BE ABLE TO MAINTAIN A UNIFORM STANDARD OF LIVING FOR THE EMPLOYEES LIFE.

I BELIEVE THAT CONGRESS SHOULD STANDARIZE THE LAWS ON ALL OF THE VARIOUS TYPES OF PENSION PLANS SO THAT EVERY INDIVIDUAL IS TREATED EQUAL.

PENSION PLAN PARTICIPANTS ARE CONTRIBUTE DIFFERENT AMOUNTS ANNUALL TO A "QUALIFIED" PENSION PLAN SUCH AS "CORPORATE PENSION PLANS", "IRA", "KEOGH", ETC. CONTRIBUTIONS ARE BASED ON A PERCENTAGE OF A INDIVIDUALS ANNUAL INCOME. "IRA", AND "KEOGH" ALLOW PENSION PLAN CONTRIBUTIONS TO BE DEDUCTED FROM EARNED INCOME, WHILE OTHERS SUCH AS"CORPORATE PENSION PLANS" DO NOT ALLOW EMPLOYEES A TAX DEDUCTION ON EMPLOYEES CONTRIBUTIONS. THIS IS DISCRIMINATION !

"<u>CORPORATE PENSION PLANS</u>" CONTRIBUTIONS ARE LIMITED TO <u>10%</u> OR $<u>2500</u>, ANNUALLY , WHICHEVER IS THE LESSSER, <u>WHICH IS NOT TAX DEDUCTABLE</u>. MINIMIUM RETIREMENT AGE IS <u>50</u>.

"<u>IRA</u>" CONTRIBUTIONS ARE LIMITED TO <u>15%</u> OR $<u>1500</u>, WHICHEVER IE THE LESSER, <u>WHICH IS TAX DEDUCTABLE</u>. MINIMIUM RETIREMENT AGE IS <u>59.5</u>.

"<u>KEOGH</u>" CONTRIBUTIONS ARE LIMITED TO <u>15%</u> OR $<u>7500</u>, WHICHEVER IS THE LESSER, <u>WHICH IS TAX DEDUCTABLE</u>. MINIMIUM RETIREMENT AGE IS <u>59.5</u>.

1: I CAN SEE NO REASON FOR "IRA" AND "KEOGH" PARTICIPANTS TO BE PERMITTED A TAY DEDUCTION ON THEIR CONTRIBUTIONS, WHILE CORPORATE EMPLOYEES ARE NOT PERMITTED A TAX DEDUCTION ON EMPLOYEES CONTRIBUTIONS!

2. I SEE NO REASON FOR INDIVIDUALS, WHO ARE IN THE LOW INCOME BRACKET FROM CONTRIBUTING THE SAME AMOUNT OF MONEY ANNUALLY TO A PENSION PLAN AS A INDIVIDUAL WHO IS IN A HIGHER SALARY!

3. INDIVIDUALS WHO DO NOT CONTRIBUTE THE MAXIMIUM AMOUNT ALLOWED BY LAW EACH YEAR, SHOULD BE PERMITTED MT MAKE UP THEIR ALLOAWABLE CONTRIBUTIONS FOR PREVIOUS YEARS

4. I SEE NO REASON FOR INDIVIDUALS TO HAVE TO WAIT UNTIL AGE 59.5 BEFORE THEY CAN RETIRE UNDER "IRA" AND "KEOGH", WHEN CORPORATE EMPLOYEES MAY RETIRE AS EARLY AS AGE 50!

5. MANY PENSION PLANS STILL DISCRIMINATE BETWEEN SEXES AS FAR AS RETIREMENT AGES ARE CONCERNED, AND ACTUARIAL REDUCTION IN PENSION BENEFITS BETWEEN MALE AND FEMALES. THIS PRACTICE SHOULD BE STOPPED!

ONE OF THE THINGS THAT CONCERNS ME MOST ABOUT PENSION PLANS IS THE FACT THAT LARGE SUMS OF MONEY ARE INVESTED IN THE STOCK MARKET. WHAT IS CONGRESS GOING TO TELL THOSE PENSION PLAN PARTICIPANTS THAT ARE WIPED OUT, SHOULD WE HAVE ANOTHER STOCK MARKET CRASH LIKE THE ONE IN 1929?

I REQUEST THAT A MEETING BE SCHULED WITH THE "COMMITTEE ON HUMAN RESOURCES" TO DISCUSS THE ABOVE IN FUTHER DETAIL IN ORDER TO CLEAR UP SOME INFORMATION THAT I HAVE OMITTED.

YOURS TRULY

JOHN L. ASLING

Note: Attachments to Mr. Asling's statement are being held in Human Resources Committee files, 4232 Dirksen Senate Office Building, Washington, D.C. 20510.

STATEMENT OF THE

ASSOCIATED GENERAL CONTRACTORS OF AMERICA, INC.

ON THE ERISA IMPROVEMENTS ACT OF 1978

SUBMITTED TO

THE SUBCOMMITTEE ON LABOR

OF THE SENATE COMMITTEE ON HUMAN RESOURCES

AND

THE SUBCOMMITTEE ON PRIVATE PENSIONS AND

EMPLOYEE FRINGE BENEFITS

OF THE SENATE COMMITTEE ON FINANCE

AUGUST 17, 1978

The Associated General Contractors of America is a national association representing more than 8,300 general construction firms. We represent the full range of the industry, including the construction of highways, buildings, municipal and utilities facilities, heavy and industrial projects. The construction business is the nation's largest industry, and AGC represents 60 percent of this industry. Our member firms annually perform 80 billion dollars of construction which involves over three and one-half million employees.

Although these hearings involve more than one bill, in order to avoid confusion, any specific references made will be to the ERISA Improvements Act of 1978.

Overall, the AGC supports the idea of improving ERISA. The original rationale of guaranteeing employees' retirement benefits requires no elaborate defense. However, in some areas, ERISA has created more problems than solutions and has had some unforeseen detrimental effects. We believe changes are necessary to make Federal pension policy workable, equitable and coherent.

The establishment of an Employee Benefits Commission, as proposed in Section 122, would be an appropriate move toward centralized administration of ERISA and related sections of the Internal Revenue Code. The overlapping of authority and the duplication of effort by the Departments of Labor and Treasury and the Pension Benefit Guaranty Corporation have resulted in unnecessary, burdensome reporting and disclosure requirements, over-regulation and an additional bundle of bureaucratic red tape. This has increased administrative costs for employee benefit plans, placing additional financial burdens on them. We support the proposal of an Employee Benefit Commission. Moreover, we would strongly recommend that at least one member of the Commission be thoroughly versed in the operation of multi-employer plans, especially as they exist in the construction industry. As noted earlier, our industry is the largest single industry in the country and we hope that some special consideration would be given to the problems peculiar to our employee benefit systems. A feature as basic as the transient nature of the industry creates special problems which require special understanding and attention.

Sections 221 through 228 are realistic and desirable modifications to the reporting and disclosure requirements of ERISA. We believe these proposals would ease the paperwork burden but still maintain a fair access to employee plan information. We think these sections allow an interested plan participant adequate opportunity to keep a check on his status in a plan. Also, we feel that consolidation of forms EBS-1 and the form 5300 series is a step in the right direction.

Reciprocal agreements, as proposed in Section 231, cause us some concern. In addition to possible record-keeping problems, reciprocity and portability may create accounting difficulties. A question that readily comes to mind is: how are different contribution rates reconciled between an away plan and a home plan? For example, if the contribution rate to the away plan is 50 cents per hour worked and the contribution rate to the home plan is 35 cents per hour worked, does the away plan simply keep the contribution difference of 15 cents per hour worked? The converse may be even more difficult to reconcile.

If the away plan has a lower contribution rate than the home plan, does an automatic funding deficiency occur simply by transferring the contributions to the home plan? In the construction industry, which maintains thousands of collectively bargained multi-employer employee benefit plans, portability or reciprocity could cause accounting and funding nightmares. The possible confusion is our major concern with that section. We think a thorough study of the implications of such an arrangement would be imperative before any such provision of law is enacted.

Section 273, Impact of Inflation on Retirement Benefits, quite frankly frightens us. We realize this section only calls for a study of the feasibility of requiring pension plans to provide cost-of-living adjustments to benefits payable under the plans. However, this is no time to even consider such a formula. The very fact that an ERISA Improvements Act has been introduced is indicative that the private pension system has to be straightened out and made more attractive. Any cost-of-living formula would greatly exacerbate present funding liabilities and in many cases would be the death knell for a great number of funds. We strongly urge the Congress not to venture into this potentially disastrous area.

Finally, we wholeheartedly support Section 274 which provides that ERISA supercedes Federal and state securities laws as to an employee's interest in an employee benefit plan. The decision of the Seventh Circuit Court of Appeals in the Daniel case was far beyond the area of concern of the Securities and Exchange Act of 1934. We think there are sufficient disclosure requirements under ERISA. Moreover, application of Federal and state securities laws to employee benefit plans are unnecessary. We believe ERISA provides employees with ample protection of their benefit rights. If the decision in the Daniel case were allowed to stand and to set precedent, innumerable pensions plans would be threatened with insolvency because of the claims of former employees. Please make special note of the AGC position on this particular issue. Others who share in our opposition to the court decision include the AFL-CIO, the National Coordinating Committee on Multi-Employer Plans, the U.S. Department of Labor and the U.S. Chamber of Commerce. We do not believe there are many issues which can produce unanimity among such diverse groups. Perhaps we should all pause and savor this moment.

So far we have only touched upon sections of S.3017. However, there are sections of ERISA which are not addressed at these hearings and with which AGC is concerned. Our list of priorities is as follows:

employer liability,
contingent employer liability insurance;
fiduciary responsibility;
paperwork; and,
state preemption

As Senator Williams pointed out in his remarks when he introduced S.3017, this bill is not comprehensive and does not address all of the problems, such as those created by Title IV of ERISA.

The Pension Benefit Guaranty Corporation has now made its report to Congress and important decisions will have to be made concerning multi-employer plans and termination insurance.

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Many of our members are involved in multi-employer pension and employee benefit plans in all parts of the country. We have very strong feelings on the application of Title IV of ERISA.

General contractor employers are in a position which, we suspect, was overlooked when the ERISA legislation was passed, i.e., unlike most employers we are regularly contributors to multiple plans. Most employers are involved with one benefit plan, but general contractors are by definition usually involved in none (where they work full open shop) or in several (where they work union).

This gives rise to liabilities which were probably unintended and which, by exceeding 100 percent of corporate worth, are patently impossible to satisfy.

It is the position of the AGC that employer liability under pension plans created pursuant to the collective bargaining process should be limited to the retirement contributions called for from such employers under the terms of the collective bargaining agreements involved. The creation of liability in excess of such amounts is inequitable, counter-productive, technically unworkable and contrary to the principles of collective bargaining which have worked so well in past years.

We object strenuously to the imposition by ERISA of various levels of liability upon employers that are not otherwise delinquent in the amking of agreed contributions to the retirement plans covering their unionized employees.

Contingent employer liability makes collective bargaining unrealistic for employers. In bargaining, both management and labor come to an agreement on the full terms and conditions under which management will employ labor. ERISA, however, adds a new wrinkle for management. By executing an agreement which contains provisions for employee benefit trusts that will be construed as "defined benefit" plans under ERISA, management agrees to the full terms and conditions plus one unknown element. As a party to the resultant collectively bargained contract, management agrees to a potential undetermined liability which may be imposed at some unknown time in the future. Moreover, an individual employer involved agrees to this unknown liability. For an employer, ERISA makes collective bargaining unworkable and undesirable. Ultimately, the last employer in business is "left holding the bag."

Thank you for this opportunity to make known the views of the Asssociated General Contractors of America. If we can supply any additional information or be of assistance, please do not hesitate to contact us.

ASSOCIATION FOR ADVANCED LIFE UNDERWRITING

Madelyn Guilian • *Executive Director*

1922 F Street, N.W., Washington, D.C. 20006 • *202/331-6081*

September 1, 1978

Mr. Michael Stern
Staff Director
Committee on Finance
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Joint Hearings on ERISA Simplification Held by the Senate Human Resources Committee and the Subcommittee on Private Pension Plans of the Senate Finance Committee

Dear Mr. Stern:

The comments in this letter are submitted on behalf of the Association for Advanced Life Underwriting (AALU) with regard to the hearings held by the Senate Human Resources Committee and the Subcommittee on Private Pension Plans of the Senate Finance Committee on the issue of pension simplification.

AALU is a national organization of approximately 1,000 members who specialize in one or more fields of advanced life underwriting. Collectively, our members are responsible for annual sales of life insurance in excess of $2 billion, mostly in circumstances involving complex factual situations and often dealing with qualified retirement plans, group term life insurance and other involved business planning. A great deal of the work performed by our members is with relatively small businesses -- businesses which tend to bear the burden of a substantial portion of the more objectionable features of ERISA.

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AALU is affiliated with the National Association of Life Underwriters (NALU), the largest life insurance industry field force organization in the United States. NALU has a membership of approximately 130,000 life insurance agents. NALU endorses and fully supports the remarks of AALU.

Although ERISA was enacted in 1974 and received substantial criticism from many quarters, Congress has still not enacted any substantial remedial legislation to correct many of the problems created by ERISA. AALU applauds the efforts of these Committees in attempting to promote this long-overdue legislation. The various agencies involved, principally the Labor Department, the Internal Revenue Service and the Pension Benefit Guaranty Corporation, have made a tremendous effort to work within the restrictive statutory confines of ERISA and deserve praise for their efforts in the last four years. Notwithstanding this, however, it is almost indisputable that ERISA has numerous problems which require legislative correction and to that end we urge Congress to promptly move towards legislating improvement of ERISA.

AALU feels that the area most in need of legislative correction concerns the paperwork burdens created by ERISA. Judging from the number of bills introduced relating to this subject, it would appear that Congress shares this sentiment. As a consequence, we will address our principal remarks to the ERISA paperwork burdens. In addition, we will comment on the problems of dual jurisdiction, SEC involvement, master and prototype plans, vesting for defined benefit plans, funding, deductible employee contributions and IRA revisions.

Paperwork Burdens

Four of the bills included in the joint hearings contain provisions that would substan-

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tially revise the paperwork burdens created by ERISA. Part I of Title II of S. 3017 (the ERISA Improvements Act of 1978), section 4 of S. 901 (the Pension Simplification Act), sections 3-4 of S. 3193, and sections 2-4 of S. 1745 (the ERISA Small Business Paperwork Reduction and Investment Act) all seek to greatly reduce the paperwork burden of ERISA.

AALU strongly endorses these efforts. Probably the greatest error in ERISA was the creation of unnecessary paperwork that is choking the growth of the private pension system, especially among the smaller businesses that are unable to cope with the administrative expense. Excessive paperwork only serves to waste dollars, create more inefficiency in government operations and prevent employers from adopting qualified plans due to the administrative costs associated with such plans.

The best approach toward the reduction of the paperwork burden is the replacement of the detailed ERISA reporting and disclosure provisions 1/ with a short statutory provision authorizing the Department of Labor to require such reports and disclosures as may be necessary to protect the interests of plan participants and beneficiaries consistent with minimizing plan administration requirements. In this regard we particularly wish to support section 222 of S. 3017 and section 4 of S. 901. We believe that the Department of Labor is in the best position to determine the need for various information on reports and is only handicapped by a detailed legislative statutory

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1/ Sections 101-110 of ERISA and sections 6047, 6057, 6058 and 6059 of the Internal Revenue Code.

listing of the requirements for such reports. Such a provision should, however, be coupled with a listing, in the Committee reports, of those areas of ERISA that have proven unacceptable. AALU's views on these specific areas are outlined below.

A number of specific modifications should also be addressed either statutorally (if the preceding proposal is not adopted) or in the Committee reports. AALU strongly supports the elimination of the summary annual report (section 223 of S. 3017) as eliminating an unnecessary disclosure requirement that increases the cost of plan administration without providing very useful information to participants and beneficiaries. Merely making copies of the annual report available to participants and beneficiaries who request it should be adequate.

AALU also endorses the elimination of the plan description (Form EBS-1) where a Form 5301 or 5300 is filed. This would eliminate a duplicative and meaningless filing requirement. Section 3 of S. 3193 generally adopts this concept.

As proposed in section 4 of S. 3193, the annual reports (Form 5500) should be kept on a consolidated basis. Further, small plans should be relieved from the necessity of annual filings and should be permitted to file less often, such as once every three years.

Further simplification is needed in the contents of the summary plan description. Concern over compliance with ERISA and potential liability for incomplete explanations have made summary plan descriptions more lengthy and expensive than is necessary to generally explain the plan. Smaller employers especially cannot afford this expense.

Dual Jurisdiction

The alternatives available to solve the problem of dual ERISA jurisdiction are the same

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alternatives that existed at the time of ERISA's enactment, i.e, a choice between creation of a new agency with consolidated jurisdiction or the division of authority over ERISA among the existing agencies involved. The choice involved is no less difficult now than it was in 1974 and AALU feels that it may jeopardize the future of ERISA legislation to include a provision on this subject.

It is, however, AALU's position that the most expeditious solution to the dual jurisdiction problem created by ERISA is along the lines suggested by Senator Bentsen in S. 901 (sections 2 and 3). In view of the recent introduction by President Carter of Reorganization Plan No. 4 and the detailed provisions of that Plan, AALU suggests that Reorganization Plan No. 4 should be adopted and should be carefully monitored. After a trial period of examining the operation of Reorganization Plan No. 4, unless the evidence indicates to the contrary, we would suggest legislatively making the provisions of Reorganization Plan No. 4 permanent under ERISA.

Removal of SEC Jurisdiction

Section 274 of S. 3017 would reverse the decision of the Seventh Circuit in Daniel v. International Brotherhood of Teamsters, 561 F.2d 1223 (7th Cir. 1977). The decision in Daniel is currently on appeal to the Supreme Court and even the government agencies were unable to agree on a position with respect to the proper result that should be reached in Daniel. 2/ In view of the detrimental effect that the dual jurisdiction has

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2/ The Securities and Exchange Commission's position is contrary to that taken by the Justice Department and the Department of Labor.

had on the operation of pension plans, AALU believes that the presence of another agency would only exascerbate this problem and strongly supports the removal of SEC jurisdiction.

Master and Prototype Plans

Title IV of S. 3017 would permit the establishment of special master and prototype plans. The thrust of the proposal is to transfer many of the statutory responsibilities from the employer to the plan sponsor.

AALU supports the concept of special master and prototype plans but believes that the concept should be broadened beyond that contained in Title IV of S. 3017. As contained in S. 3017, the master sponsors would be limited to investment managers such as registered investment advisors, banks and insurance companies.

In view of the large number of pension consultants servicing retirement plans, we believe that the essential purpose of the special master and prototype provisions would be greately enhanced if these plan consultants were also authorized to be the special master sponsors of these master and prototype plans. They probably have the greatest contact with employers with respect to employee benefits and would be in the best position to provide this service on an economical scale since they already have the expertise and frequently serve as investment advisors and administrators to plans anyway. These consultants are currently permitted to establish "field prototype" plans. 3/

Other changes should also be made in the legislative proposal. Merely transfering certain

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3/ See Rev. Proc. 77-23, 1977-1 C.B. 197.

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ERISA-created burdens will not sufficiently provide the necessary incentive for the creation of these master and prototype plans. AALU, therefore, recommends the adoption of the following changes:

(1) the sponsor should only be responsible for reporting and disclosure requirements and maintaining the accounts;

(2) the sponsor should not be an administrator, fiduciary or investment manager, unless it explicitly agrees;

(3) the program should be available for both defined benefit and defined contribution plans.

Vesting in Defined Benefit Plans

Since the adoption of ERISA, the fall-off in defined benefit plans has been particularly dramatic. AALU believes that defined benefit plans are particularly important, especially to older employees, and that Congress should provide some incentives to reverse the current ERISA-created trend in favor of defined contribution plans.

Since it is unlikely that the benefit accrual rules on PBGC liability provisions will be substantially modified to achieve this result, AALU suggests that defined benefit plans be permitted to adopt any of the statutory vesting schedules of ERISA, without regard to 4-40 vesting. Further, because of the emphasis on age in pension plans, the rule of 45 vesting schedule 4/ should be modified to delete the mandatory 50% vesting after 10 years. 5/

4/ Section 411(a)(2)(C).

5/ Section 411(a)(2)(c)(iii).

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The ability to provide slower vesting will help restore the needed balance between defined contribution and defined benefit plans.

Funding Requirements

Section 251 of S. 3017 would permit pension plans to take into account provisions that will modify plan benefits but which have not yet taken effect. AALU interprets this provision to permit current funding of future cost-of-living increases. Under current rules, the Internal Revenue Service has indicated that plans may not fund for future cost-of-living increases and cannot take into account those increases under section 415 of the Internal Revenue Code for funding purposes.

AALU believes the financial soundness of the funding of retirement plans would be better served if actuaries were permitted to make reasonable actuarial assumptions about cost-of-living increases in the future in determining the necessary current funding for a plan. AALU therefore strongly supports the provisions of section 251 of S. 3017.

Employee Contributions/IRAs

Section 303 of S. 3017 permits deductible employee contributions to qualified plans in limited amounts. The contributions permitted are not explicitly tied into the IRA contribution rules and the bill further provides (in section 303(d)) that qualified plans will be required to accept such employee contributions.

AALU strongly supports the concept of deductible employee contributions but feels the provisions of section 303 of S. 3017 do not provide the best mechanism for achieving this result. AALU particularly objects to the requirement that plans

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must accept employee contributions. For plans that do not maintain individual accounts, the acceptance of employee contributions would create a substantial administrative problem. AALU also objects to the phase-out of deductibility at upper income levels. This type of discrimination against higher income individuals is unwarranted. S. 3288 (by Senator Dole) provides a more acceptable rule for deductible employee contributions.

In addition, AALU believes that a better approach would be to link deductible employee contributions with the IRA contribution rules in a way that will permit individuals to make a contribution of 15% of income up to $1,500 per year to either an individual retirement account or to a qualified retirement plan, if the qualified retirement plan permits employee contributions. As a consequence, an employee covered by a qualified plan that permits employee contributions could make his deductible employee contribution to the qualified plan in lieu of making the contribution to the IRA. In this way the employee's funds will be kept together and administered for him or her until distribution at retirement. Futher, if an employee were to make a small contribution to an IRA (such as $300) the employee should be permitted to contribute the difference to the qualified plan (or vice versa) up to the limits previously mentioned.

Providing deductible employee contributions would greatly enhance the ability of individuals to save for retirement and thereby would serve an important social function in permitting individuals to retire with greater financial security after a life of active employment. The need for personal savings during working years becomes increasingly more important as inflation becomes more burdensome on people with fixed retirement incomes. While AALU understands that the revenue cost of such a proposal would be substantial, we believe that the results of such a program far outweigh the financial revenue cost and that the program should be actively pursued.

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In considering the foregoing comments it is important to keep in mind the necessity of assisting the small businesses in getting out from under the burdens imposed on them by ERISA. In enacting ERISA in 1974 the primary focus was on large plans that are better able to cope with the expensive administration required by ERISA. Small businesses cannot afford this expense and AALU strongly urges that special attention be given to providing relief to small businesses. AALU will be glad to develop a series of special small business proposals if that would be helpful.

If further elaboration on any of these comments would be helpful, we will be glad to provide whatever additional assistance or explanation may be desired.

Respectfully submitted,

Gerald H. Sherman,
Counsel

Stuart M. Lewis,
Associate Counsel

The Association of Private Pension and Welfare Plans, Inc.

1028 Connecticut Avenue, N.W., Suite 909
Washington, D.C. 20036
(202) 659-8274

APPWP

August 25, 1978

The Honorable Harrison Williams
Chairman, Subcommittee on Labor
352 Rayburn Senate Office Building
Washington, D.C. 20510

The Honorable Lloyd Bentsen
Chairman, Subcommittee on Private Pension Plans
240 Ryaburn Senate Office Building
Washington, D.C. 20510

Dear Senators:

The Association of Private Pension and Welfare Plans, ERISA Amendments Committee welcomes this opportunity to place these comments in the public record of the ERISA Amendments hearings Held August 15-17, 1978.

The APPWP is a national organization whose membership represents the many and varied disciplines that are involved in employee benefits administration. Last spring the Association made a major policy decision to take positions on employee benefit issues when there is agreement between labor and management.

As a result of this decision, a series of member committee have been formed to deal with various aspects of the employee benefits industry. I chair the ERISA Amendments Committee. We have been active in developing our industry paper, which is not yet complete.

To provide input to your committees, we asked the ERISA Amendments Committee members for their comments which are attached. These are the opinions of the individuals and do not constitute the official position of the Association.

We would like to thank the committees for this opportunity to add to the public dialogue. We look forward to your continued interest and activity in the employee benefits field. We are available to offer an assistance you may desire at this time or in the future.

Sincerely,

Carlton Sickles

Carlton R. Sickles
Chairman, ERISA Amendments Committee

Attachments:

#1 - List of ERISA Amendments Committee Members
2- A. Shidler Comments
3 - S. Felton Comments
4 - D. Grubbs Comments
5 - C. O'Flinn Comments

ATTACHMENT # 1

The Association of Private Pension and Welfare Plans, Inc.

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APPWP

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Director of Labor Relations
Boise Cascade Corporation
Boise, ID

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Director, Retirement & Trust Management
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ATTACHMENT # 1

APPWP ERISA Amendments Committee

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Washington, D.C.

ATTACHMENT # 2

Hansen

A. S. Hansen, inc. 1080 Green Bay Road · Lake Bluff, Illinois 60044 · Telephone 312-234-3400

May 25, 1978

Mr. Carlton R. Sickles
Committee Chairman
The Association of Private Pension
and Welfare Plans, Inc.
1028 Connecticut Avenue, N.W.
Suite 909
Washington, D. C. 20036

Dear Carlton:

Subject: Legislative Changes to ERISA—ERISA Amendments Committee

In response to your request for recommended legislative changes to ERISA, I am pleased to furnish the following list.

1. The Summary Annual Report mandatory disclosure requirement should be eliminated. Instead, plan participants should have ready access to a copy of the complete annual return. The costs and other burdensome administrative actions do not justify mandatory disclosure—especially in light of value—or lack of value—to participants.

2. The Form EBS-1, plan description, should either be eliminated or combined (if a qualified plan is involved) with Form 5300. Form EBS-1 represents unnecessary paperwork from the plan administrator's viewpoint.

3. The requirement to file the summary plan description should be eliminated. The DOL should have ready access to a copy if so needed.

4. To eliminate unnecessary duplication of efforts by actuaries and accountants under ERISA's annual reporting requirements, it should be required that accountants must rely on the correctness of any actuarial matter certified to by an enrolled actuary and it should be required that enrolled actuaries must rely on the correctness of any accounting matter as to which a qualified public accountant has expressed an opinion.

5. An updated summary plan description should not have to be furnished every five years even if amendments have been made. A disclosure requirement in this regard every tenth year is more reasonable.

Offices Throughout the United States

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Mr. Carlton R. Sickles
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6. ERISA should be amended to provide that any statements, prepared by a bank or insurance carrier regulated and subject to periodic examination by State or Federal agencies, when certified by the bank or insurance carrier as accurate and made a part of the annual report, are excluded from examination and opinion by the qualified public accountant. Certified statements by such institutions should suffice without further costly audits.

7. Delete the requirement that the annual report include the present value of all the plan's liabilities for nonforfeitable pension benefits allocated by the termination priority categories in Section 4044 of ERISA. This required information involves costly computations which is of no value to the IRS, DOL and PBGC in the case of an ongoing plan.

8. The decision by the Seventh Circuit in Daniel v. International Brotherhood of Teamsters should be reversed by legislation. This case has potentially horrendous effects unless reversed. Application of the securities laws to interests in pension plans creates potentially large unforeseen liabilities, the probability of many more plan terminations (especially more small plan terminations), the imposition of not clearing defined disclosure requirements and other disclosure requirements duplicative of ERISA, and the addition of another body of law and yet another governmental agency which compounds the existing dual jurisdiction problems.

9. ERISA should be amended so that individual employees of a corporate trustee are not within the definition of "fiduciary" so long as the plan sponsor (corporation or employee organization) of such employees is a fiduciary.

10. ERISA should be amended to specifically provide for the indemnification of fiduciaries by employers or unions for liability arising from a breach of fiduciary duty—thus codifying DOL's IB 75-4 which permits indemnification.

11. ERISA should be amended in connection with the co-fiduciary liability rules—especially in the multiemployer plan area—because qualified persons are reluctant to serve as plan fiduciaries. The statutory rule that co-fiduciary liability is imposed if the individual fiduciary knows of the breach but makes no reasonable efforts to remedy the breach is very troublesome and catches too many in the fiduciary responsibility net.

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12. The Internal Revenue Code should be amended to eliminate disqualification of corporate plans for exceeding the benefits and contributions limitations set forth in Section 415 of the Code. An excise tax imposed upon the employer as a penalty is a much more reasonable sanction.

13. ERISA should be amended to provide that nonvested terminated employees need only receive a statement that he is not entitled to a benefit rather than a statement of his accrued benefit.

14. ERISA should be amended to permit the concept of elapsed time to be utilized to measure accrual of service as an alternative to crediting service on an hourly basis.

The above recommendations represent many—but not all—of the areas of ERISA that need further examination and possible change. Much care and thought is needed in examining proposed legislative changes so that the final product will contribute to a healthier private pension system.

Sincerely,

A. S. HANSEN, INC.

Alan

Alan B. Shidler
Director, Information Services

ABS:si

Hansen

ATTACHMENT # 3

OLD KENT
BANK AND TRUST COMPANY
One Vandenberg Center • Grand Rapids, Michigan 49503

HOWARD S. FELTON
Vice President
Trust Department
616 - 774 5247

November 9, 1977

Mr. Carlton R. Sickles, Chairman
ERISA Amendments Committee
Association of Private Pension & Welfare Plans, Inc.
1028 Connecticut Avenue, N. W., Suite 909
Washington, D. C. 20036

Dear Carlton:

I'm sorry for the delay in forwarding my suggestions for consideration by the ERISA Amendments Committee. Rather than to continue being bogged down by the enormity of the task, I am taking the liberty of limiting my suggestions to a few specific items. My suggestions are of course flavored by my primary exposure to ERISA as a trust officer dealing with many small employers.

1. <u>Stock Tenders</u>

The provisions of ERISA if applied literally seem to prohibit the trustees of pension funds from tendering stock in response to a plan sponsoring company's offer, even though the transaction may clearly seem to be a wise investment decision and in the interest of plan participants. This condition seems clearly to conflict with the prudence requirements of the Act imposed upon trustees and other fiduciaries. Apparently the addition of the term "sale" to Section 408(e)(3)(B) would correct this prohibition. The legal talent on our committee may have other suggestions.

2. <u>Self Dealing</u>

Section 403 states that with certain exceptions all assets of employee benefit plans should be held in trust by one or more trustees. In small plans, where sometimes protection is needed most, it is not uncommon to have the trustee be an official of the sponsoring employer as well as a participant. In effect the individual(s) serving as

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Mr. Carlton R. Sickles, Chairman
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trustee is wearing two hats. I would favor a prohibition against having a trustee who is a participant. I believe it would solve most of the problems which have arisen by this practice. In my opinion, it is a clear conflict of interest for a participant to serve as a trustee of a plan. While I would favor this prohibition in all plans, I would especially favor such a prohibition in small plans, say with fewer than 100 participants. In these plans, there is minimal reporting and disclosure available of such transactions. This would also be consistant with other provisions of the act which encourage plans by means of incentives which place the assets with either a bank or an insurance company.

3. Benefit Accrual

ERISA originally required that all participants with 1000 hours of service in a 12 month period be entitled to share in contributions for the period, even though they may have terminated their employment. Subsequent regulations have permitted employers to not contribute for participants with 1000 hours of service, if the plan document specifies that a participant must be employed as of a certain date. I would favor a clear correction to ERISA which would offset this regulation and require that participants share on the basis of 1000 hours of service during the period.

4. Participant Loan Repayment

While ERISA clearly permits participant loans subject to adequate security and reasonable rate of interest, et cetera, there appears to be no specific requirement as to repayment terms. Consequently, there are some loans which are in effect non-taxable distributions prior to qualifying for benefits. I would favor a definite time restriction on the repayment and renewal of participant loans. While this probably could be done by regulation, I would favor its correction by amendment.

5. Joint and Survivor Annuities

I believe it was clearly the intent of ERISA to afford spouses some protection by means of the joint and survivor annuity requirements. However, pension benefits are being diluted by the cost of this protection being passed along to the participant rather than the plan sponsor. Accordingly, I would favor Section 205 specifying that the cost of joint and survivor annuity protection, if any, not be charged to the retirement benefits of the participant, but rather be funded as a retirement cost to the plan sponsor.

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There are of course many other areas in which I would like to see ERISA amended. I am submitting these suggestions in their rather limited form, solely for the purpose of trying to submit some constructive thoughts. I am sure others will submit suggestions which I would also favor. Hopefully, by the time we review the suggestions as a committee, all or most of mine will have been covered.

Very best regards,

Sib Felton/bff

ADDENDUM

1. Remove further the exposure of a co-fiduciary to the acts of an investment manager by including Section 405(a)(1) in Section 405(d)(1) and making Section 405(d)(1) absolute, insofar as any liability of a co-fiduciary.

2. Narrow the definition of fiduciary so that employees, directors or officers of a corporate trustee, when acting in such capacity, are not fiduciaries of a plan, and as such not subject to liability as a co-fiduciary.

3. Specifically limit the liability of a co-trustee to only those situations where the co-trustees are acting in concert.

4. Specifically provide for indemnification of fiduciaries to protect them from liability for acts of co-fiduciary. Act Sec. 410

5. Specifically exempt a custodian from definition of fiduciary. Act. Sec. 3(21)

6. Delete or restrict the term "proper" in Act Sec. 403(a)(1) in cases where the trustee is following the investment direction of a named fiduciary, so as to minimize the trustee's exposure as a co-fiduciary.

ATTACHMENT # 4

AMENDMENT OF ERISA REPORTING AND DISCLOSURE PROVISIONS

RECOMMENDATIONS BY DONALD S. GRUBBS, JR., F.S.A., F.C.A., M.A.A.A.

Introduction

The reporting and disclosure requirements were included in ERISA to protect the interests of participants and their beneficiaries (section 2(b)). They should be reviewed with that objective in mind.

It is in the interest of participants and beneficiaries to minimize the administrative costs of plans. When the amount of contributions are defined and expenses are paid from the trust, any increase in expense must reduce the amount of benefits that can be provided. In a defined benefit plan the effect of increased administrative expense is less direct, but no less real. Increased expenses deter employers from initiating or liberalizing benefits, and in all too many cases have led to plan terminations.

Therefore, with respect to any item of information to be provided to participants or the government, we must ask, "Does this information sufficiently add to the protection of the interests of participants and beneficiaries to justify its cost?" The answers are not always clear cut.

Providing some kinds of information does add to the protection of participants. What is most essential is that the participant have the information needed to make any decisions that may affect his benefits. When is he eligible for the various benefits? What are their amounts? How does he apply for a benefit? How can he appeal?

But other information may not help participants at all. It is doubtful that a knowledge of trust investments will assist participants in most situations.

A second reason for reporting and disclosure is to bring abuses to light and provide a basis for their correction.

ERISA provided enormous detail on the exact information to be provided to participants and to DOL. Considering the almost infinite variety of employee benefit plans, it is impossible for legislation to provide the details for appropriate disclosure to accomplish the objectives mentioned above. In

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attempting to specify the details, ERISA prevented DOL from making appropriate determinations on how best to accomplish the intent of Congress. Congress itself was, of course, not familiar with the many details it was trying to legislate.

In general, we need to change a detailed straightjacket into a flexible vehicle the Department of Labor can use to protect the interests of participants.

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1. Divided Jurisdiction

A very basic problem in the reporting and disclosure requirements is the division of the government's administrative responsibility between three governmental agencies - DOL, IRS and PBGC. Even with the best possible coordination, it is wasteful to both the government and to plan administrators to require separate filings with three different agencies, and to have two of these independently directing what needs to be disclosed to participants.

ERISA should be amended to establish a single administrative agency responsible for all aspects of governmental regulation of employee benefit plans, as has been recommended by Congressmen Dent and Erlenborn. To assure a smooth transition, PBGC could be transferred into the new body intact. Those portions of DOL and IRS dealing with pensions could also be transferred intact, with a guarantee to all of the employees involved that they could elect to be transferred back to DOL or IRS within 18 months (or such other period as determined necessary for the transition).

IRS could rely on determinations of the new commission concerning whether pension plans are qualified plans, just as they rely on the SEC to determine what is an investment company. They could also rely on the new commission to determine the maximum limits on deductible contributions for pension plans. The only pension plan responsibility for IRS would be to audit whether the amount claimed was actually paid (like any other claimed expense) and whether it exceeded maximum deductible limits (similar to auditing the ordinary and necessary requirement for other expenses).

With a single regulatory agency, many of the reporting and disclosure problems would disappear.

2. SEC Jurisdiction

If the reporting and disclosure problems are currently complex because

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of overlapping jurisdiction they threaten to become much worse. In Daniel v. International Brotherhood of Teamsters, et. al., 410 F. Supp. 541 (1976), the U. S. District Court ruled that pension plans are securities and that federal securities laws are applicable to them where fraud is concerned. If the Court of Appeals fails to overrule this decision, this could open a pandora's box of new requirements in both disclosure to employees and reporting to government. Legislation should clarify that pension and welfare plans are exempt from securities legislation.

3. Broader Discretion for the Secretary of Labor

Part I of Title I Subtitle B, "Reporting and Disclosure", was intended to provide adequate reporting and disclosure to protect employee rights under employee benefit plans. But Congress recognized the wide variety of types of plans and the difficulty of designing a single reporting and disclosure system that was suitable for all plans. Congress was also aware that reporting and disclosure requirements could be burdensome, leading to cancellation of plans and discouraging the establishment of new plans.

One recognition of this is Section 110, which allows the Secretary to "prescribe an alternative method for satisfying any requirement" if he determines the alternative is consistent with the purposes of Title I and provides adequate disclosure and that the requirement would be burdensome. While it is agreed that this allows the Secretary to provide alternatives to a requirement, it should be made clear that the Secretary can also waive such a requirement under circumstances where he finds neither the requirement nor an alternative is required. Amendment of Section 110 could clarify this.

4. Availability upon Request in Lieu of Automatic Submission

Section 103 requires submission of mammoth amounts of information for all plans. Some of this information is used for every plan as input for the computer, to provide essential records and statistics and to signal particular

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plans with potential problems which need investigation. There may be additional information which DOL uses for a significant percentage of plans.

But much of the information is never needed and never looked at by any one, except for a minute proportion of plans. Collecting and preparing and submitting such information for every plan when it is needed in only a fraction of 1% of the cases is an unnecessary expense for plan sponsors and increases the problems of storage of unneeded data by DOL. Such information should be provided only on DOL request.

Two kinds of solutions are possible. One is to add a provision to Section 103 giving the Secretary the right to waive the requirement that the annual report include any item in section 103 for any or all plans, with the right to require plan administrators to submit such information upon request.

A second solution is to review each detail of information required in section 103, for each type of plan, and designate whether such item is one that should be included in all annual reports or one that should be provided only on individual request by DOL. Consideration could be given to the cost and difficulty of preparing each item, its bulk, and the frequency with which it is needed by DOL. In most situations this is better left to administrative determination by DOL.

But a combination approach would seem best, designating certain items as not required in the annual report when it appears clear that this is the reasonable approach, and leaving other items to the discretion of DOL.

Items which should not be included in the annual report, but which should be provided only on request by DOL, are the following:

(1) For plans where all assets are held by banks and/or insurance companies, and under which there is no prohibited transaction, the accountant's opinion and notes to the financial statement - (b)(1) & (2)

(2) Schedule of all assets - (b)(3)(C)

(3) Statement of common or collective trust - (b)(3)(G)

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(4) 3% transactions - (b)(3)(H)

(5) Liabilities by termination priority categories - (d)(6)

(6) Basis of the insurer's premium rate or subscription charge -(e)(2)

(7) Financial report of the insurance company - (e)(2)

The need for these individual items will be discussed separately below.

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5. Accountant's Opinion

Because the accountant's opinion is not essential to the administration of ERISA, and because it is expensive to obtain, DOL waived the requirement for plans with less than 100 participants. Prior to ERISA most plans in which all assets are held by banks and insurance companies did not obtain an audit by an independent accountant. Banks and insurance companies are both subject to substantial regulation and audits. In such plans an independent audit usually adds nothing to the knowledge needed by either government regulators or by the employee. And as a practical matter DOL will not ordinarily read it. The employee, if he reads it, will not understand it and will not gain any increased knowledge of whether his expected benefit will actually be paid. While DOL should be able to require an accountant's opinion when it seems needed, it should not ordinarily be required where all assets are held by banks or insurance companies. Regulations have fortunately reduced the extent of the accountant's report in this situation, but have not eliminated it.

6. Schedule of All Assets - 103(b)(3)(C)

The detailed schedule of all assets with specified information for each asset is a mountain of paper which ordinarily has no value for either DOL or participants, both of which receive a summary of assets. DOL's storage problem alone would warrant eliminating this requirement, except for particular plans where DOL requests the information.

7. Annual Statement of Common or Collective Trust - 103(b)(3)(G)

DOL has wisely determined that, when a bank or insurance company files the annual statement for a collective trust or separate account, the individual plan need not attach it to the plan's report. But why is it needed at all? I am doubtful that DOL makes any use of it in most cases. Why not provide it only upon DOL request?

8. Schedule of 3% Transactions - 103(b)(3)(H)

For the medium sized plan almost every investment will usually be a 3% transaction. There is no apparent reason to obtain a listing of such transactions in the annual report, for either large or small plans. It is something DOL may want to review on its audit or examination of a particular plan. This schedule

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should be provided only on specific DOL request.

9. Liabilities Allocated by Termination Priority Categories - 103(d)(6)

Section 103(d)(6) states that the annual actuarial report shall include the plans' liabilities for nonforfeitable pension benefits allocated by the termination priority categories in section 4044. This would require a second actuarial valuation, usually using different actuarial assumptions than the basic actuarial valuation. The second valuation would be required to be done under the actuarial assumptions specified by PBGC for plan termination, in every case different than those appropriate for an ongoing plan.

Such a requirement would result in a very substantial increase in actuarial work and actuarial fees. That substantial cost increase would adversely affect employers and participants. Under collectively bargained plans under which the amount of contributions are fixed in the collective bargaining agreement, increased expense can only result in lower benefits being paid. For other defined benefit plans, this would undoubtedly lead to more plan terminations among smaller employers.

In addition to the drawback of additional expense, the information is not needed by DOL, IRS or plan participants for an ongoing plan. The information is needed and is required to be calculated for some plans that actually terminate. In addition PBGC requires it in many cases where there is a reportable event and termination appears probable. No one questions the right of DOL to require it for a particular plan when its investigation indicates the information would be helpful, but requiring annual calculations for all plans would be a massive waste.

Section 104(a)(2)(A) gives the Secretary of Labor specific authority to "waive or modify the requirements of section 103(d)(6) in such cases or categories of cases as to which he finds that (i) the interests of the plan participants are not harmed thereby and (ii) the expense of compliance with the specific requirements of section 103(d)(6) is not justified by the needs of the participants",

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PBGC, or DOL. Regulation 2520.104-42(a) waived this requirement, but Regulation 2520.104-42(b) limited the waiver to plan years beginning in 1975, and DOL is now considering whether to extend this waiver.

While the waiver under Regulation 2520.104-42(a) should be extended permanently, it would be better to eliminate the requirement from the Act.

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10. Basis of Insurance Company Premium Rates - 103(e)(2)

For certain insured plans it is necessary to attach a statement of the basis of premium rates. Such a description might be as follows:

Active Mortality: 1958 Commissioners Standard Ordinary

Interest: 3½ per annum

Expense: Graded by age from 33% of gross premiums at age 20 to 22% of gross premiums at age 65.

Would such a statement be read? Would it be understood? Would it provide the basis for any regulatory action, since premiums are not subject to federal legislation? Would it aid participants?

This requirement should be eliminated from annual reports.

11. Financial Report of Insurance Company - 103(e)(2)

Section 103(e)(2) might be understood to require the annual reports of some insured plans to include the financial report of the insurance company itself (not just a report for the plan provided to DOL). Recognizing no need for such reports, DOL has not actually required their submission. The Act should be clarified to eliminate this possibility.

12. Statement to Terminated Employees - 209(a)(1)

Section 209(a)(1) requires that every participant who terminates his service with the employer, or who has a one-year break in service, receive a statement of his accrued benefits under the plan and the percentage of such benefits which are non-forfeitable, regardless of whether he requests such a report. This is required for all terminated employees, even those not vested. Thus, a plan that makes all employees participants from their date of hire, as many plans do, would have to provide such a statement even for an employee who works one month and quits. This has never been done under any pension plan and would be extremely burdensome. So far there has been no implementation of this section of the Act because no regulations have been issued.

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If it were implemented, the additional administrative costs would be enormous. One of the results would be for employers to deliberalize participation requirements to avoid this unreasonable requirement. Certainly this is not in the best interests of participants.

Section 209 should be amended to require such statements only for (a) terminated employees who are vested and for (b) any other terminated participant who requests such a statement.

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ELIMINATION OF SUMMARY ANNUAL REPORTS

RECOMMENDATIONS BY DONALD S. GRUBBS, JR., F.S.A., F.C.A., M.A.A.A.

Except in unusual circumstances, the summary annual report does not provide any information which is of assistance to participants. The experience to date is that employees regard this as "junk" to be thrown away. Yet it has a cost which either directly or indirectly reduces the amount available to provide benefits.

The complete annual report is available to all participants upon request. Therefore there is no need to provide a summary annual report, and the requirement for it should be deleted from ERISA.

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The following is a summary of the report presented to the Annual Meeting of the Association of Private Pension & Welfare Plans by the Acting Chairman of the Tax Policy Subcommittee of the ERISA Reform Committee

Much of what you might consider tax policy reform under ERISA is the concern of other subcommittees whose reports preceded this one. Consequently, this report does not deal with suggested changes to the prohibited transactions sections which were covered by the fiduciary subcommittee nor with changes in the minimum standard which were the subject of the minimum standard subcommittee. In addition, the major item of tax policy ERISA reform, the deduction for income tax purposes of employee contributions to qualified plans will be the subject of a major address at a later point in the meeting. I would like to discuss three items of reform toward which the subcommittee is presently very favorably disposed. These are:

[1] Elimination of the "disqualification penalty" on qualified plans which violate the ERISA maximums on contributions and benefits.

[2] The creation of a funding vehicle for excess benefit plans which will not penalize the American taxpayer but will permit employers to provide top management with security for their promised excess pensions.

[3] The prohibition of reducing benefits payable from employee welfare plans by increases in Social Security benefits which occur after the welfare plan benefits become payable.

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Following is the reasoning behind the committee's present posture on these topics.

Presently Section 401(a)(16) of the Internal Revenue Code strongly implies that a qualified plan which pays benefits in excess of the ERISA maximum may be disqualified for doing so. The consequences of disqualification fall most heavily upon the employee participants of the plan; however, in the normal circumstances the employee participants will not have in any way been responsible for the breach of this Code provision. The penalty, ther. should fall upon the plan fiduciary whose duty it was to conform the plan benefits to the requirements of the law. In remedying this injustice, Congress should take into account that the present ERISA maximum rules particularly the rules regarding "grandfathered" maximum benefits under ERISA Section 2004(d) are extremely complicated and difficult to understand.

The creation of a funding vehicle for excess benefit plans is vitally important because of the "one/two punch" rendered top executive pensions by the ERISA maximum rules and Section 83 of the Internal Revenue Code. Because these two sections exist, it is not possible to provide top management with a pension in excess of the ERISA maximums which is backed by anything more than a naked promise. Pensions are an important part of compensation for top management just as they are for all other employees. Eliminating the security behind top management pensions over a certain amount in effect makes these pensions subject to change even when the employer is financially solvent. No one can guarantee financial solvency over the twenty or thirty years

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an individual's career may span. In addition, pressures from various sources can be brought to bear to change the pension promised to an individual rendering it less valuable. The pressure may come from stockholders, other members of management, government agencies or the government itself which may decide to regulate future payments or to regulate the industry in which the executive participates. The solution in our mind is to find a way to fund excess benefit plans which does not require the taxpayers of America to make up a revenue loss and which does not tax the executive presently for the value of a pension payable in the future. A possible solution is funding these excess benefits with a taxable trust which will pay income tax on the earnings each year. A more extreme solution but not quite as satisfactory might be to limit the deductibility of employer contributions to such a trust. The point is that the Congress in protecting the interest of the average taxpayor has created a serious motivational problem for top management in the private sector. The last proposal we wish to comment on concerns the use of increases in the Social Security benefits to reduce benefits payable to employees under employee welfare plans. Presently, as you know, ERISA prohibits the reduction of pensions payable to retirees by increases in Social Security benefits which occur after retirement. For some reason, welfare plans were not similarly regulated. For example, presently it is legal for a disability income plan to reduce disability payments by increases in Social Security benefits which occur after the date disability benefits

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begin under the plan. That is after the date of disability. We feel that the same policy ~~considerations~~ which motivated Congress to limit the use of Social Security benefits with respect to the reduction of pensions apply to the use of such benefits to reduce benefits under disability plans and other welfare plans.

Christopher W. O'Flinn
Acting Chairman
Tax Policy Subcommittee

ARTHUR YOUNG & COMPANY

277 PARK AVENUE
NEW YORK, N.Y. 10017

STATEMENTS

OF

ARTHUR YOUNG & COMPANY

TO

SUBCOMMITTEE ON LABOR OF SENATE COMMITTEE
ON HUMAN RESOURCES

AND

SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE
FRINGE BENEFITS OF SENATE COMMITTEE ON FINANCE

ON

SENATE BILL S. 2992
SENATE BILL S. 3017

AUGUST 31, 1978

33-549 1634

Arthur Young & Company is pleased to have an opportunity to comment on Senate bills S.2992 and S.3017. Our comments can be summarized in two statements:

- If adopted, Senate bill S.2992 would effectively terminate a major effort by the private sector to improve standards of financial accounting for pension plans just before that effort bears fruit. As a result, desirable changes in such standards would be delayed, and the quality of the end product might also be impaired.

- Sections 226 and 228 of Senate bill S.3017 are not required to accomplish the purposes for which they are intended -- existing law and regulations are adequate for those purposes -- and enactment of those sections would interfere seriously with the freedom of a plan administrator to take certain actions that he may believe are necessary for him to carry out his fiduciary responsibilities.

We deal with each of these matters in turn in the following paragraphs:

Improving Standards of Accounting for Pension Plans

We support without qualification the setting of financial accounting standards in the private sector. Ever since its creation in 1933, the Securities and Exchange Commission has had the authority to establish accounting standards but has preferred instead to rely largely on the private sector to carry the primary responsibility for this task.[1] The response of the private sector has been to establish a body of financial accounting standards that is widely acknowledged to be the most highly developed and sophisticated in the world. We strongly oppose any proposal that would transfer the responsibility for setting financial accounting standards, either in general or for a particular type of entity, to a government agency. The resources already exist in the private sector for that purpose; they do not exist in government at the present time and, in our opinion, cannot be duplicated there.

Shortly after the Employee Retirement Security Act of 1974 (ERISA) was enacted, the Financial Accounting Standards Board (FASB), the professional body largely relied on by both the SEC and the accounting profession as the authoritative body to establish accounting standards, placed on its technical agenda a project on accounting and reporting for defined benefit pension plans. The FASB's due process procedures, which are similar to but more extensive than those required by the Administrative Procedures Act, include appointing a task force of experts, preparing and publicizing a neutral and comprehensive Discussion

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[1]The SEC's position on this matter is set forth in Accounting Series Release No. 4 and No. 150 (Exhibits A and B attached). The SEC has recently reaffirmed its support for setting financial accounting standards in the private sector in its "Report to Congress on the Accounting Profession and the Commission's Oversight Role."

Memorandum analyzing the issues related to a project, soliciting written comments on the issues, holding a public hearing on the subject, preparing and publicizing an Exposure Draft of a proposed standard, and soliciting of written comments on the Exposure Draft. Because of the importance of the defined benefit pension plan project, the FASB has gone beyond the minimum requirements of its due process procedures to maintain continuous liaison with the Department of Labor and to work with the actuarial profession on matters of common interest. These procedures have now been nearly completed, and the FASB has stated that it expects to issue a final standard to be applicable to plan financial statements for 1979.

The FASB's due process procedures obviously require much time and, because of them, the Board may have given the impression that it did not comprehend the need to act on this project in a timely manner. We submit that a better interpretation would be that the FASB is very much aware of the urgency of the project, but is determined to follow the procedures, and take the time, necessary to insure that its final standard is well thought-out, responsible, and in the public interest.

In view of the time and effort that the FASB has devoted to this project and its nearness to fruition, the issuance of standards of accounting for defined benefit pension plans cannot be accelerated by transferring responsibility for issuing the standards to the Secretary of the Treasury. Certainly, the Administrative Procedures Act would require the Secretary to follow some of the procedures already carried out by the FASB. It may be that the Secretary could be empowered to rely on the work already done by the FASB, but the most that would accomplish would be to minimize delay. It would certainly not accelerate the process and would sacrifice the benefit of the experience the FASB and its staff have gained from having followed its procedures. Finally, it would be rejecting the system of setting accounting standards in the private sector which, with the oversight of the Securities and Exchange Commission, has worked successfully for over forty years.

If, contrary to our belief, it is determined that legislation is needed to give authority to set financial accounting standards to the Secretary of the Treasury, we recommend a permissive rather than mandatory statute, following the example of Section 19 of the Securities Act of 1933 (Exhibit C attached). Suggested wording for such a statute has been included in a marked-up version of Senate bill S. 2992 that is attached as Exhibit D.

Restricting the Scope of Audits of Pension Plans

The stated purposes of Section 226 and 228 of Senate bill S. 3017 are "to cut down on unnecessary fees paid by clients to accountants and actuaries who may be, in some instances, doing duplicative work" and to cut down "on apparently unnecessary auditing by accountants of the assets and liabilities of common or collective trusts, separate accounts or separate trusts of financial institutions such as banks or insurance companies which are regulated and subject to periodic examination by State or Federal agencies."[2]

The existing provisions of ERISA and related regulations seem to be already sufficient for those purposes. Section 103 of ERISA and the Annual Reporting Requirements (Final Regulations) of the Department of Labor already allow a plan administrator to limit the scope of an audit of a plan's financial statements so as to avoid what, in the administrator's judgment, is unnecessary duplication. It is quite common, for example, for a plan administrator to invoke Regulation No. 2520.103-8, "Limitations on Scope of Accountant's Examination" in order to limit the audit of investment assets trusteed at a bank.

Enactment of Sections 226 and 228 of Senate bill S. 3017 would go beyond the existing law and regulations by requiring a plan administrator to limit the scope of an audit, even if the administrator wished to obtain an audit with an unlimited scope. Such a requirement, in our opinion, would restrict the freedom of a plan administrator to take whatever action he judges necessary in his capacity as fiduciary to safeguard the plan's assets and to insure the integrity of the plan's financial statements. We submit that the public interest would be ill-served by such a restriction.

In addition, the experience of capital markets in this country and others has demonstrated the value to the users of

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[2] Remarks of Senator Williams, Congressional Record, May 1, 1978, p. 5

financial statements of unlimited scope audits conducted by one class of professionals. Independent public accountants have particular expertise for the independent verification and informative presentation of financial statements, and their training and experience have qualified them to judge what procedures are required to achieve prescribed audit objectives.

The auditing standards of the profession permit an auditor to avoid duplicating the work of an expert in another field, such as an actuary, if the auditor makes the inquiries and performs the review procedures necessary to enable the auditor, among other things, to establish that the actuary or other expert is basing his judgment on information that is consistent with the facts known to the auditor as a result of his own work. This is not a duplication of effort -- actuaries and other experts generally are not trained to, or expected to, independently verify or take responsibility for the accuracy of the data (e.g., payroll information) on which they base their decisions. Rather than a duplication of effort, the inquiries and review by the professional auditor enable him to assume overall responsibility for the financial statements of the entity being audited.

Similar problems may arise under Section 228 of Senate bill S. 3017 concerning statements furnished by banks or insurance companies.

With the enactment of Sections 226 and possibly 228 of Senate bill S. 3017, an auditor would be precluded by law from carrying out those auditing procedures which, in his professional judgment, are necessary for him to accept overall responsibility for the fair presentation of a plan's financial statements. When this occurs, those who rely on the financial statements can no longer look to one professional for the fairness of presentation of the statements, but rather are left in a quandry. Sections 226 and possibly 228 of S. 3017 would outlaw an otherwise salutory situation by requiring an auditor to accept limited responsibility for only a portion of the information set forth in the statements, and perhaps a relatively minor portion at that. It is one thing for a plan administrator to decide that this outcome is satisfactory. It is, however, another matter altogether to require that outcome as a matter of law. We submit that the public interest is not served by such an inflexible requirement.

Exhibit A

[¶ 3005] RELEASE NO. 4

April 25, 1938, 11 F.R. 10913.

Administrative Policy on Financial Statements.

The Securities and Exchange Commission today issued the following statement of its administrative policy with respect to financial statements:

"In cases where financial statements filed with this Commission pursuant to its rules and regulations under the Securities Act of 1933 or the Securities Exchange Act of 1934 are prepared in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be presumed to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material. In cases where there is a difference of opinion between the Commission and the registrant as to the proper principles of accounting to be followed, disclosure will be accepted in lieu of correction of the financial statements themselves only if the points involved are such that there is substantial authoritative support for the practices followed by the registrant and the position of the Commission has not previously been expressed in rules, regulations, or other official releases of the Commission, including the published opinions of its chief accountant."

Exhibit B

[¶3152] RELEASE NO. 150

December 20, 1973, 38 *F.R.* 1260.

Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards.

Various Acts of Congress administered by the Securities and Exchange Commission clearly state the authority of the Commission to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements to be filed under the Acts and the responsibility to assure that investors are furnished with information necessary for informed investment decisions. In meeting this statutory responsibility effectively, in recognition of the expertise, energy and resources of the accounting profession, and without abdicating its responsibilities, the Commission has historically looked to the standard-setting bodies designated by the profession to provide leadership in establishing and improving accounting principles. The determinations by these bodies have been regarded by the Commission, with minor exceptions, as being responsive to the needs of investors.

The body presently designated by the Council of the American Institute of Certified Public Accountants (AICPA) to establish accounting principles is the Financial Accounting Standards Board (FASB). This designation by the AICPA followed the issuance of a report in March 1972 recommending the formation of the FASB, after a study of the matter by a broadly based study group. The recommendations contained in that report were widely endorsed by industry, financial analysts, accounting educators, and practicing accountants. The Commission endorsed the establishment of the FASB in the belief that the Board would provide an institutional framework which will permit prompt and responsible actions flowing from research and consideration of varying viewpoints. The collective experience and expertise of the members of the FASB and the individuals and professional organizations supporting it are substantial Equally important, the commitment of resources to the FASB is impressive evidence of the willingness and intention of the private sector to support the FASB in accomplishing its task. In view of these considerations, the Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB with the expectation that the body's conclusions will promote the interests of investors.

In Accounting Series Release No. 4 (1938) the Commission stated its policy that financial statements prepared in accordance with accounting practices for which there was no substantial authoritative support were presumed to be misleading and that footnote or other disclosure would not avoid this presumption. It also stated that, where there was a difference of opinion between the Commission and a registrant as to the proper accounting to be followed in a particular case, disclosure would be accepted in lieu of correction of the financial statements themselves only if substantial authoritative support existed for the accounting practices followed by the registrant and the position of the Commission had not been expressed in rules, regulations or other official releases. For purposes of this policy, principles, standards and practices promulgated by the FASB in its Statements and Interpretations[1] will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered[2] to have no such support.

In the exercise of its statutory authority with respect to the form and content of filings under the Acts, the Commission has the responsibility to assure that investors are provided with adequate information. A significant portion of the necessary information is provided by a set of basic financial statements (including the notes thereto) which conform to generally accepted accounting principles. Information in addition to that included in financial statements conforming to generally accepted accounting principles is also necessary. Such additional disclosures are required to be made in various fashions, such as in financial statements and schedules reported on by independent public accountants or as textual statements required by items in the applicable forms and reports filed with the Commission. The Commission will continue to identify areas where investor information needs exist and will determine the appropriate methods of disclosure to meet these needs.

It must be recognized that in its administration of the Federal Securities Acts and in its review of filings under such Acts, the Commission staff will continue as it has in the past to take such action on a day-to-day basis as may be appropriate to resolve specific problems of accounting and reporting under the particular factual circumstances involved in filings and reports of individual registrants.

The Commission believes that the foregoing statement of policy provides a sound basis for the Commission and the FASB to make significant contributions to meeting the needs of the registrants and investors.

By the Commission.

— Footnotes —

[1] Accounting Research Bulletins of the Committee on Accounting Procedure of the American Institute of Certified Public Accountants and effective opinions of the Accounting Principles Board of the Institute should be considered as continuing in force with the same degree of authority except to the extent altered, amended, supplemented, revoked or superseded by one or more Statements of Financial Accounting Standards issued by the FASB.

Exhibit C

Securities Act
Section 19

[¶ 761] **SPECIAL POWERS OF COMMISSION**

Sec. 19. (a) The Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this title, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical and trade terms used in this title. Among other things, the Commission shall have authority, for the purposes of this title, to prescribe the form or forms in which required information shall be set forth, the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. The rules and regulations of the Commission shall be effective upon publication in the manner which the Commission shall prescribe. No provision of this title imposing any liability shall apply to any act done or omtted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission be amended or rescinded or be determined by judicial or other authority to be invalid for any reason. [As amended by Act of June 6, 1934, 48 Stat. 908; amended by Act of February 5, 1976, Pub. Law 94-210.] . . .

Suggested revised wording

Exhibit D

95TH CONGRESS
2D SESSION

S. 2992

IN THE SENATE OF THE UNITED STATES

APRIL 26 (legislative day, APRIL 24), 1978

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

A BILL

To amend the Internal Revenue Code of 1954 to provide uniform accounting of pension liabilities of tax-exempt pension funds.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 412 of the Internal Revenue Code of 1954 is amended by adding the following new subsection (j):

"(j) UNIFORM ACCOUNTING.—~~Within 90 days of the date of enactment of this subsection,~~ T~~t~~he Secretary shall have the authority to promulgate uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions used in such calculations.".

II

The Committee for
ERISA WORKING ACTION

1978 AUG .. 4: 03

August 23, 1978

The Honorable Harrison A. Williams
Chairman, Subcommittee on Labor
Committee on Human Resources
The United States Senate
Washington, D.C. 20510

REGARDING ERISA IMPROVEMENT ACT OF 1978

Gentlemen:

At the subcommittee meeting on ERISA Improvemnet Act of 1978, (Aug 15 - Aug. 17) we were unable to give the oral presentation.

In lieu of that we have been advised by Mr. Sacher (Steve Sacher—Spedial Counsel to the Human Resource Committee) that we could submit our following proposals for inclusion into the Congressional Record.

We at ERISA WORKING ACTION believe in the following:

SINCE NO PERSON IS GUARANTEED A JOB, NO PERSON IS GUARANTEED A PENSION

Pensions are given to employees as a fringe benefit completely voluntarily; it is the employers expense of doing business, it is established by the employer, is used as an incentive and by the current law can be dissolved at any given moment.

When pensions are established, they are motivated by the employer to be beneficial to the employee. The employee's interest was and is the soul persuit of it. But as the time went on however, it resolved to benefit more and more the employer rather than the employee.

The results are now such that only one out of three of the emplyees receive a pension.

Due to scores of obstacles set up on the way to vesting, it benefits fewer rather than all employees.

We believe that ERISA PASSAGE tightened some of the existing loopholes and brought order to loosely managed pension funds.

It did not however do the job completely. It even created negative results.

P.O. Box 36035 Grosse Pointe, Mich 48236

The Committee for
ERISA WORKING ACTION

We believe that a employee should conserve some of their funds for their old age. We also believe that they must be helped by government and employers, to do so. For human nature is such that the majority of us do not prepare for old age.

"WE SIMPLY DO NOT BELIEVE THAT WE ARE GOING TO OLD SOMEDAY."

We believe therefore, that all employees with every working year should accumulate money for a secure old age.

We propose the following:

I. Discontinue job dependency on pensions.

<u>Vest all emplyees at year one</u>.

Let an employee accumulate their pensions as they move through life from employer to employer.

Have a yearly ceiling no matter what earning. After all, an average emplyee's yearly salary is $14,000. So, it could be suggested that a $12,000 yearly pension should be a sufficient amount.

If an employee is used to living on more, then let him make his own luxury nest in addition—nobody is holding him away from it.

This way we would be guaranteeing a pension for all employees, three out of three, not one out of three, as it is now.

II. Or give employees a choice in joining a company pension plan or setting up their own tax exempt pension existing now for the self employed only.

Under the current law the major loop hole exists:

An employee can be working for four employers in his lifetime,

5 years company X
7 years company Z
9 years company W
5 years company Y

have twenty-six years of employment, and have no pension at all.

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The Commitee for
ERISA WORKING ACTION

No way to make it up and be left to live his ~~old~~ age on social security.

This traveling through those compromises can be his choice, but it can also be their choice.

<u>Dumping people as they approach elegibility for pension is not uncommon.</u>

Grey Panthers estimated that on million people have lost their hard earned pension in 1974 before ERISA became law.

Although it was predicted that the Passage of ERISA would result in some turnover in employment, the ultimate results are much higher than expected.

WHY IS THE TURNOVER SO HIGH?

WHY ARE OUTPLACEMENT OFFICES BOOMING?

Those are some of the questions the law makers should as themselves before they will pass new revisions to the ERISA law.

The mere fact that the hearings reopened supports our belief that the way the law stands now is unacceptable.

IT IS UNFAIR
IT IS NOT IN EMPLOYEES INTEREST
IT IS NOT ENOUGH
IT IS TOO COM PLICATED (TOO MANY VARIATIONS)

By giving the employee a choice we will cut down on the unnecessary turnover in employment, and make jobs more secure, since not all employees would belong to the employers pension plan. It would also cut down the employers practice of judging employees performance as pension eligibility approaches, and stop the employer from making those unpopular periodical vesting decisions that saves the employer's money and add to employee turnover.

III. PENSION FINANCES

In either cases, year one vesting or joining employees pension plan, the pension dollars accumulated from employees and employers voluntary contribution should be required a separation from the employer financing. The pension fund dollars once put aside for employees are no longer employers money.

The Commitee for
ERISA WORKING ACTION

Many employers operating statement would now look grim if they would be required to do so.

IV. Pension plan should be required to use simple, unsophisticated, understood by all, language.

Employees want to know right up front where they stand now, and in the future.

The now existing "maybe you get a pension," mus t be clearly understood by employees and an alternative should exist in making a choice decision.

If an employee plans to choose employers pension plan and is taking the risk, he can only blame himself if the employer chooses not to give him a pension. Or, allow the employee to establish his own, thereby reducing the employers liability while securing the emplyees job.

Hoping that our evaluation will shed light on some of the existing problems from the viewpoint of the employees,

Rest-assuredly,

E Bielski

Ewa T. M. Budek - Bielski
Chairman of the committee for ERISA WORKING ACTION

EB/ek

P.O. Box 36035 Grosse Pointe, Mich 48236

ADVANCING VOLUNTARY LEADERSHIP IN A CHANGING WORLD

Chamber of Commerce of the United States
HILTON DAVIS, VICE PRESIDENT
LEGISLATIVE ACTION

1615 H STREET, N.W
WASHINGTON, D.C. 20062
202-659-6140

1978 SEP -1 AM 12:33

August 31, 1978

The Honorable Harrison A. Williams, Jr., Chairman
Subcommittee on Labor
Senate Committee on Human Resources
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

Attached is a statement expressing the views and recommendations of the Chamber of Commerce of the United States on ERISA Amendments.

We will appreciate your consideration of these views and request that the statement be made a part of the record.

Cordially,

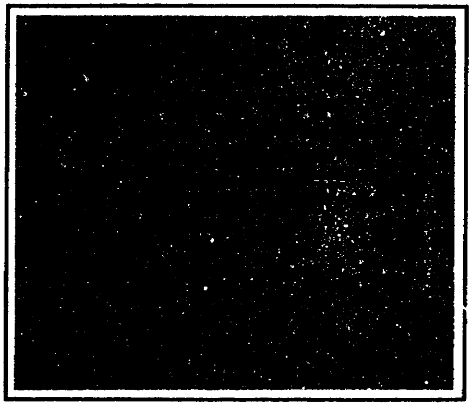
Hilton Davis
Hilton Davis
Vice President
Legislative Action

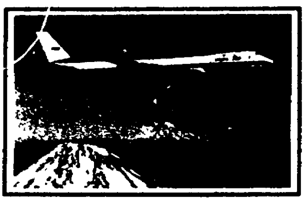
Attachment

cc: Subcommittee Members
Steven Sacher
Peter Turza

1978 SEP -5 AM 10:21
COMMITTEE ON
HUMAN RESOURCES

Statement of the
CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA





STATEMENT
on
ERISA AMENDMENTS
for submission to the
SUBCOMMITTEE ON PRIVATE PENSIONS AND EMPLOYEE FRINGE BENEFITS
of the
SENATE COMMITTEE ON FINANCE
and the
SUBCOMMITTEE ON LABOR
of the
SENATE COMMITTEE ON HUMAN RESOURCES
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Michael J. Romig*
September 1, 1978

This statement is submitted on behalf of the more than 76,000 business and organization members of the National Chamber. With our nation's retirement income systems financed largely by employer contributions to social security, private pensions, profit sharing and welfare plans, the business community has a vital stake in the pending legislation.

RETIREMENT: A NATIONAL CONCERN

The United States appears to be in the early stages of a social and economic change of enormous importance. Demographic, employment and retirement patterns suggest numerous problems ahead in terms of meeting the needs of the elderly who, by 2030, may constitute over 20 percent of our population.

Concerns about the adequacy of retirement income and national policies designed to encourage sound retirement savings take on a sense of urgency when we consider that the number of older citizens in America is increasing and that, because of advances in longevity and improvements in pension programs, the number of years spent in retirement is growing. These trends will have a dramatic impact on retirement costs.

Already, 24 percent of the FY 78 budget of the federal government is allocated to the elderly. Old Age Insurance, Survivors and Disability Insurance, Medicare, Supplemental Security Income and Black Lung benefits will pay out more than $94 billion to persons over 65. Another $14 billion will be paid to this group under Civil Service, railroad and military retirement programs. Still

* Director of Economic Security, Education and Manpower Section of the National Chamber.

another $4 billion will go to the elderly under other programs providing housing subsidies, food stamps, and social and unemplcyment services.

These expenditures, large as they are, pale in comparison to HEW's estimates of $635 billion per year in 2025 -- more than 40 percent of total outlays. Whether these costs can be afforded is a serious question and one that must be answered soon if people are to make adequate preparations for their retirement security.

For these reasons we are extremely pleased to note the establishment of the President's Commission on Pension Policy (Executive Order 12071, July 12, 1978). This Commission is to undertake a comprehensive review of retirement programs and develop national policies to ensure that the programs are effective and equitable and take into account available resources and relevant demographic changes.

We hope this Commission will render valuable assistance to the Congress and the private sector as we move to meet the challenges ahead. And, we hope that these subcommittees will take the necessary steps to see that the Commission is afforded sufficient opportunity to carry out its important tasks.

SOCIAL SECURITY: A NATIONAL CONCERN

The cost of social security is also a matter of national concern. Granted, today's workers are letting the Congress know how much they dislike the tax increase approved last year; but today's workers should have as much concern about the costs of social security when it is their turn to retire.

Despite the massive payroll tax increase -- over $220 billion in the next 10 years -- the social security system remains in trouble. Payroll taxes will soon cover nearly all wages paid in America. Presently, they are imposed at a 12 percent rate (6% by employers and 6% by workers) but that figure must be doubled early in the 21st century to keep the promises being made today. If today's workers are rebelling at the prospect of 12 to 14 percent payroll taxes, what certainty is there that tomorrow's workers will be willing to pay a rate double today's?

Seeking new revenue sources appears to be a lost cause. The federal government has considerable trouble staying within its own revenue limitations. Indeed, its deficit spending practices have escalated the cost of retirement programs. Thus, we are left with re-examining the system itself to determine how we might control its costs.

While an exploration of this matter might be worthwhile, our purpose here is not that but rather to note that, to the extent private pensions and individual retirement savings are encouraged, the severity of the problems discussed above will be alleviated.

PRIVATE PENSIONS: A NATIONAL CONCERN

It is in the foregoing context that we premise our comments on the several bills that are up for joint consideration by the subcommittees on Labor and Private Pensions and Employee Fringe Benefits. Our policy goal is to assure that private retirement saving efforts -- by employers, employees and individuals -- play a substantial role in meeting the needs of the nation's elderly. To the extent that government policies, laws and regulations help achieve this goal, our concerns over the adequacy and the affordability of public programs are diminished.

Thus we urge these committees to create a statutory environment that is attractive for retirement savings. We look for streamlined administration with a minimum of paperwork and compliance cost. We also look for tax policies that make retirement savings an attractive investment alternative but with appropriate safeguards to assure tax fairness and protect against undue revenue losses.

Many aspects of the bills pending before the subcommittees reflect those viewpoints. Indeed, Section 201(a) of S. 3017 would add the following to Section 2 of the Employee Retirement Income Security Act (ERISA):

> It is hereby further declared to be the policy of this Act to foster the establishment and maintenance of employee benefit plans sponsored by employers, employees or both.

We believe this proposed declaration to be a very important addition to ERISA.

ERISA is our nation's primary statute governing private pension programs. It will soon mark its fourth anniversary. It seems appropriate that as it does so, we evaluate how well it is meeting the objective of extending the benefits of private pensions to a larger group of Americans. The disappointing statistics on plan terminations and new plan formations over the last four years indicate that Congressional attention is warranted.

Our discussion of ERISA will focus on the following issues:

(1) Multiple Jurisdiction
(2) SEC Jurisdiction
(3) Preemption of State Laws
(4) Paperwork Reduction
(5) New Benefit Requirements
(6) Fiduciary Requirements
(7) New Pension Coverage Proposals

(1) Multiple Jurisdictions

The administrative provisions of ERISA requiring action by both the Treasury and Labor Departments and in some cases, the Pension Benefit Guarantee Corporation (PBGC) have resulted in bureaucratic confusion, unnecessary delays, complex requirements and justifiable criticism.

Response by both the Congress and the Executive Department has been gratifying. The Congress, exercising oversight responsibilities, has called attention to the most glaring problems while the agencies have executed an agreement which culminated in the President's Reorganization Plan Number 4 which was unveiled on August 10. This plan's objective is to divide clearly the respective responsibilities and minimize duplication of efforts.

While we are not certain that the new reorganization plan will resolve all of the problems of ERISA, we welcome it and urge Congressional concurrence in the hope that it will be effective.

S. 3017 and H.R. 4340 would establish a new agency to carry out most of the ERISA administrative functions while S. 901 would amend ERISA to divide by statute the respective functions of the Departments of Labor and Treasury.

While each proposal has merit, we are not certain that changing horses in midstream makes sense. We would prefer that the unfinished job of issuing ERISA regulations, interpretations and exemptions be completed before making dramatic regulatory shifts. Staying with the current arrangement as revised by the President's proposal seems to be the more prudent course at this time.

(2) SEC Jurisdiction

Related to the foregoing discussion is the issue of whether a pension is a security within the coverage of state and federal securities laws. If it is, then what statutory obligations are imposed upon plan administrators and what liabilities might arise for failure to comply with these obligations. Moreover, what effects will this additional regulatory burden have on pension plans?

This issue has arisen in the context of litigation pending before the U.S. Supreme Court in which the National Chamber has filed a brief as a friend of the court. The case, Daniel v. International Brotherhood of Teamsters, presents the unique question of whether the application of the anti-fraud provisions to pension plans of the Secutities Act of 1933 and The Security and Exchange Act of 1934 are precluded by ERISA. The U.S. Court of Appeals for the Seventh Circuit concluded ERISA did not preclude application of the securities acts.

We disagree with the conclusions reached by the Court. We hold that it was never the intent of Congress to have the securities laws of this nation apply to pension plans. This intent is reflected by the long history of never applying these Acts to pensions, as well as enactment of ERISA for the exclusive regulation of pension plans.

Should the Supreme Court affirm the Appeals Court decision, we fear the implications it might have for pension plans. Significant costs and liabilities may be imposed not only on pensions but on employers, unions and others as well. These would be in the context of: (1) claims for benefits for previously terminated participants in excess of those payable under the pension plan provisions, resulting in unanticipated liabilities and possibly in plan terminations; and (2) serious problems and substantial costs associated with meeting the additional disclosure requirements of the securities acts.

Studies by the U.S. Department of Labor estimate that, depending on the scope of the Court's decision, pension liabilities may range from $4 to $40 billion. These potential liabilities do not include legal fees and other costs of litigation which themselves might be very substantial.

For these reasons, we support the provisions of S. 3017 to clarify the Congressional intent that ERISA, and not the Securities Laws of 1933 and 1934, govern the federal reporting and disclosure requirements for pension plans.

(3) Impact of ERISA on State Laws

Another major problem affecting pension plans and the application of ERISA involves the question of whether ERISA has preempted the application of state laws to pensions and welfare plans. The preemptive statutory language of Section 514 of ERISA is increasingly being challenged in courts. It has been argued that, on one hand, it broadly preempts all state laws relating to employee benefit plans and, on the other hand, it preempts only those state laws which are duplicative of ERISA.

The results have been chaotic for pension and welfare plan administrators. Clearly the issue must be addressed and resolved, yet none of the proposals pending before the subcommittees ventures a solution.[1/] It is extremely important for Congress to clarify this situation; we stand ready to assist in the effort.

(4) Paperwork Reduction

Compliance with ERISA's reporting and disclosure requirements has been unduly burdensome and confusing to plan administrators and participants. While all three regulatory agencies (Labor, Treasury and PBGC) have tried to overcome these problems, the statutory requirements of ERISA continue to thwart the effort to reduce paperwork requirements.

No one disputes the need for a basic minimum of reporting and disclosure, but ERISA is clearly a case of overkill. We fully support the intent of ERISA to assure that employees know and understand their rights under the Act, but we question the advisability of ERISA's specific and detailed requirements on how, what, when and where information must be reported. We recommend that the Congress provide more flexibility for the regulatory agencies in determining how to assure meaningful disclosure to pension plan participants. An indepth review to determine what information is really of benefit to regulators and plan participants is essential.

Of the proposals before the Subcommittees, S. 901, S. 1745, S. 2992, S. 3017 and S. 3193 contain provisions to revise the reporting and disclosure requirements of ERISA. Most, if not all, are improvements.

(5) New ERISA Benefit Requirements

Two bills pending before the subcommittees (S. 250 and S. 3017) would increase the benefit obligations of pension and welfare plans in instances where the participant had also qualified for a disability award under the Social Security Disability Insurance program or state workers' compensation programs.

1/ S. 1383 would exempt state health plans from Section 514 of ERISA

ERISA already provides that a benefit to a participant currently receiving benefits under a pension plan may not be reduced whenever his benefits under Social Security or Railroad Retirement are increased as a result of cost of living increases.

Both S. 3017 and S. 250 would extend this prohibition to welfare plans providing disability benefits when the participant receives an increase in his disability benefit under Social Security or Railroad Retirement. S. 3017 would go further by extending this prohibition to workers' compensation awards as well.

We see no reason for these changes in ERISA. Disability awards under Social Security, Railroad Retirement and workers' compensation can already be combined to result in awards that will exceed an individual's prior take home pay. To the extent that they do so, they are a substantial disincentive to rehabilitation and return to work.

In this same vein, we are concerned about the recent IRS Revenue Ruling 78-178 which requires that, starting with plan years beginning in 1979, unemployment compensation benefits may not be used to offset benefits paid by qualified pension plans. Congress has already expressed its conviction (Public Law 94-566) that retirees should not be entitled to unemployment compensation. Now the IRS seems to be undercutting this judgement. Revenue Ruling 78-178 should be overturned by Congress.

S. 3017 would also make significant changes to the joint and survivor annuity requirements of ERISA. Currently, the statute requires that each participant in a pension plan be given the right to elect a survivor annuity for his/her spouse in the event of his/her death <u>after retirement</u>. The cost of this option is paid for by the employee in the form of actuarially reduced benefits.

S. 3017 would make two significant but questionable changes in this requirement:

(a) The survivor annuity would be a mandatory feature for all pension plans and not at the option of the employee:

(b) The survivor annuity benefit would have become available whenever the employee became 50% vested as opposed to the current point of early retirement age.

We question the advisability of these changes. Joint and survivor annuities may be socially desirable for purposes of protecting survivors of a deceased plan participant but, in most instances, the benefit provided would be so minimal that it would hardly justify the significant costs associated with this change.

Moreover, the new provisions will often conflict with existing group life insurance plans that are a common feature of almost all employee benefit packages. Providing both a survivor annuity and life insurance is duplicative and unnecessary. We recommend against its enactment.

S. 3017 also directs the Secretary of Labor to conduct a study of the feasibility of requiring employee benefits to provide cost-of-living (C-O-L) adjustments to benefits. Such a study would portend significant changes for employee benefits particularly with respect to cost. We have already witnessed the intense financial problems that C-O-L provisions have presented for public plans (e.g. social security) and we would not want to see similar results in private benefit plans.

Rather than institutionalizing inflation through wider application of cost of living escalators, we would prefer to have government focus on how to curb inflation in our nation's economy. Attacking the roots of the problem rather than its manifestations simply makes sense.

(6) Fiduciary Requirements

One of ERISA's most worrisome provisions is Section 504 which makes one fiduciary under a plan potentially liable for a breach by another fiduciary, if the first one knows about it but fails to object to the questionable conduct. Often co-fiduciaries include organizations such as the employer company and a trustee bank as well as a number of indviduals in each organization.

While ERISA allows the allocation of responsibility among fiduciaries, it is not so clear that the liability is restricted, or conincides with the area of a fiduciary's particular responsibility. This means that a plan fiduciary, who may have had no responsibility for or part in an objeccionable decision, may nevertheless be held liable as a co-fiduciary.

A fiduciary should be liable only for his own act or involvement in a breach of duty. To a certain extent S. 3017 would ameliorate this problem by limiting an organization's liability to information actually known to an officer or employee who has responsibility regarding the matter involved. We think this is a step in the right direction.

Yet another problem area is that involving parties in interest. ERISA requires that plan transactions involving parties in interest be prohibited unless specifically exempted by government authorities. This provision has proven to be the most troublesome feature of the Act because of the universe of transactions that fall within its reach. As a result, huge backlogs of applications for exemption have built up at great loss or expense to pension plans.

S. 3017 narrows the definition of a party in interest. While this does not resolve the problem in its entirety, it is a step in the right direction and we support its enactment.

ERISA's fiduciary requirement has been thought to have had a chilling impact on pension plan investments in more risky enterprises, especially small businesses. While we have no concrete evidence to substantiate this allegation, it is fair to assume that there are numerous instances where plan investments managers have shied away from small business securities because of the fiduciary requirement.

Some have suggested amending ERISA's prudence requirement to permit such investments up to a specific percentage of plan assets. We would prefer, rather than adding to ERISA's already confusing overlay of specific rules and prohibitions, that Congress reduce the number of these in favor of more reliance upon the age-old concept of fiduciary obligations which are well understood by investment managers and others who take on such obligations.

(7) Extending Pension Coverage

A major objective of several of the bills pending before the subcommittee is to extend the coverage and protection provided by pension plans to more workers and their dependents. It is estimated that currently one-half of our workforce enjoys these benefits. The nation would be well served if coverage could be extended to the other one-half.

S. 3017 provides a number of incentives designed to stimulate the growth and improvement of pension plans. S. 3017 and S. 3140 would enable employers to establish simplified pension agreements by adopting IRS or IRS-approved master plans in which there would be a minimum of paperwork and fiduciary responsibilities on the employers' part. S. 3288 and S. 3017 would permit employees to make tax

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deductible contributions to their pension plans to increase their pension income.

We offer the following comments on these suggestions:

(a) Tax Incentives - To promote the establishment of pension plans by small employers, S. 3017 provides a tax credit to employers over and above the allowable deduction for employer contributions. The credit would be based on a percentage of those contributions and would be phased downward over a period of five years.

In addition, S. 3017 would provide a somewhat less generous tax credit to employers (irrespective of size) who improve their plan in a manner approved by government authorities.

The use of tax credits in this manner raises important tax questions which we are presently reviewing. For example: where is the equity for employers who have long financed excellent pension plans? Why is size a relevant consideration? How successful will these incentives prove to be? Are they administerable by tax authorites? What are the revenue implications?

Admittedly, current incentives are not sufficient to cover the gaps in pension coverages, but we believe the incentives must be studied carefully.

(b) Master and Prototype Plans - In addition to tax incentives, S. 3017 and S. 3140 would establish mechanism for special master plans which provide sound retirement income programs without the paperwork and other burdens associated with maintaining a pension plan.

Despite the similarity of objectives, there are some significant differences between the bills. S. 3017 envisions defined contribution plans largely marketed by the banking and insurance community with no limits beyond existing qualification requirements of the Internal Revenue Code. S. 3140 contemplates a combination IRA-Keough plan in which the current Keough plan limits for vesting, participation, nondiscrimination and social security integration would apply. Of the two, we suspect S. 3017 would prove more attractive to employers because of the more flexibile requirements. In any event, we would not want these plans subjected to more stringent requirements, as is suggested by Treasury authorities, nor would we want these plans to be an excuse for not curing the compliance burdens discussed earlier in our statement.

(c) Deductible Contributions - Both S. 3017 and S. 3288 attempt to eliminate a patently discriminatory feature of our tax laws whereby some taxpayers may exclude their retirement savings from their current taxable income while others may not.

Our tax laws for a great number of years have sought to encourage pensions. In 1962, Congress expanded this policy by establishing favorable tax treatment for the retirement savings of the self-employed. In 1974 Congress encouraged the retirement savings of those employees who were not participants in a qualified pension plan.

Since Congress has seen the wisdom of permitting an individual to set aside funds from his current income and defer its taxation until retirement, considerations of elementary fairness should guide Congress to assure that all taxpaying individuals be afforded this opportunity. S. 3017 and S. 3288 attempt to rectify this situation by permitting individuals to exclude from their current income their contributions to group pension plans established and qualified under Section 401 of the Internal Revenue Code.

S. 3017 would require all qualified plans to accept employee contributions while S. 3288 would give plan administrators the option of of accepting them. Both bills would limit the deduction of 10% of pay or $1,000 whichever is less while S. 3017 would phase out the deduction for employees whose incomes exceeded $30,000. An added aspect of S. 3288 is the fact that employee contributions would be included in the measurement of "discrimination" in the employer plan for tax qualification purposes.

We fully support efforts to encourage the establishment of private pensions and greater individual efforts at retirement savings. Specifically, we could support legislation to allow an active participant in any type of qualified retirement plan to deduct his contribution to an Individual Retirement Account (IRA) or to his employer's qualified plan except that his contribution may not exceed the lesser of 15% of his earned income or $1,500 reduced by the amount of his employer contribution.

We would also support legislation increasing the $1,500 annual limit on contributions to Individual Retirement Accounts (IRA's) to $2,000 and adding a cost-of-living adjustment in order to maintain an appropriate tax deferral level for these retirement plans.

CONCLUSION

The National Chamber is concerned about the adequacy of existing national policies and laws designed to foster retirement savings. The disappointing data on plan terminations and widespread complaints about the burdens and costs of ERISA compliance indicate that urgent attention is warranted.

Our policy goal is to assure that private retirement saving efforts -- by employers, employees and individuals -- play a substantial role in meeting the needs of the nation's elderly. To the extent that government policies, laws and regulations help achieve this goal, our concerns over the adequacy and the affordability of public programs are diminished.

Thus we urge these committees to create a statutory environment that is attractive for retirement savings. We look for streamlined administration with a minimum of paperwork and compliance cost. We also look for tax polices that make retirement savings an attractive investment alternative but with appropriate safeguards to assure tax fairness and protect against undue revenue losses.

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SENATOR WILLIAMS, N.J.
1978 AUG 30 AM 8 41

August 29, 1978

Senator Harrison A. Williams, Jr.
Room 352
Russell Office Building
Delaware and Constitution Avenues
Washington, D.C.

Dear Senator Williams:

This letter addresses two provisions of the bill you introduced into the Senate (S. 3017) proposing a series of amendments to the Employee Retirement Income Security Act of 1974. The first permits multiemployer plans to refund monies paid by mistake of fact within one year after the "plan administrator" discovers the error. The second prohibits 10% owners from maintaining Investment Retirement Accounts (IRAs). I discuss these two provisions *seriatim*.

ERISA's prohibition on the restitution of pension contributions paid by mistake is bad law. Honorable people give back money they've received in error. Reflecting that ethical principle, the right to recover monies paid by mistake has been part of the common law for centuries. See *United States* v. *Barlow*, 132 U.S. 271, 282 (1889); *Strauss* v. *Hensey*, 9 App. D.C. 541 (1896); 66 Am. Jur. 2d, RESTITUTION AND IMPLIED CONTRACTS, §119 (1973) (collecting cases). Hence, it is hard to see how trustees of a collectively bargained plan can, in good conscience, refuse to refund mistaken contributions. Employers typically don't believe the claim that ERISA prohibits such refunds. And imagine what citizens think of their legislators when apprised that this is what Congress has compelled!

Just why ERISA compels pension funds to act inequitably by prohibiting such repayments, unless made within one year, I cannot fathom. Perhaps proponents of the ERISA restriction can think of other transactions in our society subject to such an outrageous restriction. I cannot.

The bill you have introduced, of course, is designed to ameliorate the effects of the existing provisions in the law. But I cannot for the life of me understand why the provision has not been excised altogether; why, in other words, relief is limited

Senator Harrison A. Williams, Jr.
August 29, 1978
Page 2

to multiemployer plans, to a one-year period, and to mistakes of "fact." I reiterate that the common law has dealt with the matter of mistaken payments for several hundred years. Why has the Congress seen fit to muck up the law and establish a principle which is unfair to contributing employers and therefore sparks animosity between them and the funds to which they are obliged to contribute as a result of collective bargaining? I cannot imagine that there is any political opposition to an outright repeal of the prohibition on repayment of mistaken con-ributions. Nor can I see any policy reason for the creation of such a restriction, let alone for preserving it.

The second provision in your bill I'd like to discuss is Section 306. It would prohibit 10% owners from maintaining IRA accounts under circumstances under which everyone else in the nation may. No doubt this provision reflects your discovery that a great many small employers either do not have pension plans or have terminated them in response to ERISA. The assumption underlying this provision is that every 10% owner can have a full-fledged employee benefit plan instituted and that if he or she fails to do so, he or she has opted for an IRA instead and should be penalized.

That assumption is wrong in a great many instances. It should be perfectly obvious to you that in many small businesses 10% owners do not as a practical matter control the policy of the firm with respect to fringe benefits. In this respect they are in much the same position as employees. There is no justification for penalizing them on the pretense that they have a choice employees do not.

In addition, in many businesses the margin between revenue and ordinary expenses is too small to make it possible to institute qualified retirement plans - with their substantial administrative costs. As I am sure you are aware, the smaller the business, the greater the per-participant cost of ERISA compliance. And many employers have found employees simply prefer to receive their compensation in wages rather than pension contributions.

There are other problems with Section 306's outrageous treatment of people who have some equity interest in a small business. At Congress' invitation, many 10% partners and minority shareholders in businesses that do not have qualified plans opened IRA accounts. Mutual funds, savings banks and insurance companies, among other institutions that service small investors,

Senator Harrison A. Williams, Jr.
August 29, 1978
Page 3

expended considerable startup costs to accommodate these investors in the good-faith expectation that the accounts would be long lived. Those costs will now be charged to someone. Will it be the minority owners you choose to discriminate against? In some cases, the IRA account contracts so provide. Are you being fair to minority equity owners of small businesses by setting them up for this patent injustice?

I think Section 306 is part of a bigger picture. The rich in our society get enormous, tax-deductible perquisites: company cars, country clubs, medical plans, life insurance, etc. Having excess money, they can often invest in tax-saving schemes and acquire great wealth. The not so poor get all kinds of tax-financed and private benefits, ranging from Medicaid to tuition-free college educations for their kids. (Government employees get similar benefits.) The small entrepreneur gets none of the above. He's (or she's) being squeezed. Why should such people be discriminatorily deprived of a modest incentive to put some money away for retirement?

The antipathy to small business reflected in Section 306 and the outrageous discrimination that it establishes seems to me both unprincipled and unfair. If you believe that pension plans should be mandatory, then they should be mandatory nationwide. If you believe that the IRA was a bad idea, then it ought to be repealed - nationwide. You ought not take off after a segment of the employer group, especially where, as here, the enormous variety of businesses affected (not all of them necessarily small) makes it absolutely certain that the paradigm you have in mind (the equity owner who readily could but does not establish a qualified plan because he or she prefers an IRA) will occur in only a few instances.

I urge you to expand the scope of Section 263 to delete the provision of ERISA prohibiting refunds of mistaken contributions. And I urge you to eliminate Section 306 of the bill.

I have taken the liberty of sending a copy of this letter to Mr. Frank Cummings, Chairman of the Subcommittee on Pension, Welfare and Related Plans of the American Bar Association Labor Law Section.

Very truly yours,

George B. Driesen

George B. Driesen

gbd/jat
cc: Frank Cummings, Esq.

SENATOR
WILLIAMS, N.J.

1978 AUG 17 AM 9:44

San Diego, Ca.,

August 13, 1978

Dear Senator:

Today I have read the Congressional Record of August 2, 1978, page S.12383 on private pensions. It is too late to send the enclosures into Michael Stern so I am sending this direct to you. I am 81 years old, a veteran of World War 1 with a service connected award of compensation but without any pension and now the meager Carpenter Pension of just $.50 (fifty cents) a day. My Army serial number is #829726.

Sincerely,

Rudolph J. Ellingsen

Rudolph J. Ellingsen

Enc: 4

Address:

1551 Felspar Street
San Diego, Ca. 92109

COMMITTEE ON
HUMAN RESOURCES
1978 AUG 17 AM 11:25

WILLIAM SIDELL, GENERAL PRESIDENT
UNITED BROTHERHOOD OF CARPENTERS
AND JOINERS OF AMERICA

101 CONSTITUTION AVE., N.W.
WASHINGTON, D.C. 20001

January 1, 1978

Dear Sir and Brother:

As we have reported to you several times in the past, Section 54C of the Constitution and Laws provides that the amount of pension (payable from the Brotherhood) will be established by the General Executive Board. The amount is determined based upon the income to the Fund. The last change in pension amount went into effect on January 1, 1976. At that time your current benefit of $18 per month was adopted.

Since 1976 more than 8,000 members have been added to the pension list. The increase in the number of pensioned members has been following the estimated figures almost exactly. At the same time the beneficial membership of the United Brotherhood has been dropping, largely reflecting the drop in construction jobs for the last few years. Therefore, there is less money added to the Pension Fund each month.

The General Executive Board recently met and received an updated report on the status of the Fund. After careful study of all the possible actions which could be taken, the Board determined that the highest possible benefit which could be supported at this time is $14.00 per month—or $42 per quarter.

Therefore, effective with the first quarter in 1978, the amount of the Brotherhood's pension will be fixed at $42 per quarter until further notice.

Fraternally yours,

R. E. Livingston
Secretary,
General Executive Board.

William Sidell
Chairman,
General Executive Board.

P.S. My Carpenters pension now reduced to $14 mo.
Rudolph J. Ellingsen

After over 40 yrs. membership the only 33 yrs. continuous, my pension of $30 month is now reduced to $22 mo. a 27% reduction. R. Ellingsen.

WILLIAM SIDELL, GENERAL PRESIDENT
UNITED BROTHERHOOD OF CARPENTERS AND JOINERS OF AMERICA

101 CONSTITUTION AVE., N.W.
WASHINGTON, D. C. 20001

March 27, 1973

Dear Sir and Brother:

In our Informational Bulletin of February 1, 1973, which we furnished to all beneficial Local Unions for mailing to all their members, we advised that expenditures resulting from increased monthly pension benefits together with a drastic increase in the number of pensioners had consumed all reserves in the Pension Fund.

We notified the members that it would, therefore, be necessary to reduce the monthly pension benefit to be commensurate with Pension Fund income unless the members voted an increase in per capita tax to provide the necessary Pension Fund income so that we could endeavor to continue to pay a Pension benefit of $30.00 per month.

By action of the General Executive Board and upon the recommendation of an Advisory Committee, a referendum was conducted in accordance with the Constitution and Laws of the United Brotherhood which proposed an amendment to Section 45 D of the Constitution and Laws to increase the per capita tax payable on behalf of all beneficial members by $1.25 per month, which our actuaries projected could be sufficient to support the $30.00 monthly Pension payment for the next ten years if our beneficial membership did not substantially decrease.

Voting was completed and returns were made to the General Secretary by March 15, 1973.

The Tabulating Committee appointed to tally the vote has submitted its report under date of March 22, 1973.

The Tabulating Committee counted a total of 122,265 votes. Of these, 60,176 votes were cast for the proposed increase in per capita tax, but 62,089 votes were cast against it. Thus, the Proposition lost and the per capita tax remains unchanged.

It is, therefore, now necessary that the monthly Pension benefit payable under the Constitution and Laws be reduced effective April 1, 1973 in accordance with current Pension Fund income.

The Pension benefit payable for each quarter in the future will be based on the Pension Fund income during the preceding quarter. The funds available were sufficient to pay each member currently on the Pension rolls $22.00 per month, or $66.00 for the quarter beginning April 1, 1973. No reserve is currently being maintained in the Pension Fund.

Our actuaries advise us that further reductions in the Pension benefit payment will have to be made in the future. As we informed you in our February 1, 1973 Informational Bulletin, because of the constantly increasing number of members on the Pension rolls unless additional funds are provided it will be necessary over the next ten year period to gradually reduce the Pension benefit. If, in the meantime, our beneficial membership, whose per capita tax supports the Pension Fund, should show a substantial decrease, still further reductions in the Pension benefit payment may be necessary.

We regret the necessity of reducing the Pension benefit but we can only pay out in benefits the income we receive for the Pension Fund under Section 45 D of the Constitution and Laws, and we are bound by the vote of the members as expressed in the referendum with respect to the amount of per capita tax.

Fraternally yours,

William Sidell

Sept. 4 through Nov. 2, 1975 - Payroll at Pump 8, Alaska Pipe line, Fairbanks, Alaska

GROSS EARNINGS	F.I.C.A.	FED. INCOME	STATE INCOME	S.U.I.	NET PAY
789.99	$ 46.21	$ 199.30	$ 41.85	$ 4.74	$ 497.89
1209.75	70.28	350.40	71.83	3.38	713.87
1226.46	71.75	354.42	74.86	7.35	716.08
1226.46	71.75	354.42	74.85	7.35	716.08
1226.46	71.75	354.42	74.86	7.35	716.08
1228.69	71.86	357.25	75.02	7.37	717.19
1232.61	72.11	358.65	75.31	7.39	719.16
1226.46	71.75	354.42	74.85	7.35	716.08
1287.72	75.33	378.46	79.48	7.72	746.71
$10,654.44	$619.78	$3049.74	$642.89	$60.00	$6,259.16

Total taxes deducted from 9 weeks work $4392.41 which was 42% of my gross earnings.

Rudy Ellingsen

FLUOR ALASKA, INC.
FAIRBANKS ALASKA 99701

EMP NO	EMPLOYEE NUMBER	SOCIAL SECURITY NUMBER	FROM DATE MO	DAY	YR	TO DATE MO	DAY	YR	NAME
22	27440	536-14-0016	10	06	75	10	12	75	RUDOLPH J ELLINGSEN

TOTAL EARNINGS	OTHER COMPENSATION	OI	FICA	WITHHOLDING TAX	INTERNAL DEDUCTS	AMOUNT OF CHECK	CHECK NO
1226.45	.00	.00	71.75	350.42	82.20	715.08	54106

	HOURS WORKED	HOURLY RATE	GROSS AMOUNT	TYPE HRS CODE
1	40.0	13.530	541.20	
2	20.0	20.295	405.90	
3	10.0	27.060	270.60	

TYPE HRS CODE: 1-ST 2-OT 3-OT 4-TT 5-OT

DEDUCTIONS DESCRIPTION	AMOUNT
STATE W/H	74.85
SUI	7.35

OTHER EARNINGS	AMOUNT
5	8.75

1-MILEAGE
2-SUBSISTENCE
3-BUS
4-TRAVEL ALLOW
5-TOLL
6-TRAVEL PAY

NOT NEGOTIABLE DETACH AND RETAIN FOR OUR RECORDS

U.C. 9 - TAXABLE FOR FICA AND SUI ONLY

47288

On Pipeline we work 10 hr. day & 7 days each wk. I worked just 9 wks. then we have R&R for 2 wks. At my age I just couldnt work any more. Rudolph J. Ellingsen.

Ref: [illegible] Burns Comm.

EXCERPTS FROM CONGRESSIONAL RECORD 1977 Page 1

SUBJECT	SPEAKER	PAGE	DATE	
Foreign import of shoes now more than 50% of shoes sold	Hathaway	S.24	Jan.	4
Mineral imports from listed countries and the %	Goldwater	S.32	"	"
Representatives elected to 95th Congress		H.1	"	"
Vote in House on Rules changes		H.22	"	"
Pay War 1 Veterans pensions now	Burke	H.37	"	"
Tenants' Tax Justice Bill	Harris	H.49	"	"
Registration of Lobbyists	(66 pages)	H.84-150	"	"
Constitutional amendment to abolish income tax	Symms	H.83	"	"

#2

SUBJECT	SPEAKER	PAGE	DATE	
Texan Ron Paul election defeat challenged	Wiggins	H.156	"	6
Electoral vote count by States for President & Vice President		H.158	"	"
The Constitutional crisis in State Election Laws	McDonald	E.76	"	"
Rev. Farell on Golden Calves	Collins	E.81	"	"
Promotions in the Military		S.64-94	"	"

#3

SUBJECT	SPEAKER	PAGE	DATE	
President Ford's Energy Message		H.224	"	10
We are in a declared state of emergency since 1933	Bingham	H.225	"	"
Energy		S.97-103-12-S.287	"	"
Morality in Foreign Policy. Keep recognizing Free China	Goldwater	S.344	"	"
Water Shortages	Abourezk	S.311	"	"
The Trilateral Commission	Goldwater	S.1104	"	19
	Humphrey	S.1121	"	"
	Hansen	E.212	"	"

I am a paid subscriber to cong. record since 1934 and this sheet is page 1 of 84 sheets of excerpts on various subjects for 1977. R. Ellingsen

16

STATEMENT OF PETER L. FABER
AT A HEARING ON PROPOSALS TO IMPROVE
THE EMPLOYEE RETIREMENT INCOME SECURITY ACT
OF 1974

AUGUST 15 - 17, 1978

My name is Peter L. Faber. I am a lawyer in private practice and am a partner in the law firm of Harter, Secrest & Emery in Rochester, New York. I specialize in tax law and a good part of my practice is concerned with employee benefit plans. I am a former chairman of the Tax Section of the New York State Bar Association and am now a member of the Section's Executive Committee and Committee on Employee Benefits.

My firm represents over 200 qualified pension and profit sharing plans, ranging from plans established by businesses with only one employee to large industry-wide plans. Most of our clients are small businesses, and I appear before you today to present a view of the impact S.3017 would have on pension and profit sharing plans maintained by small businesses, on which so many of our workers rely for retirement income.

Let me begin by stating unequivocally that, in my view, ERISA has been a disaster. Although undoubtedly well-intentioned, many of its provisions were poorly thought out and drafted. It abounds with inconsistencies, ambiguities, and, most of all, complexities. Members of Congress have frequently congratulated themselves for taking such impressive steps to protect pension rights. If they had to draft and administer pension and profit sharing plans to meet its many obscure requirements, they would be less proud of their work product. I dare say they would be embarrassed by it.

Little thought was given in drafting ERISA to the difficulty and expense of compliance, particularly for small businesses. Almost all of my clients have complained bitterly to me about the increasing cost of ERISA compliance. Many plans we represent have already been terminated, and many more will be before the year is out.

Consider for a moment what has been necessary to bring plan language into compliance with the law. ERISA established a series of deadlines for amending plans to meet its many requirements. Each plan had to be completely restated because the technical changes were so numerous. The law required restatements to be made at a time when the Internal Revenue Service and Labor Department had not issued final regulations. In fact, many plans had to be amended before proposed regulations were available. After the original restatement was submitted to the Internal Revenue Service, a second amendment was usually required to make technical changes demanded by the Service as a condition of issuing a favorable determination letter. Many plans were amended a third and even a fourth time because, upon reflection, the company's management or their professional advisors had second thoughts on how to handle technical problems posed by the law. Earlier this year, the Internal Revenue Service announced that still another amendment would be necessary for each plan in order to meet the final regulations, which by now have been issued with respect to most ERISA provisions. Since most plans were restated and later amended before final regulations were out, most plans will have to be amended once again before the end of the year. Every time a plan is amended, additional expenses are incurred. These include legal fees for drafting the amendment and submitting it to the Internal Revenue Service, accounting fees for preparing schedules to be submitted to the Service along with the plan, and, frequently, actuarial fees for preparing the required supporting actuarial data. These expenses are a mild irritant to the large publicly held corporation; to a small business, they are a substantial item and may lead to the termination of the plan. In addition to expenses already incurred, many of my clients have indicated a feeling that further changes will be required in the future as Congress and the administrative agencies change their requirements. I wish I could advise my clients that an end to the changes is in sight, but unfortunately I cannot. Many small businessmen are terminating plans because they just don't have the time or money to cope with the never-ending stream of directives emanating from Washington.

I and other professionals in the field have been disturbed at the tendency of Congress to critize the Internal Revenue Service and Labor Department for issuing complicated regulations and reporting forms under ERISA. Compliance with ERISA has, indeed, been difficult, but the principal fault does not lie with the dedicated and capable personnel at these two agencies. It lies squarely with Congress. Although one can quarrel with specific regulations, in general the Service and Labor Department have made valiant efforts to simplify plan administration. Unfortunately, it would be hard to produce a readable and administrable set of regulations implementing many of ERISA's requirements.

ERISA's reporting and disclosure requirements are burdensome and unnecessary. The cost and aggravation of preparing numerous documents that employees and government officials will never read is infuriating to the small businessman. Aside from the annual reports and supplementary statements, the requirement that notices be given to plan participants and other persons when a plan is submitted to the Internal Revenue Service helps noone but paper manufacturers. In my practice, we have amended over 200 plans and submitted them to the Internal Revenue Service, in each case posting the required notice to participants. I am not aware of a single instance in which a participant or beneficiary availed himself of the opportunity to comment on the submission.

Although ERISA added certain elements to the protection of participants and beneficiaries in the fiduciary responsibility area by giving the Labor Department a more active role in enforcement and in specifically prohibiting certain transactions deemed to have a potential for abuse without regard to fairness, this could have been done in a much simpler manner. Although the fiduciary responsibility provisions are, by and large, unexceptionable, I seriously question whether they were necessary. Almost all pension and profit sharing plans were operated as trusts, and the trustees were held accountable under existing law to strict principles of fiduciary responsibility. Although they were not technically trustees, it was abundantly clear that company management personnel involved in plan administration were legally required to administer the plan in accordance with its objectives which, under the Internal Revenue Code, had to be for the exclusive benefit of participants and beneficiaries.

Proponents of pension reform legislation exaggerated the extent of the problem. In my experience and that of other professionals in the field, instances of abuse of employee rights under prior law were rare indeed. ERISA was aimed at the infinitesimal number of plans which were dishonestly or improperly run. Unfortunately, it has seriously impaired the operations of the overwhelming majority of plans which were well designed and honestly administered.

Let me now turn to the specific provisions of S.3017. Some parts of the Bill deserve praise.

Without commenting on the details of the provisions of the Bill that would consolidate the administration of plans in a single agency, their objective should be applauded. Dual jurisdiction of the Labor and Treasury Departments, which arose from a silly squabble between two congressional committees, should be given a not necessarily decent burial. The Treasury and Labor Departments deserve high praise for attempting to work out a sensible and efficient regulatory scheme within such an absurd framework.

Section 274 of the Act, which would reverse the Daniel case and provide that the interest of an employee in most employee benefit plans is not a security, should be enacted, although it mignt be tightened by revising the language to include thrift and other plans in which participation (or some elements of participation) is voluntary. Retirement plans are regulated by enough government agencies as it is, and the court decision which added the Securities and Exchange Commission to the list did a service to noone.

The elimination of some of the more burdensome and unnecessary reporting and disclosure requirements is a step in the right direction.

Clarifying the status of reciprocal agreements between collectively bargained plans would eliminate a major area of uncertainty from present law. Section 231 of the Bill, which would amend ERISA §209 to allow such reciprocal agreements,

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should go further and specifically provide that it is an exception to the rule of ERISA §208 that an amount not be "transferred" from one plan to another unless certain requirements are met. This provision and its counterpart in the Internal Revenue Code, which were intended to prevent losses to employees when plans merge, literally apply to transfers pursuant to reciprocal agreements. Although government officials with whom I have discussed this agree that such a result was not intended, they have expressed doubt as to their ability to avoid reaching it under the present statute.

Unfortunately, many of the provisions of S.3017 are as poorly thought out as were the original provisions of ERISA. Some will do little to improve the law while others will make it infinitely worse.

The basic drafting approach is questionable. Instead of eliminating the dual set of rules in ERISA and the Internal Revenue Code, the Bill creates its own sets of rules and requires, in §2, that the Secretaries of the Treasury and Labor within 90 days after enactment submit to the Congress a draft of conforming changes in the Code and ERISA. Presumably, we will now have three statutes covering the same material instead of only two. Maybe the two agencies will be able to conform the three laws, but maybe they will not. The instances in which Congress forgot to put counterpart provisions in the Internal Revenue Code with the result that provisions in ERISA were inoperable (e.g. the provisions relating to the return of contributions to the employer) does not inspire one with confidence. It would be better to put all provisions relating to the subject matter in the Internal Revenue Code and simply repeal their counterparts in other laws.

Section 238 of the Bill would amend the joint and survivor annuity provisions of ERISA to broaden their coverage.

The joint and survivor annuity provisions of present law go far beyond what is necessary to accomplish their purpose, and the one thing they do not need is to be expanded. They provide that, if an annuity is available, whether as the normal or an optional form of benefit, the standard benefit under a plan must be a joint and survivor annuity if a participant is married unless the participant elects otherwise. The Internal Revenue Service and Labor Department have developed detailed election procedures to implement these rules. Apparently, Congress felt that participants were unwittingly doing their surviving spouses out of benefits by electing life annuity pensions under which payments stopped when they died. The ERISA requirements went far beyond what was needed to cure the problem, if, indeed, a problem existed. Many plans, although providing that life annuities are optional benefit forms, do not make them the standard forms. If a participant indicates that his preferred form of benefit is a lump sum or a series of payments guaranteed for a period of time without regard to how long he lives, there is no reason in the world why his employer should have to notify him of the availability of a joint and survivor annuity form of benefit. His spouse will not be prejudiced by his choice of benefit.

S.3017 would expand the joint and survivor annuity requirements far beyond the bounds needed to deal with the problem with which Congress was concerned. They would require the payment of an annuity to a participant's spouse without regard to the participant's wishes. At least present law gives the participant a choice. In many situations, it is desirable for one reason or another that benefits under a pension or profit sharing plan not be paid to the participant's spouse. This would be the case if the spouse was incompetent, in which case benefits might be better paid to a trustee for her benefit, or if the spouse was extremely wealthy in her own right, in which case sensible financial and tax planning might dictate the choice of another beneficiary for the participant's interest. The proposed Bill would require benefits to be paid to the spouse under certain circumstances even where this defeated sensible financial planning objectives. In fact, the proposed changes would require the payments to a surviving spouse even if serious marital difficulties had developed.

The Bill would also require a joint and survivor annuity to be paid in some situations in which a person is at least 50% vested in his accrued benefit under the plan, even if the plan does not provide for the payment of benefits in the form of an annuity. If an annuity is not available as an option under the plan, the danger of an inadvertent cutoff of the spouse's benefits by an ill-informed participant would not be present.

Rather than expand the joint and survivor annuity requirements, they should be contracted. A more constructive amendment would be to make the election procedures wholly inapplicable unless a participant expressed an interest in receiving a life annuity form of benefit. Only in this case would there be a possibility that his spouse would lose benefits if he died prematurely. If a participant expressed an interest in receiving a life annuity, it would be appropriate to require that he be notified of the joint and survivor annuity form of benefit and be given an opportunity to elect another form if he so desired. On the other hand, if the participant's preferred benefit form was a lump sum or payments guaranteed for a period of years, there would be no reason to bring the elaborate election procedures set forth in the regulations into play.

Section 238(a) of the Act would impose unnecessary tax liabilities on the estates of many participants. It would require the payment of the surviving spouse benefit where the plan did not provide for an annuity option to be made in a lump sum to the surviving spouse. Under Section 2039(c) of the Internal Revenue Code, as amended by the Tax Reform Act of

1976, lump sum distributions from a qualified pension or profit sharing plan are subject to estate tax, while distributions paid over more than one taxable year are not. By requiring payment in a lump sum, the proposed change would require the benefit to be subject to estate tax. This makes no sense at all and should be deleted from the Bill.

It has been suggested that the joint and suvivor annuity requirements should be dropped entirely from defined contribution plans such as profit sharing and money purchase pension plans. If Congress is still concerned about the possibility that participants might unwittingly cut off their spouses from benefits, I would disagree with those advocating elimination of the requirement from defined contribution plans. I do believe, however, that the notice and election procedures should not come into play unless a participant indicates at the outset that he would like to receive his benefits in the form of a life annuity.

The proposed changes to the joint and survivor annuity provisions amount to still another example of well intentioned but misguided meddling with the retirement plan system that will result in still another round of plan amendments. The social good to be gained from their enactment would be dubious at best, and the cost in terms of legal, accounting and actuarial fees necessary to amend thousands of plans throughout the country would be out of proportion to the benefits.

Section 303 of the Bill, which would allow employees who participate in qualified plans to deduct contributions to those plans within certain limits, would be a step in the right direction. The present rule, which prevents employees from deducting contributions to individual retirement accounts if they participate in qualified plans even though no employer contributions are made for them under the plan in which they participate or they are not vested in their accounts is unfair. Unfortunately, the Bill, in order to prevent discrimination against employees who participate in plans that do not allow employee contributions, would amend §401 of the Code to require all plans to accept employee contributions. This is a poor way to approach the problem. Many plans do not allow employee voluntary contributions because to do so would result in administrative expense and potential liability for those persons responsible for investing employees' money. Rather than require plans to take on this added administrative burden, it would make more sense to allow participants in qualified plans to establish individual retirement accounts just as persons who are not participants can do. The more rigorous contribution limits set forth in the Bill could be applied to persons who already participate in qualified plans. The proposed amendment to §401 to require plans to accept employee contributions would be still another change that would require legal and accounting fees and the submission of the plan to the

Internal Revenue Service.

The Bill would encourage employers to establish and improve plans by providing income tax credits. These are artificial devices. It is somewhat ironic for a Congress that has done so much to discourage employers from establishing and improving plans to now turn around and, without eliminating the provisions of the law that have caused the problem, to create an artificial incentive by permitting a tax credit having no relation to the corporation's real net income. I would submit that the way to encourage employers to establish or improve plans is to eliminate complexities and ambiguities from the law and not to add still more.

The determination of what is an "improved plan" for purposes of the new credit under proposed §44D of the Internal Revenue Code will result in still more detailed regulations and technical requirements.

The statutory language pertaining to the credits could use some refinement. Section 44D seems to say that the credit will be available for any year in which an approved plan is "maintained", which would seem to include years after the improvement is made, although I can't imagine that this is intended by the proponents of the Bill. Employers frequently establish and amend plans toward the end of their taxable year. If this done, it would presumably be necessary to get a ruling from the Employee Benefits Commission that the plan meets the requirements of Section 44C or D. If the Commission takes as long to process applications for approval as does the Internal Revenue Service, employers may not be in a position to know their tax liability when their tax returns are due. If certification by the Commission is to be a prerequisite for claiming the credit, at the very least an automatic extension of time to file tax returns should be allowed.

Section 306 of the Act would deny the privilege of establishing individual retirement accounts to persons owning 10% or more of a business (whether incorporated or unincorporated) or who are officers of corporations. This is just one more example of discrimination against small businessmen that so pervades the tax laws.

A self-employed person or an owner of a small corporation with no employees other than himself may not want to spend the money to establish a qualified retirement plan. Such a person should be allowed to form an individual retirement account and deduct contributions to it.

The Bill's denial of individual retirement account benefits to owners of businesses would not be limited to the earnings of the businesses they owned. A person who is employed by a corporation that does not have a retirement plan and of which he is not a substantial owner should not be denied the privilege of contributing to an IRA with respect to his income from the business simply because he is the principal owner of another business the income of which is not considered in determining individual retirement account contributions. Further, tax consequences should not flow from whether a person is an "officer" of a corporation. Many corporate offices are held by people who have no real say in the operation of the business (e.g. assistant secretaries of banks, who are typically fairly low level middle management employees) or are nominal. It is common in states requiring more than one officer for a professional corporation that the spouse of a professional engaged in the solo practice of medicine or law in the corporate form will be secretary of the corporation. Although technically an "officer" of the corporation, the spouse will normally not receive any compensation for his or her efforts. If the holder of such an office has another occupation and earns money from it, there is no reason why he or she should not be able to establish an individual retirement account with respect to earnings of the other occupation.

In conclusion, I would submit that Congress should stop making minor amendments to the laws affecting pension and profit sharing plans. Unless it contemplates significant changes, it should let ERISA sink in awhile so that people can get used to it. The constant "improvement" of the law will only result in more plan terminations. In recent years, we have seen a continuous string of proposals to change the pension and profit sharing plan laws. The proponents of these changes seem blissfully unaware of the chaos they are causing. Any change requiring an amended plan results in increased administrative, legal, accounting, and other costs. This may not be a problem for the large corporation, but it is a significant one for the small businessman. Any amendment of a plan, no matter how simple, is bound to result in legal fees of at least several hundred dollars when the drafting and submission of the amendment to the Internal Revenue Service are completed. Moreover, it can be expected that two amendments may be necessary for those changes other than the very simplest, since the Internal Revenue Service on submission is likely to require further technical changes to conform with its notion of the law's requirements. This does not include the further cost resulting from the need to explain the amendments to the employees and to file whatever reporting and disclosure documents are necessary.

Improvements to the law should be confined to correcting mistakes, of which there are many, and eliminating anbiguities.

With respect to mistakes in the law, the Committee on Employee Benefits of the Section of Taxation of the American Bar Association has prepared a detailed report pointing out over fifty errors in ERISA. This report should be required reading for all members of Congress and their staffs. A technical corrections bill is sorely needed in the employee benefit plans area.

With respect to ambiguity, Congress might consider addressing itself to some of the consequences of requiring plans of related employers to be treated as a single plan. This requirement is wholly unsuited to profit sharing plans which allow contributions to be made at the discretion of the corporation's board of directors. Assume, for example, that two corporations are both owned by the same person. One makes substantial profits and the other does not. Is it permissible under ERISA for the profitable corporation to contribute to its plan and for the unprofitable corporation not to do so if the employees of the unprofitable corporation are in general lower paid than those of the profitable corporation? Can contributions be set at a uniform percentage of profits for each company? This is a very practical problem that the general pronouncements of ERISA shed no light on whatsoever.

Finally, let me urge that any further changes to the laws be expressed in simple language. If the Internal Revenue Code is a disgrace, as has been suggested by some, it is because it is too complicated to be understood by experts, much less laymen, and not because it is unfair. Congressmen, who, for the most part, are well-informed laymen, have a duty to their constituents to read the language of bills they vote on. If you cannot understand the statute prepared by the committee staff, don't take the word of the draftsman that it does what you want it to do. If you cannot understand it, the chances are that most people in the country won't be able to either, and you should not hesitate to send your staff back to the drawing board to produce language that is clear and concise.

Financial Accounting Standards Board
HIGH RIDGE PARK STAMFORD CONNECTICUT 06905 203-329 8401

DONALD J KIRK Chairman of the Board

August 10, 1978

The Honorable Harrison A. Williams, Jr.
Chairman
Subcommittee on Labor
Committee on Human Resources
United States Senate
352 Russell Senate Office Building
Washington, D.C. 20510

Attention: Steven J. Sacher

Re: ERISA Hearings August 15-17, 1978

Dear Senator Williams:

The Financial Accounting Standards Board (FASB) is pleased to submit its comments on S.2992 to the Senate Human Resources Subcommittee on Labor in connection with the ERISA hearings to be conducted jointly by your Subcommittee and the Senate Finance Subcommittee on Private Pension Plans and Employee Fringe Benefits on August 15-17, 1978. The FASB had earlier submitted similar comments to the latter Subcommittee.

S.2992 would amend the Internal Revenue Code of 1954 to require the Secretary of the Treasury to promulgate uniform standards of accounting and reporting for pension plans. Inasmuch as the FASB has on its agenda a project to establish accounting and reporting standards for defined benefit pension plans ("pension plans"), it is the judgment of the Board that S.2992 is not needed.

As the enclosed comments more fully explain, the Board is well along on its project following extensive due process procedures that ensure broad public participation (described on pages 3 and 4 of the comments). The Board expects to issue its final standards in time to apply to the preparation of pension plan financial statements for 1979. Throughout its deliberations the Board has worked closely with both the Department of Labor and the American Academy of Actuaries, and it continues to do so.

The enclosed comments were submitted to Senator Bentsen's Subcommittee on June 30, 1978. Since that time, the Board has received a final draft of proposed recommendations of the American Academy of Actuaries regarding the calculation of the actuarial present value of accrued benefits, and the FASB staff has informally reviewed a draft of the Department of Labor's proposed instructions to a revised Schedule B to Form 5500. Since June 30, also, the Board has continued its deliberations on pension plan accounting at three public meetings of the Board, reaching initial decisions on the following matters, among others:

- That the primary objective of financial statements of a pension plan should be to provide financial information that is useful in assessing the security for the payment, when due, of participants' benefits.
- That investments in securities and real estate should be reported at their current value.
- That operating assets should be reported at cost less accumulated depreciation.
- That the information about benefits to be reported in a plan's financial statements should be determined on the assumption that the plan is an ongoing plan (as opposed to an immediate termination assumption).
- That plans in similar circumstances should use a uniform basic method for determining the information about plan benefits to be included in plan financial statements.
- That the accrual basis (rather than the cash basis) should be followed in preparing plan financial statements.
- Data as of a date preceding that of the financial statements may be used to determine the benefit information provided the results obtained do not differ materially from those that would otherwise be determined using data as of the date of the financial statements.
- That information about both vested and nonvested benefits should be presented.

The foregoing initial decisions have been made without distinguishing between plans having particular characteristics (e.g., small vs. large plans, public vs. private plans). Whether those decisions should be applicable to all plans or only to certain plans will be considered at a future Board meeting. An additional six public Board meetings on pension plan accounting are scheduled between now and the end of October.

The Honorable Harrison A. Williams, Jr.
August 10, 1978
Page Three

At the conclusion of its deliberations, the Board will determine whether there is a need to solicit additional public comment or whether it can proceed directly to final rulemaking. Either way, a final pronouncement is expected to be issued no later than the early part of 1979.

The Board would be pleased to provide additional information about its project to your Subcommittee, and I would be pleased to meet with you, with Senator Bentsen, and with members of your Subcommittees if you feel that will be helpful. I am confident that the standards of accounting and reporting that will be adopted by the FASB will, consistent with the objectives of ERISA, provide meaningful information to plan participants and other users of plan financial statements, and thereby serve the public interest.

Sincerely,

Donald J. Kirk

Donald J. Kirk

DJK/slh

cc: Senator Lloyd Bentsen, Chairman
Subcommittee on Private Pension
Plans and Employee Fringe Benefits

The Honorable W. Michael Blumenthal, Secretary of the Treasury

The Honorable Ray Marshall, Secretary of Labor

The Honorable Harold M. Williams, Chairman
Securities and Exchange Commission

Mr. Wallace E. Olson, President,
American Institute of Certified Public Accountants

Mr. Edwin Boynton, American Academy of Actuaries

Mr. Ira Cohen, Department of the Treasury

Mr. Ian Lanoff, Department of Labor

Mr. A. Clarence Sampson, Securities and Exchange Commission

Mr. Fred Stuckwisch, Department of Labor

Mr. Thomas Woodruff, Department of Labor

COMMENTS OF THE

FINANCIAL ACCOUNTING STANDARDS BOARD

ON

S. 2992

Comments of the

Financial Accounting Standards Board

on

S.2992

June 30, 1978

Introduction

The Financial Accounting Standards Board ("FASB" or the "Board") welcomes the opportunity to submit these Comments on S.2992 (the "Bill") to the Subcommittee on Private Pension Plans and Employee Fringe Benefits ("the Subcommittee") of the Committee on Finance of the U.S. Senate.

The Board is aware of and shares the concerns that have resulted in the Bill. In 1974, the Board placed two projects on its technical agenda to improve financial reporting relating to pension plans. (Those projects are more fully described in subsequent paragraphs.) Significant progress has been made by the Board to respond, in a responsible manner, to the need for improved financial reporting. It is the Board's belief that resolution of issues relating to reporting the assets and liabilities of pension plans should remain with the private sector's standard-setting process, which, with the oversight of the Securities and Exchange Commission (the "SEC"), has worked successfully for forty years.

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Establishing Financial Accounting Standards

The FASB is the authoritative professional body designated by the American Institute of Certified Public Accountants and recognized by the SEC to establish and improve financial accounting and reporting standards. It is widely endorsed by the accounting profession, the financial and business community, accounting educators, and others. The FASB does not set auditing standards or regulate auditing, which involves examining financial statements for the purpose of expressing an opinion as to whether they are presented fairly in conformity with generally accepted accounting standards.

As the independent, full-time financial accounting standard-setting body, the FASB is primarily concerned with the Bill's provision that the Secretary of the Treasury establish uniform standards for calculating and reporting the assets and liabilities of pension plans. Although the Bill would amend Section 412 of the Internal Revenue Code, which describes the minimum funding standards for plans, the Board presumes that the Bill's use of the word "reporting" is not limited to reporting to the Internal Revenue Service but is also intended to encompass general-purpose external financial reporting. That presumption is based on certain of Senator Bentsen's remarks in introducing the Bill. In those remarks, he referred to "the numbers that are reported in the accounting and actuarial reports of pension plans." The nature of the accompanying articles inserted into the Congressional Record when the Bill was introduced, and the wording of the press release announcing the Subcommittee's June 14 hearings also appear to support a broad interpretation of "reporting."

In the Board's opinion, the private sector's system for setting financial accounting standards, as it has evolved and is evolving, is successfully serving the public interest. The Board is not aware of any evidence that substituting the Secretary of the Treasury for the Board as the authoritative body to set accounting standards for pension plan financial statements would better serve the public interest. The private sector is proceeding to establish accounting standards for financial reporting by defined benefit pension plans. A brief history of the Board's efforts in that regard follows.

FASB Project on Defined Benefit Pension Plans

In recognition of the financial reporting requirements for most employee plans as a result of the Employee Retirement Income Security Act of 1974 ("ERISA"), the significance of both the assets held by pension plans and the benefits accumulated by participants in those plans, and the diversity of existing accounting and reporting practices of employee benefit plans, the FASB placed on its technical agenda in November 1974 a project on accounting and reporting for employee benefit plans. The Board's due process procedures are similar to those required by the Administrative Procedures Act and include appointment of a task force of experts for each major project,* preparation and publication of a neutral and comprehensive Discussion Memorandum ("DM") analyzing issues related to a project,

*The Board also invites individuals from various governmental agencies to meetings of its task forces. Regarding the projects relating to pensions, those individuals have included representatives from the Department of Labor, the Pension Benefit Guaranty Corporation, the Cost Accounting Standards Board, the Securities and Exchange Commission, and the House Pension Task Force.

solicitation of written comments on the issues in the DM, and holding a public hearing on the subject. The Board received 104 position papers in response to the DM on employee benefit plans* and heard 23 presentations at its public hearing.

An Exposure Draft ("ED") of a proposed Statement on "Accounting and Reporting by Defined Benefit Pension Plans" was issued on April 14, 1977,** and comments on it were solicited. In the Board's opinion, the final Statement for this project should satisfy the Bill's requirement for the promulgation of "uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions used in such calculations."

To date, the Board has received approximately 700 letters of comment in response to the ED. The Board would be pleased to provide copies of those letters to the Subcommittee, should they be desired.

ERISA requires that private plans annually provide certain financial and actuarial information to the Department of Labor ("DOL") and a summary of that information is to be provided to participants. Because of those requirements, many letters of comment have expressed the view, which the Board shares, that to avoid duplication of efforts on the part of preparers and to avoid confusion on the part of users of the respective information, it would be beneficial if the standards developed by the FASB for general-purpose external financial reporting purposes were acceptable to the DOL for its reporting needs.

*The Subcommittee's staff has been provided with a copy of the DM issued on October 6, 1975. Additional copies can be provided, should the Subcommittee so desire.

**The Subcommittee's staff has been provided with a copy of the ED. If desired, additional copies can be provided.

From the beginning of the FASB project, the Board has communicated with the DOL. The Board believes that a cooperative effort with the DOL is in the public interest. The Board is also working with the actuarial profession (through the American Academy of Actuaries) to resolve certain concerns expressed by respondents to the ED. With the cooperation of those groups, substantial progress has been made since the ED was issued.

Recently, FASB staff met with a representative of the American Academy of Actuaries ("Academy"), and the Board met with a representative of the DOL. The purpose of each meeting was to discuss informally the current views of the respective organization on certain critical issues related to the project. The Board is encouraged by the results of those meetings and expects to receive within the next month formal statements of the views of those organizations. The substance of those views is described in the written statements those organizations have made to the Subcommittee. After considering the formal statements of the Academy and the DOL, the Board will begin final deliberations this summer on a Statement of accounting standards for reporting by defined benefit pension plans. In preparing for those deliberations, the Board would welcome the views of the Subcommittee regarding any or all of the issues facing the Board. Deliberations of the Board are held in "sunshine," and representatives of the Subcommittee are welcome to observe those deliberations, should they so desire. The Board expects that its deliberations will be completed in time for a final Statement to be applicable to the preparation of plan financial statements for 1979.

FASB Project on Accounting by Employers for Pension Plans

Although the wording of the Bill is unclear as to whether it is intended to encompass the reporting by employers for their pension plans, the issues enumerated in the Committee's June 6, 1978 press release announcing the hearing clearly indicate the Subcommittee's interest in the reporting by the employer.

In addition to its project on accounting by the plans themselves, the Board has on its technical agenda a project on accounting by employers for pension plans. The objective of that project is to reconsider the requirements of the existing authoritative accounting literature with regard to accounting by employers for the cost of pension plans. The basic existing literature is Opinion No. 8, "Accounting for the Cost of Pension Plans," issued in 1966 by the Accounting Principles Board, the FASB's predecessor. Supplementing that Opinion is FASB Interpretation No. 3, "Accounting for the Cost of Pension Plans Subject to the Employee Retirement Income Security Act of 1974."* For companies registered with the SEC, that agency has an additional reporting requirement--namely, the disclosure of unfunded past service costs.

In 1975, the task force for this project considered whether there was a need for any immediate amendments or additional interpretations of Opinion No. 8 (FASB Interpretation No. 3 having been previously issued) as a result of the passage of ERISA. Because many of the proposed areas for possible interpretations or amendments either required reconsideration of the fundamental conclusions expressed in the APB pronouncement or were

*The Subcommittee's staff has been provided with a copy of the Interpretation. If desired, additional copies can be provided.

related to matters that would be addressed in the project on employee benefit plans, it was concluded that the FASB would not proceed with any interpretations or amendments at that time. At a meeting in 1976, the task force considered a preliminary outline of a discussion memorandum with regard to reconsideration of Opinion No. 8. However, following the public hearing on accounting and reporting by employee benefit plans, it was concluded that first priority should be given to establishing standards for defined benefit pension plans, not only because of ERISA's reporting requirements but also because a critical issue in the reconsideration of Opinion No. 8 is the nature of the employer's obligation for its pension plans. The possibility of and conditions for a contingent employer liability insurance program under ERISA have not been decided by the Pension Benefit Guaranty Corporation. The nature of an employer's obligation could be significantly affected by such a program. In addition, the Board has on its technical agenda a project that is intended to establish a conceptual framework for financial accounting and reporting. Within that project, the Board is addressing the nature of accounting liabilities.

Although top priority has been given by the Board to the defined benefit pension plan project, progress has also been made in resolving issues related to the project on accounting by employers for pension plans. Following and perhaps concurrent with the completion of the defined benefit pension plan project, the Board expects to place a high priority on completing its due process for reconsidering Opinion No. 8. An initial phase of that process will be the development of a discussion memorandum to address the various issues to be resolved. Those issues will include the issues enumerated in the Subcommittee's press release that pertain to accounting by employers.

In addition, the Board will be considering the appropriateness of issuing, following completion of the defined benefit pension plan project, an amendment of the disclosure requirements of Opinion No. 8. The possible amendment would require uniform disclosures based on the financial status of the employer's pension plans as reflected in the plans' financial reports. That amendment would be an interim step that would be withdrawn when a comprehensive final Statement is issued that addresses the accounting and reporting by employers for pension plans.

Concluding Comments

The Board is keenly aware of the need to improve financial reporting relating to pension plans. As highlighted in this submission, the Board is in the midst of two projects aimed at meeting that need. The Board is confident that the issues relating to reporting by pension plans and their sponsors can be effectively resolved by the private sector's standard-setting process in a manner that will best serve the public interest.

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FINANCIAL EXECUTIVES INSTITUTE
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CHARLES C HORNBOSTEL
PRESIDENT

September 5, 1978

The Honorable Harrison A. Williams, Jr.
Chairman
Subcommittee on Labor
Committee on Human Resources
United States Senate
352 Russell Senate Office Building
Washington, D. C. 20510

Dear Senator Williams:

Financial Executives Institute (FEI) wishes to comment on Senate Bill S.2992, which would require the Secretary of the Treasury to promulgate uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions used in such calculations.

FEI is a professional organization of independent financial executives who represent companies in virtually every segment of the United States economy. FEI strongly supports maintaining in the private sector the functions of establishing financial accounting and reporting standards. FEI believes that the professional organizations responsible for the standard-setting functions in the private sector have been effective in meeting the needs of the users of financial accounting and reporting data.

Specifically, with respect to the objectives of S.2992, the Financial Accounting Standards Board (FASB) already has under development uniform standards for accounting and reporting by defined benefit pension plans. The FASB has followed extensive due process procedures involving input from and dialogue with the many parties at interest in this area, including the Department of Labor, and is scheduled to issue a final Statement of Financial Accounting Standards applicable to the preparation of pension plan financial statements for 1979.

Page Two September 5, 1978

FEI believes the FASB's project in this area is responsive to your concerns for improving the quality of pension accounting and reporting standards, and that the FASB efforts, with subsequent monitoring of results by both the Securities and Exchange Commission and the users of the financial reports, should precede further legislation in this area. Accordingly, we urge that action on Senate Bill S.2992 be postponed pending completion of the FASB project.

Sincerely,

C. C. Hornbostel

cc: The Honorable W. Michael Blumenthal
Secretary of the Treasury
The Honorable Ray Marshall
Secretary of Labor
The Honorable Harold M. Williams, Chairman
Securities and Exchange Commission
Mr. Donald J. Kirk, Chairman
Financial Accounting Standards Board

CCH:dmd

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June 23, 1978

The Honorable Harrison A. Williams, Jr.
United States Senator
Russell Senate Office Building, Room 352
Washington, D.C. 20510

Dear Senator:

Our company has been involved in writing insurance and annuity programs in connection with all types of employee benefits for a long, long time. As a result, we have been deeply involved in the implementation of ERISA with respect to these plans. We have been concerned about the duplication and administrative problems that such a complex piece of legislation has imposed upon this very important part of our employed citizen's economic well-being. Thus, we were extremely interested in your proposed ERISA Improvements Act. We have now had an opportunity to review that proposal and would like to offer a number of comments regarding it.

Generally, we are extremely happy that you have taken the initiative to clear up some of the duplication and ambiguity that exists in the present legislative scheme. We also believe that the single administrative responsibility concept contained in the proposal to establish an Employees Benefit Commission has a great deal of merit. Finally, we think that the encouragement of plan improvements through improved tax credits is a good idea.

We would now like to make some specific comments by section of the bill:

Title	Section	
I	122	While not critical, the policy statement made in section 201(a) is very good and we would recommend that this statement be added to section 122(d). This might set a goal for the Commission of fostering the establishment and operation of employee benefit plans.
	123(c)	We support the concept of consolidating all functions under the new Employee Benefit Commission (EBC). However, we would like to say that the PBGC appears to be functioning smoothly at this time and there would seem to be little reason to transfer this operation into the new organization. Such a move might cause delays in getting the EBC off the ground and result in excessive costs and, what is worse, might result in a deterioration in services from the PBGC.

The Honorable Jacob K. Javits
Washington, D. C.
June 23, 1978

Title	Section	
	124(b)(2)	The terms "significantly earlier participation" and "significantly more rapid" are very ambiguous terms which could result in great confusion in the regulatory body charged with carrying it out, as well as the industry which must attempt to cope with the law. As a result, we would encourage Congress to set out those standards in the bill which they would hope to achieve as a result of the inducements granted in the Act. We suspect that you have some thought of what those minimums ought to be and it would be good for everyone to know the goals when they are set.
II	201	The definition of "employees' beneficiary association" contained in 201(b)(1)(B) is too broad in our opinion. It would bring under ERISA's jurisdiction many kinds of associations of employees which are more or less professional organizations which are not directly related to the employer-employee relationship. We are not sure what problem in the current definition this new definition is intended to correct. I am sure, however, we don't believe that the wide array of employee associations or professional associations should be brought into ERISA. If a problem exists with certain associations which have been formed to market benefit plans they can probably be addressed with more specific language.
		In section 201(b)(2)(B) the statement concerning persons providing professional services to a plan ought to be more specific. Again, we would like to know the problem which is being addressed and perhaps more specific language could be used to clarify the kinds of prohibited transactions which are being dealt with.
	221	We would recommend that the language in section [105(c)(3)] be changed to provide that the penaltyof $10 for each employee who fails to receive required information "may be assessed." I do not believe the penalty should be automatic, but should be one which is imposed only after a determination that there has been a lack of reasonable cause.
	222	We recommend that the word necessary be deleted from section 110(1). This would give the Secretary more flexibility in granting exemptions.

AMERICAN LIFE
COMPANY ST. LOUIS

PAGE 3

The Honorable Jacob K. Javits
Washington, D. C.
June 23, 1978

Title	Section	
	231	This section provides a method for portability between collective bargaining plans. While this has much merit, we believe that any system for something this complex should be very specific. In addition, it should address potential problems which might exist in any such arrangement with the funding requirements of Title II of ERISA.
	236	This section provides for correcting amendments to plans which are adopted before final regulations are available. Apparently, however, it deals only with Title I. We recommend that such correcting amendments also should be permitted under Title II of ERISA.
	238	The joint and survivor annuity provision under ERISA is already a problem. The entire concept ignores the fact that a great majority of plan participants have, in addition to their benefits under a pension plan, group life insurance which is intended to provide their death benefit. This amendment would further complicate that problem by adding many rather small benefits which are deferred for many years. The small advantage for plan participants would be far outweighed by the administrative complexity. In addition, the existing provisions of ERISA provide that increased costs resulting from the election can be charged against the participant. This section has been inadvertently deleted under the new section 205 of ERISA.
	251	This section is extremely confusing and it would appear to allow manipulation of fund arrangements without any overriding need to permit that manipulation. On the other hand, it could be interpreted to reach an opposite result. Thus, we think this should be clarified in the context of the "need" which the drafters were attempting to deal with.
	261	We are opposed to the new section 401(b) of ERISA as contained in this proposal. We would prefer that the language now contained in section 401(b) of ERISA be maintained. It is clear in our mind that the existing wording deals with the kinds of contracts that insurance companies issue as opposed to the benefits being provided by the plan. We would prefer language such as the following: "In the case of a plan to which a policy or contract

The Honorable Jacob K. Javits
Washington, D. C.
June 23, 1978

Title	Section	
	261 (cont'd)	is issued by an insurer, the assets of the plan shall be deemed to include such policy or contract, but shall not solely by reason of the issuance of the policy be deemed to include any assets of such insurer; provided, however, that this provision shall not apply to any policy or contract pursuant to which assets are maintained by the insurer in one or more separate accounts." Our intent here is to make it clear that we would not be fiduciaries with respect to amounts held under contracts out of our general account.
	266	This section attempts to give regulatory authority to the Secretary regarding many of the recently established multiple employer trusts. We believe, however, that the language is much too broad and might include other kinds of arrangements which should not be subject to federally established reserve requirements.
	303	We believe that this section should make it clear that the deduction is applicable to voluntary employee contributions and not to mandatory contributions. In addition, we would recommend that the time the contribution is deemed to have been made is the time of the due date for the individual's tax return rather than on the last day of the taxable year.
	304	We were not able to determine why the credit would not be allowed as a carry-forward if it could not be currently utilized. Perhaps this could be clarified or changed.

Finally, we would like to recommend that a clear statement should be made in the Act that an employer or plan administrator will not be required to furnish information with respect to a plan transaction to more than one agency. We also think that it should be clear in the event of a conflict between the EBC regulations and the regulations of any other regulatory agency, that the regulations of the EBC would take precedence.

In conclusion, we would like to again commend you on having taken an interest in clarifying and simplifying the problems of ERISA and we would hope that you might be able to obtain passage of this legislation in the near future.

Sincerely,

MS

Milton F. Svetanics

dl

cc: Senators Eagleton and Danforth and Congressman Gephardt
American Council of Life Insurance

Hansen

A. S. Hansen, inc. First International Building, Suite 2020 • Dallas, Texas 75270 • Telephone 214-748-0501

WILLIAM N. BRET
Chairman of the Board

1978 SEP 11 AM 11 35
COMMITTEE ON
HUMAN RESOURCES

7 September, 1978

Senator Harrison A. Williams
352 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Williams:

Enclosed is a report on employer liability that we have just furnished to the PBGC, at their request. We believe it offers solutions to the multi-employer problems and should be most seriously considered by you and your committee.

With best regards,

Sincerely,

A. S. HANSEN, INC.

William N. Bret

William N. Bret

WNB:MAB

Enclosure:

197: SEP 11 AM 10 37
SENATOR
WILLIAMS, N.J.

Comments and Recommendations by A. S. Hansen, inc.

PENSION BENEFIT GUARANTY CORPORATION MULTIEMPLOYER STUDY ON PLAN TERMINATION INSURANCE

August 25, 1978

Comments and Recommendations
by A. S. Hansen, Inc.

PENSION BENEFIT GUARANTY CORPORATION
MULTIEMPLOYER STUDY ON
PLAN TERMINATION INSURANCE

The PBGC study on plan termination insurance recommends a change in the definition of multiemployer plans. If adopted, the new definition would bring under the PBGC multiemployer type of plan termination insurance coverage more plans than ERISA originally contemplated. We agree with and support this concept and recommend that it be expanded even further. Rather than using "multiemployer" as the category, (that is, two or more employers), we recommend the category be all plans established under Section 302 of the Labor Relations Act of 1974 as defined in ERISA -- Section 3, paragraph 16(B), "plans established or maintained by one or more employers and one or more employee organizations". The plan sponsor in these cases is a joint board of trustees. This would bring under the scope of this program plans to which only one employer contributed if (a) the collective bargaining agreement provided that employer contributions were required only during the period of the agreement, and (b) a joint board of trustees had responsibility for the plan. Hansen's comments and recommendations are based upon the premise of this redefinition.

Difficulties with PBGC Recommendations

The PBGC study presents thirteen alternative approaches for insuring, or providing reorganization assistance, for multiemployer plans, with estimated premiums for each. Six relate to the employer liability of up to 30% of net worth being applicable to terminations of multiemployer plans and six to an alternative of 100% of net worth being applicable to such plans. The thirteenth alternative contains no net worth liability and no benefit insurance, but provides financial assistance to plans under certain conditions. We recommend that this latter alternative be rejected on the basis that if the PBGC guarantees benefits for single employer plan participants, (approximately 75% of all participants in qualified pension plans), it is desirable and in the public interest for a corresponding guarantee to be available for the 25% of participants belonging to multiemployer plans (that is, jointly-trusteed plans, even if only one employer is involved).

Hansen

The other twelve alternatives all presuppose that the net worth of a terminating employer will be available, in varying degrees, to guarantee benefits. Whatever the merits may be for such liability in the case of unilateral single-employer plans, we believe the net worth liability approach is structurally unsound and impractical for multiemployer plans and will contribute to their instability. Our reasons for this conclusion are:

(a) An individual employer is not a "sponsor" of a jointly-trusteed or multiemployer plan, as these plans are organized, and as defined in ERISA. A few employer appointees may act as trustees for these funds, but they do not represent the employer -- they represent the participants and beneficiaries. Employers are not responsible at the corporate board-of-directors level for the design of the program, the investment of the funds, or the administration of the funds, as they are for plans they sponsor.

(b) Collective bargaining agreements almost invariably provide that the employer's responsibility is limited to making contributions based upon a formula related to employee work and selected non-working periods during the period of the contract. Other than providing these monies and appropriate reports to a designated fund agreed to in the collective bargaining agreement, the employer has no further responsibility. Any ERISA or PBGC modifications to this collective bargaining arrangement interferes with a bargaining process long established in our labor history. Such interference would restrict the freedom of action of the employer, employees, and union in the collective bargaining process, so that determinations of economic working conditions, terms of contracts, and union representation will be significantly modified.

(c) Most industries which institute multiemployer plans are characterized by significant mobility of employees, with participants transferring from employer to employer as jobs are completed and new ones created. The basic characteristic is representation by the union for a type of work in a given region, based upon contracts with employers who may move in and out of the area and industry. Binding the employer to long-term commitments beyond the period of hire for the employee is impractical.

We recommend elimination of employer liability, and, in our opinion, this would be advantageous to employers, unions, and funds for the following reasons:

(a) More than 50% of multiemployer funds are in the construction industry. A contractor can do business only if bank loans and bonding are available to assure that contracts can be fulfilled. Contractual contributions during the period of the bargaining agreement create no difficulty, but additional commitments of unknown amounts, related to fund operations over which the contractor has little or no control, could be catastrophic. Employers in other industries where these types of funds are prevalent would have similar difficulties.

(b) This difficulty will encourage or even force some employers to go "non-union" to stay in business. It would have an extremely negative effect on the union's ability to be recognized as the representative of the employees. Bargaining a known amount for a known period has been necessary, since employees must move from one employer to another based upon the employer who is the most successful on a contract.

(c) Employer liability will force withdrawals of employers and participants from funds -- a threat to pension funds. A reduction in active membership and in new contributions is the most frequent reason for fund collapse. Withdrawals may occur by joint agreement between the employer and the union. When funds must be abandoned, the employer may use other employee benefit approaches or decide to operate in a "non-union" or "open shop" environment, without pension liability commitments.

Are Multiemployer Plans a Viable Alternative?

The PBGC study's data, statistics and analysis provides valuable information. One could conclude from the summary, however, that the future of multiemployer plans is dim. We disagree! As indicated in the study, few plans have been in financial difficulty in the past. They have made a significant contribution to the private pension field and should continue to do so. While most plans are sound and progressive, some have been severely impacted in recent years. Some of the difficulties have occurred because of ERISA, such as costs of vesting, coverage of employees who worked less than full time, and additional administrative and reporting requirements. Investment performance has generally been below expectations in recent years, as in almost all pension funds, further straining resources.

In some funds, benefit promises have been too high, particularly to those retired or near retirement, and have often been based on service for which no employer contributions (or lesser contributions) were made. These promises were made upon the expectation of the same level of active employee participants and hours worked per year, on which new contributions would be received, continuing in the future.

However, corrective measures are readily available. We believe the funds are an important part of the long range security for 8,000,000 workers. Necessary modifications can and should be made as quickly as possible. Strong viable funds (the majority) should not be further impacted by high premium rates or employer liability or they too may have difficulties.

Properly designed plans would be more financially secure if they cover more employers and a wider geographical area. This would reduce risks related to the financial problems of any individual employer, and local economic difficulties. There are too many small programs with fewer than 500 participants. The administration of multiemployer plans is complex. Administrative costs, as a percent of contributions, are generally excessive for smaller groups. We agree that mergers and consolidations should be encouraged, provided they enhance plan continuance prospects and are in accordance with good business purposes.

We believe it is necessary to develop an approach, by modification of the statute and by regulation, whereby plans may be maintained on a sound basis with appropriate controls so that benefits for employees can be protected at a reasonable insurance risk without employer commitment beyond that covered by the bargaining agreement.

Our Recommendations for Multiemployer Plans

A. Funding

We recommend that the minimum funding approach be revised to require the larger of:

1) The present requirement of 40 years for amortization of the unfunded past service liability; amortization of experience losses over 20 twenty years, and amortization of any shortfall losses in accordance with the present approach, or

2) 15-year funding of the basic guaranteed benefit to be insured by the PBGC, at annuity prices developed by the PBGC for all programs. Any additional liability created by benefit improvements, changes in PBGC annuity rates, or changes in actuarial valuation of assets would be funded over 15 years from the years in which the event occurred. The definition of "insured benefit" should be modified by eliminating the minimum $20 monthly benefit increase per year and including only the 20% per year adjustment.

This recommendation is similar to the PBGC consideration of a Minimum Contribution Requirement. The PBGC recommended change to 30-year funding from 40-year funding is not included, because in our opinion it does not hit at the real issue of protection of insured benefits, particularly if the number of active participants is declining. It would limit, unnecessarily, the benefits which could be provided by sound viable funds.

An illustration of the approach is as follows:

Present Valuation Approach for Fund	Year 1
Past Service Liability	$21,437,000
Actuarial Value of Assets	8,200,000
Unfunded Past Service Liability	$13,237,000
Accumulated Experience Losses	1,200,000
Computation of Minimum Funding Standard:	
Normal Cost for Year	$ 1,870,000
40-Year Amortization of Unfunded Liability	880,000
20-Year Amortization of Losses	105,000
	$ 2,855,000

Minimum Insurance Funding

Case I - Normal mixture of actives, vested, retired.
Case II - Heavy concentration of old and retired due to declining workforce.

	Year 1	
	Case I	Case II
Value of Insured Benefits at PBGC Annuity Prices on Census Date	$15,690,000	$20,690,000
Less: Actuarial Value of Assets	8,200,000	8,200,000
Unfunded Insured Benefits	7,490,000	12,490,000
15-Year Amortization of Unfunded Liability	$ 771,000	$ 1,286,000
Expected Additions to Insured Benefits during Year	1,500,000	1,900,000
Insurance Funding Requirement	$ 2,271,000	$ 3,186,000
Minimum Requirement	$ 2,855,000	$ 3,186,000

In Case I, minimum insurance funding should remain less than 40-year funding approach unless:

a) benefit changes were made which heavily increased benefits to retirees or for past service of vested active participants (to be amortized over 15 years),

b) changes were made in PBGC annuity prices or the actuarial valuation of assets was reduced significantly due to market losses (market losses amortized over 20 years under present valuation basis compared to 15 years on insurance basis), or

c) there was a significant decline in contributions received due to reduction in hours worked or number of active participants (might be covered by use of shortfall method under present valuation approach with 15-year amortization compared to 1 year impact under insurance method).

In Case II, contributions would have to be increased or benefits reduced to place financing within Insurance Funding minimum.

It should be required that within one year of adoption of this approach the trustees would notify participating employers and the union as to the impact and increased contributions, if any, required to maintain present benefit promises. The program would go into effect twelve months after the conclusion of the next bargaining contract, but not longer than four years from the date of the change in the requirement.

If insufficient contributions were negotiated during the bargaining process, the trustees would be required to reduce benefits in accordance with the following alternatives:

(1) Reduce or eliminate benefits based on service prior to employer contributions for the participant. Such service should be eliminated or reduced equitably for retired, vested, and active participants.

(2) Provide a prorata reduction of all benefits for retirees, vested, and for the accrued benefits for the current, active group.

(3) A combination of the above.

B. <u>Design of PBGC Insurance and Financial Assistance</u> --

Our recommended concept of Insurance and Financial Assistance is three-phased, based upon the minimum insurance funding requirement. The three phases are:

1) Optional PBGC insurance for ten years, to give the minimum insurance funding requirement time to make most funds reasonably secure,

2) Compulsory PBGC insurance for all funds after ten years with a premium approach reflective of each fund's financial position,

3) Financial assistance for bridging temporary cash flow difficulties.

We recommend that during the ten-year period, PBGC shall provide insurance to funds only when it appears that a plan is "insurable" on a business risk basis. Objective underwriting considerations should be used, such as:

- Assets are x% of the value of insured benefits (such as 80% or more).
- Past and current contributions have met the minimum insurance funding requirements for a significant period of time, such as five years.
- National industry statistics indicate that the fund's participants have a reasonable opportunity of continuing.
- Statements of the enrolled actuary and the Board of Trustees confirm that there are reasonable expectancies that minimum insurance funding requirements can continue to be achieved.

The following is a suggested approach to implement this objective:

(1) The present PBGC premium of 50¢ per year per participant should be maintained for monitoring purposes and be chargeable to all plans whether or not they are insured.

(2) The PBGC should analyze each plan and determine, based upon criteria satisfactory to the PBGC, whether and when it would offer the insurance to the plan. During the ten-year period, the trustees of the plan would have the option of payment of the premium to be insured.

(3) When the PBGC determines that the plan is eligible for insurance within the ten-year period, it should provide such insurance using a premium rate under a uniform formula. A suggested formula for consideration would be an additional 50¢ per year per participant plus a uniform percentage per year of the outstanding unfunded insured benefits.

(4) The trustees of the plan will be required to submit annually to each participant, employer, and the union, a report including:

(i) The status of the fund as to insurability by the PBGC.

(ii) If the fund is accepted for insurability by the PBGC, an indication of whether or not the fund has elected the insurance.

(iii) A statement indicating the basis of the premium of the PBGC.

PBGC financial assistance to plans in the form of bridge loans should be permissible if, in the PBGC's opinion, there is a good potential for return of the loan with reasonable interest, due to bargained commitments which could include additional employer commitments for this purpose. In other words, PBGC financial assistance would be available only in the time lag between collective bargaining agreements or when the timing for reduction of benefits was such that there was a shortfall in the cash flow requiring additional temporary aid.

C. Employer Withdrawals

It is not realistic for the PBGC or ERISA to interfere with the employers, employees, or the union on their rights to bargain. This includes the employees' right to decertify the present union, select another union, or become a non-union group. Employer withdrawals cannot be unilateral, since the subject is a part of the bargaining process.

An employer may effectively withdraw and still be technically covered by the collective bargaining agreement by:

(1) Having no employees covered (either temporarily or permanently) due to no business of the type covered by the agreement, or

(2) Going out of business due to reorganization, sale, or bankruptcy.

In either situation, some or all of the employees may still be covered and contributions may be received by the fund by their working for another covered employer.

Thus, there may be no fund impact due to employer withdrawal. The impact may or may not be substantive. It may be positive or negative for the fund's future. The key issue is whether or not benefits promised can be protected without significant negative impact on the remaining participants.

Since the possibilities are so varied, it is recommended that decisions be made at the trustee level of the fund, on an equitable and uniform policy basis. Benefit adjustments may be required in some instances. Negotiations as to transfer of liabilities and assets to another multiemployer fund, or to an employer-sponsored fund, may be appropriate to protect both employee benefits and the remaining participants of the original fund.

It is recommended that each approach (i.e., adjustment in benefits or transfer of assets and liabilities) be considered a "reportable event" so that the PBGC would have the authority to monitor and approve the action taken as the insurer or potential insurer. Such an approval should be helpful to the trustees, as PBGC approval of the transaction should limit the potential trustee fiduciary liability in case of a challenge to the action.

If the trustees determine that no action should be taken, the effect of their decision will be reflected in the status of funding progress if the impact is significant.

D. Mergers and Transfers

We agree with the PBGC that the present rules for single-employer plans are unworkable for multiemployer plans. In our opinion, the PBGC recommendations on "plan continuation tests" and "business purpose tests" are appropriate and respond to the need to merge funds to achieve larger and more effective groups in the multiemployer field.

IBM

International Business Machines Corporation

Armonk, New York 10504
914/765—1900

August 22, 1978

Mr. Michael Stern, Staff Director
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D. C. 20510

Re: Written Testimony Regarding
Pension Simplification

Dear Mr. Stern:

As Plan Administrator of the IBM Employee Benefit Plans, I am pleased to submit the enclosed written testimony to the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Committee on Finance and to the Subcommittee on Labor of the Senate Committee on Human Resources. Our testimony contains comments regarding legislation to simplify the current laws and rules governing the private pension system in the United States.

In an effort to limit our comments to those items which are of primary concern to IBM, we have structured the attachment in accordance with the order of the sections in S.3017, with one exception. In our comments regarding section 274 of S.3017 regarding preemption, we also offer our comments regarding S.1383.

We stand ready to provide any further information which the Committees may request with regard to IBM's position on any of the matters covered in the attachment. Thank you for giving the opportunity for us to express our positions.

Very truly yours,

H. P. Kneen, Jr.
Director of Employee Benefits

/jaf
enclosure

Section 223. Elimination of Summary Annual Report

We support the elimination of this requirement as a significant reduction of the paperwork burden created by ERISA. We believe that the availability of the Form 5500 to an employee who wishes to review such material, adequately satisfies the need for disclosure of this type.

Section 226. Opinions of Actuaries and Accountants

We support the requirement that accountants and actuaries rely on the correctness of each other's opinions. This change should result in efficiency and reduced costs. There is no question but that choices are available to actuaries and accountants with relation to various aspects of retirement plans. Reasonable persons can reasonably differ, and both can be correct. This change will eliminate the cost to the plan sponsor of the time spent by actuaries and accountants in debating which of two correct methods might be preferable under specific circumstances.

Section 238. Joint and Survivor Annuity

IBM strongly opposes this proposed provision. First, it is unclear that the present concepts of employee election and actuarial adjustments to avoid increased cost to the plan would be maintained. To do otherwise, would impose substantial additional financial burdens on companies and would represent a major departure from prior legislative intent. Second, we do not believe that the requirement to make a joint and survivor option available should be expanded to employees who are not eligible to retire. A requirement to provide survivor protection under a retirement plan to individuals not eligible to retire is inconsistent with the objective of the early survivor annuity as enacted presently. The objective of the present provision is to permit an employee eligible to retire with an immediate pension an opportunity to protect that pension for a spouse through actuarial adjustments - in the event that the employer continues employment and dies prior to actual retirement.

Section 273. Impact of Inflation on Retirement Benefits

We oppose any study leading toward legislation which would require companies to automatically increase benefits to retirees to offset the effects of inflation. We are fully aware of the erosion caused by inflation. We have chosen as free and responsible businessmen to initiate these changes for the good of those already retired, within the capacity of our business resources.

The IBM Retirement Plan has been improved twenty-one times since it was first announced in 1945. All these improvements have been passed on to retired employees. We stand on that record. Our approach to benefit design for persons who are still in our employment and for those now retired, incorporates design features to control automatic escalation. These controls force us to regularly reexamine our plan, measure changes within and without the company, reflect on our objectives and attainment. Burdensome as such repeated reexamination may be for us, we feel it is a much sounder and more responsible method to tailor responses to a changing environment rather than move thoughtlessly and without signficant control along an escalator formula.

Section 274. Preemption/S.1383 ERISA Preemption

IBM strongly supports the clarification which will result from the proposal in S.3017 to eliminate any applicability of the securities laws to the environment of employee benefit plans.

Even more so, we take this opportunity to urge the Congress to reiterate the clear language of §514 and its legislative history, and reject S.1383. Judicial encroachment of preemption cannot be permitted no matter how laudatory its objective might be enunciated in the narrow view of any advocate for the law of one particular state. As a company doing business in every U.S. jurisdiction, we can be subject to the inconsistent priorities of multitudinous state laws and agencies. §514 of ERISA permits us to provide a uniform set of benefits to over 180,000 active and retired employees. We deem our benefits programs to be among the best that are available to employees anywhere. Yet, we have been advised by state regulators that the laws of Hawaii, and states such as California, Minnesota, Connecticut and others would require us to change our benefits, regardless of whether such changes were appropriate in the context of IBM's relationship with its employees. This disarray of legislation, regardless of any laudatory intentions of state legislators, is fraught with needless complexity, fuels inflation and restricts the flow of interstate commerce. §514 is the solution and its language must be strengthened to avoid such unacceptable results as occurred in Wadsworth v. Whaland, 562 F. 2d 70 (1st Cir. 1977), cert. den., 46 U.S.L.W. 3545 (Apr. 18, 1978), where in order to comply with a New Hampshire insurance statute mandating mental health coverage in a medical benefits plan, the plan administrator was forced to discontinue other benefits. §514 was intended to prevent such intrusions by states into the area of employee benefit plans and erroneous construction of the statute and its legislative history must not be permitted to go on unchecked.

Section 303. Deductions for Employee Contributions to Qualified Plans

The complexities of the proposal are substantial. We provide defined retirement income benefits on a noncontributory basis. Section 303 specifies treating employee contributions as individual accounts which means, in effect, a defined contribution plan. We would face the complexities of the dual system for planning, funding, communication and administration.

Our conclusion is that the goal of this provision is better achieved by permitting employees to deposit tax deductible limited contributions into financial instruments for retirement income purposes (e.g. IRA's) and to permit tax free growth of such deposits until withdrawn. The growth in investment capital will be local and significant.

Section 305. Credit for the Improvement of Qualified Retirement Plans

IBM questions the concept of rewarding through decreased taxes those plan sponsors who maintain minimal plans as an incentive to cause such sponsors to make plan improvements. The cost of such tax credits eventually will be borne by those plan sponsors who have been improving their plans regularly in the past.

Additionally, the administrative complexities of this proposal may render it impossible to implement as one can note from the basic difficulty of trying to define what type of action constitutes "an improvement" or how much it costs.

ILWU
INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S UNION
LOCAL OFFICE 451 ATKINSON DRIVE • HONOLULU HAWAII 96814 • PHONE 949-4161
HAWAII DIVISION 100 West Lanikaula St Hilo Hawaii 96720 • OAHU DIVISION 451 Atkinson Drive Honolulu, Hawaii 96814
MAUI COUNTY DIVISION Lower Main Street Wailuku Maui 96793 • KAUAI DIVISION P O Box 1910 Lihue Kauai 96766
LOCAL 142

August 4, 1978

The Honorable Harrison A. Williams
Chairman, Subcommittee on Labor
Committee on Human Resources
The United States Senate
Washington, D. C. 20510

The Honorable Lloyd Bentsen
Chairman, Private Pension Plans and
Employee Fringe Benefits
Senate Committee on Finance
The United States Senate
Washington, D. C. 20510

Gentlemen:

Local 142 of the International Longshoremen's and Warehousemen's Union fully supports the purpose, intent, and accomplishments of the Hawaii Prepaid Health Care Act.

Although the ILWU has succeeded in providing adequate health care for its members through collective bargaining, we are mindful that there are over two hundred thousand workers in Hawaii who do not have unions to protect their interests in this area and that these workers include a disproportionate number of low-paid, minimum wage employees. It is these workers who most need, and must not be deprived of, the protection the Prepaid Health Care Act provides.

These workers are now assured of comprehensive health care benefits at a cost they can afford, thereby improving the health and well-being of the entire community.

We commend the legislators of Hawaii for their courage and foresight in enacting this law and urge your prompt and favorable consideration of S. 1383.

Respectfully submitted,

Carl Damaso

Carl Damaso, President
ILWU LOCAL 142

CD:bw

cc: Joshua Agsalud, Director - Hawaii State Department of Labor
howu

IPCO, Incorporated
475 Park Avenue South
15th Floor
New York, N.Y. 10016
Phone: (212) 894-0552
SPECIALISTS IN MODERNIZING
RETIREMENT PLAN SERVICES
INSTITUTIONAL PENSION CONSULTANTS

July 27, 1978

Mr. Steven Sacher
c/o Senator Harrison J. Williams
352 Russell Senate Office Bldg.
Washington, D.C. 20510

Dear Mr. Sacher:

Enclosed are my comments to you on S-3017. I understand from speaking to John David Allen, my Washington representative, that the number of persons appearing personally to offer their comments will be of such a great number as to preclude the opportunity of my appearing. Although I would have welcomed the opportunity to have appeared, and to have been available at that time for any questions which may have been posed, I recognize the time and scheduling constraints associated with Congressional hearings. I hope, however, that you will read the enclosed material and take it into consideration in the further development of this important legislation.

Since I will not be appearing, I have taken this opportunity to schedule myself for some minor surgery which will make it impossible for me to attend. I am asking Mr. Allen to attend in my absence so that we may hear, first hand, what the thoughts of the other commentators will be.

I look forward to discussing these and other related matters with you in the future, and will attempt to make myself available to the extent necessary.

Sincerely,

Ralph N. George, Jr.
President

COMMENTS ON S.3017 (THE WILLIAMS-JAVITS BILL)

INTRODUCTION

Gentlemen, my name is Ralph George. I am President of IPCO Institutional Pension Consultants, Inc., a pension consulting firm serving financial institutions nationally through our offices in New York, Massachusetts, and here in Washington. I am also the Executive Director of the National Retirement Plans Training Conference Inc., a non-profit association of financial institutions dedicated to the enhancement of employee benefit services funded through financial institutions.

Among other things, our organization attempts to provide assistance to the U. S. League of Savings Associations, the American Banker's Association, the National Association of Mutual Savings Banks and the Credit Union National Association with respect to legislative and administrative considerations affecting these plans.

Since the passage of ERISA, the members of these national trade associations, which represent over 80% of the financial institutions in the nation and over 90% of the assets, have become increasingly interested in developments in this area. Under ERISA, certain of those developments (including the following) have resulted in substantial deposit inflows over the last four years.

1. The increase in the Keogh limit from \$2500 a year to \$7500 a year.

2. The advent of Contributory IRAs, with their \$1500 annual limit.

3. The advent of Rollover IRAs, with their virtually limitless potential.

One would think, that since the small businessman on the one hand, and the average American on the other, is affected by these provisions, an effort would have been made to assure the simplicity of these laws. Quite the contrary. Lurking among the shadows of these seemingly innocuous sections of the Internal Revenue Code are "beasties", which make Lewis Carroll's famous Jabberwocky seem as tame as Mickey Mouse.

There is a strong desire among financial institutions to see order brought to this chaos. Keogh and IRA accounts represent one of the most important sources of stable, long-term savings deposits. The federal banking regulatory authorities have recently taken a number of steps to stem the flow of deposits out of savings accounts. Unfortunately, disintermediation continues, and the availability of funds for the mortgage market diminishes. Some institutions have found that as much as 35% of their new deposits are coming from these accounts. One of the largest thrift institutions in the country, which has been actively marketing these accounts, announced in their 1977 published financial statements that their Keogh/IRA deposits as of year-end totalled $173 million. This figure represents an increase of $58 million over the prior year-end totals for that institution; or about enough for 1,450 mortgages of $40,000 a piece. Official industry-wide statistics are not available, but we have obtained some unofficial information from the files of the Federal Home Loan Bank Board and the Federal Reserve Board.

Savings & Loan Associations	Total Deposits
Keogh	$1.5 Billion
IRA	3.2 Billion
(As of 3/31/78)	

Banks	Total Deposits
Keogh and IRA Accounts	$2.1 Billion
(Based on 560 Banks reporting)	

The need for there to be a reasonable investment alternative for the small plan is an important reason for active participation on the part of thrift institutions (including the savings departments of commercial banks). The average trust department finds these clients' assets to be too small to be profitable. The alternatives are mutual funds or insurance. Many people seeking fixed income investments with a reasonable return and no burdensome sales charges have opted for savings certificates.

But now let's look at the problem itself. When ERISA was signed into law on the White House lawn on September 2, 1974 some problems were solved, but many new ones were created, and still others were perpetuated. The Williams-Javits bill is entitled "The ERISA Improvements Act of 1978". This important piece of legislation should be drafted with care, utilizing all of the technology that is available in the field. The resulting edifice should be one of which we can all be proud; rather than stop-gap legislation, which is no better than a little Dutch boy trying to plug a hole in a dike. One of the aims of such legislation should be to promote retirement planning on the part of individuals and small businesses.

KEOGH PLANS

In analyzing this subject, one must recall Congress' concern at the time HR-10 was enacted in 1962. There was fear that self-employed individuals might abuse their discretion and utilize Keogh accounts as tax sheltered "pocket books". Reaction to this concern was evidenced by the providing of lower contribution and deduction limitations for owner-employees; the imposition of more restrictive vesting provisions; the prohibition on distributions to owner-employees prior to their attaining age 59 1/2; the requirement that distributions to owner-employees begin at age 70 1/2; the inclusion of transfers for estate and gift tax purposes; and the differential between self-employeds and common-law employees in the taxation of lump-sum distributions. In 1974, we saw this philosophy further perpetuated by the restrictions on rollovers by self-employed individuals.

Many of these restrictions have since disappeared, while others have remained as vestages of an antiquated philosophy... the Keogh contribution and deduction limitations have increased, while the corporate limitations have decreased...it is now possible to have transfers excluded for purpose of the federal estate and gift taxes...there is now parity with corporate plans in the treatment of lump-sum distributions.

Anyone worth his salt knows that the remaining restrictions can be eliminated by incorporating. In fact, a major portion of the small corporations in this country were created merely to avail their owners of the more flexible retirement plan provisions. Although many of the original restrictions were developed during a period when certain professionals (doctors, lawyers, accountants) were not permitted by the laws of their states to incorporate; in the years since 1962, all 50 states have adopted some form of professional corporation law which allows for even these groups to incorporate.

In corporate plans, the principal is neither precluded from taking a distribution prior to his attaining age 59 1/2, nor is he penalized for having taken such a distribution. Even in the case of IRAs, which Congress for some reason designed as the ultimate tax sheltered pocket book, the participant is not prohibited from taking a distribution prior to attaining age 59 1/2, he is merely penalized with the 10% excise tax.

Under the laws, as they presently exist, <u>ANYONE</u> adopting a Keogh rather than a corporate plan is either <u>ill-advised</u>, not very bright, or just lazy. I say this for one reason, if for none other - the absolute prohibition against distributions to an owner-employee in a Keogh Plan prior to his attaining the age of 59 1/2 is an unnecessary burden. What makes the propensities of the unincorporated businessman such, that the rights to his benefits should be so much more restricted than those of an individual in a one-man corporation? Many years of experience have shown us that the corporate counterpart has not abused his privileges. We should anticipate no greater abuse on the part of self-employeds.

The law was amended under ERISA to allow a "mini Keogh" contribution of the lesser of 100% of one's earnings or $750. It was discovered that, as drafted, this provision conflicted with the limitation on additions under §415 of the Code. This was remedied under the Tax Reform Act of 1976; but the new provision limited the availability of that provision to persons with adjusted gross income of no more than $15,000. The practical effect was the virtual inapplicability of this provision, since the average person earning less than $15,000 cannot afford to take advantage of this provision. In fact, it has resulted in a windfall to those in higher income brackets. Where, for example, one spouse is the major wage earner and the second is self-employed part-time, to either supplement the income or to occupy the hours, the income of the second spouse is eligible for a mini Keogh contribution. We believe that the $15,000 earnings limitation was not part of the original intent, and that it does not serve the purpose of eliminating a tax benefit for the highly compensated.

Also, there appears to be a technical infirmity with this section. It appears to allow for the making of mini Keogh contributions on behalf of common-law employees, while §404 still limits the annual deductible contribution on behalf of common-law employees to 15% of their aggregate compensation. This suggests that, were a mini Keogh contribution made on behalf of a common-law employee, the difference between the §404 limitation and the amount contributed would be an excess contribution, which is not currently deductible and which is subject to an annual 6% penalty.

The many problems with Keogh Plans are further complicated by a lack of case law. Neither the general public, nor their counsel, is able to determine many of the answers to their questions. They can only guess, and often incorrectly.

Congress should not be bound by archaic concepts; now is the time for a renaissance. Keogh Plans should be treated basically the same as corporate plans. Section 401(d) and the subsections under Section 401(a) which deal with Keogh Plans should be repealed, or at least, suitably revised.

IRA PLANS

The "simple world of IRAs" has proven to be one of the most complex and confusing provisions in the law. The following is a list of items which require attention so that these plans can be handled on a more sane and orderly basis.

1. Double taxation of excess contributions: This is by far the most critical item. The following examples will illustrate the problem.

> Example 1: X makes a $1500 contribution in 1977. It is later determined that his deduction is limited to $1400, resulting in a $100 excess contribution. He now wishes to withdraw the $100 excess, but for some reason he does ot take the distribution until April 16, 1978 (after the tax return due date). §408 requires him to include the $100 in his 1978 income. This means that he has paid tax on the same $100 twice; since it was already included in his 1977

income and since contributions in excess of the limitation may not be deducted.

Example 2: Y receives a lump-sum distribution in 1977 from his former employer's profit-sharing plan in the amount of $200,000. He rolls it over into an IRA, but completes the transaction on the 61st day after he received the distribution (beyond the required 60 day period.) As a result, the distribution does not qualify for rollover treatment. However, the disqualification is not discovered until he is audited in 1979. Since this amount which was "contributed" into an IRA, is not a rollover, the question arises whether it is an excess contribution. If it is, and since it was not removed from the account by April 15, 1978, the same double taxation might apply. In other words, the $200,000 would be included in X's income in 1977 under §402 and again in 1979 (the year of the distribution from the IRA) under §408. It's conceivable in such a case, especially with the possible state and local income tax impact, for a person to pay an effective tax rate of more than 100% of the amount distributed. We believe the federal income tax laws were designed to tax income. This is clearly the taxation of capital.

2. The requirement that distributions begin within 5 years of death, rather than within 5 years of notice of death: The problem here is that, on the one hand, the trustee may be unaware of the participant's death; and on the other hand, the beneficiary may be unaware of the existence of the account. Under §4974, failure to make a timely distribution would result in a 50% penalty. This could result in a beneficiary, who is entitled to the balance in a $300,000 rollover account, paying a $150,000 penalty. We believe the statute should be amended to require distribution within 5 years after the trustee knows or reasonably should know of the participant's death; or within 5 years after any beneficiary with knowledge of the existence of the account knows or reasonably should know of the participant's death; whichever is earlier.

3. The inequities which exist with respect to the requirement that a person not be an "active participant" in a qualified or governmental plan: This loosely defined statement is frought with problems, one of which we will attempt to highlight. Although an employee may be participating under his employer's profit-sharing plan, his employer may elect not to make any contributions to the plan on his behalf in a particular year. So long as that employer's contributions into that plan are considered "substantial and recurring", this is allowed. In some cases, this type of election may even extend over several years. But, so long as that employee is eligible to have a contribution made on his behalf under his employer's plan, he is deemed to be an active participant and is, therefore, ineligible to make a

deductible contribution into an IRA on his own behalf, even in those years in which his employer made no contributions to his account.

4. The need for the institution of Limited Employee Retirement Accounts (LERAs) which would allow limited contributions on behalf of certain employees currently participating under qualified plans: It is our strong belief that the LERA concept must come into being. The present law denies many individuals who need IRAs the right to establish them because small amounts are being contributed into plans on their behalf. In fact, in some instances, a person may never receive any benefit from contributions made by his employer, and still be unable to set aside amounts toward his own retirement. This is especially true in the case of certain social security integrated plans. (The Administration proposal with respect to integrated plans reduces this problem to a limited extent.) This is also true in the case of an employee participating under a plan with a 10 year "cliff" vesting formula. Even if the employee is certain that he will not be around for 10 years to acquire a vested interest in the plan, he is still considered to be an active participant in a qualified plan and is therefore ineligible to make a deductible contribution into an IRA. We understand that one of the reasons why LERAs did not come into being under the Tax Reform Act of 1976 was the problem of determining the allowable IRA contribution for a person participating under a defined benefit pension plan. §303 of the Williams-Javits bill allows for the making of deductible contributions into an employer's plan. This concept should allow for the making of similar contributions into a LERA, as an alternative to contributing into the employer's plan. This would cover those situations where the participant is not satisfied with the funding vehicle under the employer's plan.

5. The need to amend the provision that imposes the 6% excess contribution penalty on all contributions in excess of $1,500: The law states that the 6% penalty could be avoided to the extent that the excess contribution and earnings are withdrawn before the due date for the filing of the federal income tax return, including any extensions. This rule does not apply to the extent that the contribution exceeds $1,500. Two problems come to mind. A person may have made a contribution into his own IRA, and his employer may subsequently decide to make a contribution on his behalf into an employer IRA in the same year. To the extent that the combined amount exceeds $1,500, the employee will be subject to a 6% penalty. The second situation involves rollovers. As discussed earlier, a rollover which fails to qualify may be an excess contribution. To the extent that the rollover exceeds $1,500, the 6% penalty may not be avoided.

RELATIONSHIP BETWEEN KEOGH AND IRA ACCOUNTS

We believe that an attempt should be made toward an integration of concept between IRAs, Keogh Plans, and Corporate Plans. At present, the rules are very similar, but different enough to cause confusion. Let's take a look at some of these:

1. The inconsistency between Keogh and IRA plans with respect to the treatment of excess contributions: In the IRA situation, excess contributions may be corrected up to the due date for filing the federal income tax return (including extensions). Apparently, once a Keogh excess contribution has been made, the 6% penalty cannot be avoided. On the other hand, the cumulative effect of the penalty for Keogh plans can be avoided by either withdrawal or undercontribution; while undercontribution in the case of IRA plans apparently results in the loss of certain deductions, since the IRA deduction is limited to the amount contributed during the year. (This is another point which has not been clearly interpreted by the IRS.)

2. The inconsistency between Keogh and IRA plans with respect to the time when contributions may be made: Why is February 14th the last day for making IRA contributions, while ~~ril 15th is the last day for Keogh and Corporate contributions? It would seem that a self-employed person making an IRA contribution does not need any less time than a self-employed person making a Keogh Plan contribution?

3. The difference in the treatment of Keogh and IRA distributions before age 59 1/2: Why are Keogh plan distributions to owner-employees before the attainment of age 59 1/2 totally prohibited under §401, while IRA distributions before age 59 1/2 are only subject to a 10% penalty under §408.

4. Why are Keogh Plan distributions subject to the "doctrine of constructive receipt", while IRA distributions are not?: I think the fact that there is no application of the "doctrine" of constructive receipt" with respect to IRAs, leaves the IRA open to quite a bit of tax abuse. A person could put an amount into an IRA in a year in which his income is in a higher tax bracket; then in any future year, if he has substantial losses, he could take whatever he wants out. Moreover, if he has attained the age of 59 1/2, there is no penalty. I think this illustrates one of the areas where there is a disproportionate advantage in favor of the highly compensated.

5. Keogh and IRA distributions upon death are required to be made within 5 years or there must be an annuity "purchased": This latter requirement should be expanded to allow payments out of the trust over the life expectancy of the beneficiary or over the joint and survivors expectancies of the beneficiary and spouse.

This bill should incorporate the necessary amendments to §§72, 401, 408, 409, 219, 220 and any other section(s) necessary to remedy the aforementioned problems.

CONTENTS OF THE WILLIAMS-JAVITS BILL, #S-3017

Now that we have talked about those things which should be incorporated into the bill, let's take a look at the language in the bill itself, as it is presently drafted.

Form of Benefit Payments: Title II, Subtitle B Part 2, §238 requires any plan which "does not provide for the payment of benefits in the form of an annuity, with respect to any participant who under the plan has a nonforfeitable right to not less than 50 percent of his accrued benefit derived from employer contributions and who dies before receiving such percentage of his benefit which is nonforfeitable, such plan shall provide that the participant's account balance shall be distributed in the form of a lump-sum to the participant's surviving spouse not later than 60 days after the end of the plan year in which the participant died". This language appears to preclude the payment of benefits over a specified number of years. If this is true, it will be impossible to avoid the federal estate tax without having plan language which provides for a joint and survivor annuity. In other words, payments over a specified term, not to exceed the life expectancy, will no longer be allowed.

Lump-Sum Distribution: Title III, §301 alters the definition of lump-sum distribution in the case of a multi-employer plan. Since this definition is significant with respect to whether or not an individual is eligible to make a rollover, further attention should probably also be given to amending or expanding upon other concepts under §402(e)(4) of the Internal Revenue Code. Specifically, two elements come to mind:

1) Identification of "Lump-Sum Distributions". Except in the case of plan terminations, payments must meet the definition under §402(e)(4) of a lump-sum distribution in order to be eligible to be rolled over. Especially in those cases where an employer maintains several plans, the burden should be placed upon the employer at the time of the making of a distribution to advise the distributee of whether it qualifies as a lump-sum distribution. This would avoid his walking into an institution without prior knowledge of whether his distribution may be rolled over. Since Form 1099-R requires the payer to identify lump-sum distributions, and since the trustee of a particular plan may not have sufficient information to make such a determination, the responsibility to identify should be placed upon the employer.

2) Application of "the 5-Year Rule". The definition of lump-sum distribution is expanded under §402(e)(4)(H), which requires an individual to have been a participant in the plan for 5-years prior to the year of the distribution. It appears that this provision was included to limit the application of the 10-year income averaging rules. An unintended side effect was the limiting of rollovers. We believe that this should be corrected.

Deductible Employee Contributions: Title III, §303 requires all qualified plans to allow participants to make deductible contributions into such plans in an amount up to 10% of their earnings, not to exceed $1000. This bill allows both common-law employees and self-employeds to make these contributions. A person earning over $30,000 must reduce the $1000 deduction by 20% of the excess of his earnings over $30,000. Therefore, a person earning $35,000 or more would not be entitled to any deduction under this section. The $30,000 figure represents, not only earned income but, income from all sources which would be includible in a person's adjusted gross income. For example, a person earning $25,000 and receiving $10,000 in alimony would not be entitled to make a contribution. It should also be noted that, since a self-employed is allowed to make these contributions, even if he is the only participant in the plan, this effectively increases the contribution limitation of a self-employed earning $30,000 from $4500 to $5500. The statute fails to make reference to the effect, if any, of making a contribution greater than the limitation. We assume that this means that there are no excess contribution rules to deal with.

The bill automatically picked up the 45-day rule as the "time when contributions will be deemed made". This rule is just as faulty here as it is under the sections dealing with IRAs. We believe that contributions should be allowed up to the due date for the filing of the federal income tax return, including extensions.

Special Master & Prototype Plans: Under Title IV, §401, in an effort to encourage small businesses to adopt qualified plans, the bill provides for Special Master and Prototype (M & P) Plans. The rules pertaining to these plans are supplemental to the existing M & P provisions under the law.

The bill requires that all of the assets of a Special M & P Plan be under the control of an Investment Advisor [which includes a "bank"], as that term is defined under the Investment Advisors Act of 1940. In addition to commercial banks, that statute defines banks as ".... any other banking institution or trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which is supervised and examined by State or Federal authority having supervision over banks...." We assume that this includes not only banks and savings and loan associations, but credit unions as well.

Allocation of Responsibilities: One of the most important provisions of the bill deals with the allocation of responsibilities. In standard M & P plans, to which we have become accustomed, the sponsoring organization may or may not be designated Plan Administrator and/or Named Fiduciary. Under this bill, the "Master Sponsor" automatically assumes both of these responsibilities.

It is, therefore, important for us to identify the Master Sponsor. The Master Sponsor is apparently the institution which will be both submitting the plan to the IRS for approval, and serving as Investment Manager. This presents an interesting problem for the thrift industry. Eighty-five percent or more of all thrift institutions presently offering M & P plans are using plans which are sponsored, not by themselves, but by their state or national trade associations. Since so many individual institutions would obviously prefer to use plans developed by their trade associations, this part of the bill should be rewritten.

The responsibility of the "Employer Sponsor" is limited to the making of timely contributions; and the furnishing of such timely, complete and accurate information as is required in the plan. An Employer Sponsor is defined as any employer whose employees are participating in the plan. The Master Sponsor, as Plan Administrator, would have the responsibility, among other things, to prepare a Summary Plan Description. If there are variable provisions which may be selected by the employer in an adoption agreement, does this not impose an unreasonable burden upon the Master Sponsor to be sure the description properly summarizes the plan of each Employer Sponsor. Also, in the event of any discrepancy between the plan description and the plan itself which is held by a court of competant jurisdiction to extend the rights of a participant, will the Master Sponsor be responsible for this increased liability?

In addition, there may be at least one problem with the Master Sponsor's being designated Named Fiduciary, specifically in the context of Keogh Plans. There has been some concern among many financial institutions as to whether allowing a distribution to an owner-employee prior to his attaining the age of 59 1/2 might involve the institution in a prohibited transaction. A recent IRS private ruling indicates that if the institution is offering a plan which provides that distributions are made only pursuant to directions from the employer or from some other "Named Fiduciary", the institution will not be liable for following such directions. Might not an institution be foregoing its insulation by becoming Named Fiduciary? A possible answer to this might be in this bill's addition of new ERISA section 601(c)(5), which indicates that the Master Sponsor will not be responsible to determine "whether information (or possibly directions) required to be furnished to the Master Sponsor by an Employer Sponsor, pursuant to the terms of a Special Master Plan, is accurate or complete".

PLAN APPROVAL

Proposed §601(d) of ERISA provides an interesting dilemma. This section suggests that the Commission (the new entity which will take the place of the IRS in approving plans) will approve the Master Plan if each individual adopting employer would satisfy the requirements of the law, both as to design and as to that employer's operation. It looks like the cart has been put before the horse. At what point is it contemplated that a review can be made of the employer's operation if the plan has not yet been approved and, therefore, adopted by the employer.

The bill tries to limit the Master Sponsor's exposure by providing that, if the Employer Sponsor "fails to make such timely contributions and payments or fails to furnish such timely, complete and accurate information as may be required under the terms of a Special Master Plan", it results in the Employer Sponsor being deemed to be the Plan Administrator. From that point on, the Master Sponsor would cease being the Plan Administrator and Named Fiduciary with respect to that employer's employees. But is this sufficient in light of the fact that this provision appears to be very broad in scope, and might itself lead to some confusion.

We hope that these comments will encourage Congress to move with care in drafting its provisions. There is no doubt that the paperwork problems should be resolved with haste, but the other matters must be dealt with more deliberately. Even if this means that much needed legislation will not be immediately forthcoming, we should not slip back into the errors of ERISA. We must not have a law passed again which relies so heavily on the overburdened staff of the federal agencies. Regulations should interpret the will of Congress, not create law.

Although one or more of our services is being used by over 1,500 financial institutions nationwide, we wish to make it clear that we are not commenting on behalf of any of these institutions, nor on behalf of the industry at large. These are our own thoughts which have been developed as the result of providing assistance in this area.

Thank you for giving me the opportunity to present my comments. I am available to answer any questions which you may have.

RNG:ls

Ralph N. George, Jr.

KAISER ALUMINUM
& CHEMICAL CORPORATION

THOMAS K. SINGER
VICE PRESIDENT AND GENERAL MANAGER
WASHINGTON OPERATIONS

September 1, 1978

Mr. Steven J. Sacher, Counsel
Committee on Human Resources
Subcommittee on Labor
United States Senate
Washington, D. C. 20510

Dear Mr. Sacher:

Kaiser Aluminum & Chemical Corporation strongly opposes the proposal in Section 23/ of S. 3017, the ERISA Improvements Act of 1978, which would prohibit reducing "pension benefits" by workers' compensation awards. We are particularly concerned that this Section would prohibit workers' compensation offsets to disability pensions which commence immediately upon the participant's disability and convert into a normal pension upon the participant's attainment of normal retirement age under the plan. We feel that the application of such offset prohibition to such disability pensions would be unjustified and counterproductive for a number of reasons.

In some of our plants the applicable pension plan does not provide for such workers' compensation offsets against disability pensions. An employee eligible for both workers' compensation benefits and an immediate payment of a disability pension will receive combined income far greater than he would have earned had he continued to work at his normal wage rate. An example is a worker whose wage was $831 per month who was recently awarded workers' compensation benefits of $728 per month and commenced to receive a disability pension from a Kaiser Aluminum pension plan of $658 per month. The worker's pay at the time of disability was subject to Federal and State tax. However, his workers' compensation benefits and disability pension are exempt from these taxes under IRC Secs. 104(a) (1), 105(d) and 3121(a). Thus, this employee now receives almost twice as much in after-tax income by being disabled than he would have received if he had continued working or if he had returned to work. His total after-tax income could be further increased by receipt of Social Security disability benefits. We believe that the ability of a worker to dramatically increase his income by going on disability pension and obtaining a workers'

900 SEVENTEENTH STREET N W WASHINGTON D C 20006

compensation award has provided many workers with disincentives to continue working --- to the disadvantage of national productivity.

Since workers' compensation and disability pension costs are borne solely by employers, the prohibition of such offsets potentially creates a very costly duplication of benefits. Disability pensions commencing prior to normal retirement age are considered "ancillary benefits" under ERISA (IRS Reg. Sec. 1.411(a)-7(a) (1)) and are not part of "accrued benefits" protected by ERISA. (The House Ways and Means Committee Report on the legislation establishing ERISA, dated February 21, 1974, states on page 60: "To require the vesting of these ancillary benefits would seriously complicate the administration and increase the cost of plans whose primary function is to provide retirement income.") Thus, the response by employers to the prohibition proposed in Section 237 and resultant increased pension costs may be to eliminate or sharply curtail such disability pensions to the disadvantage of all plan participants, particularly those who are disabled in other than work related injuries.

Section 237 of S. 3017 would constitute a drastic change in long established pension policy and is inconsistent with policy in related areas. Offsets of workers' compensation awards have been permitted by the Internal Pevenue Service for many years and continue to be allowed under final ERISA regulations (Rev. Rul. 68-43; Rev. Rul. 78-178 and IRS Reg. Sec. 1.411(a) (4)). Also, pension benefits may be reduced by Social Security disability benefits. See IRS Reg. Sec. 1.411(a) (4) and Rev. Rul. 71-446. In fact, the Social Security Act requires the reduction, subject to certain limits, of Social Security disability benefits because of the receipt of workers' compensation benefits. See 42 U.S. C.A. 424(a).

There is no similar prohibition against workers' compensation offsets from disability benefits paid under a welfare plan. Thus, the proposed legislation would inadvertently encourage employers who desired to retain disability programs to delete disability pensions from pension plans and insert them in insured welfare plans. The effect of this would be to unnecessarily increase the employer cost of operating a disability program (e.g., additional state premium taxes on insurance premiums, extra costs to cover the insurer's profits, etc.) and reduce the security of disabled workers since welfare plans need not meet the ERISA minimum funding requirements.

For the reasons outlined above, we believe that any legislation that would prohibit reductions in pension benefits to offset workers' compensation awards would have far reaching and adverse ramifications. We therefore urge that this provision be deleted.

We respectfully request that this letter be made a part of the permanent record of the hearings held on S. 3017 on August 15, 1978 through August 17, 1978.

Sincerely yours,

Thomas K. Singer

Thomas K. Singer

TKS:cbs

WILLIAM M.
MERCER
INCORPORATED

Barnet N. Berin, F.S.A./Director-Professional Standards

August 15, 1978

Mr. Michael Stern
Staff Director
Committee on Finance and
Employee Fringe Benefits
Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Stern:

I wish to submit the attached written statement, five copies, for the record, in connection with the joint hearings of August 15, 16, and 17. My particular comments are addressed to S.2992, "sponsored by Senator Bentsen which would direct the Administration to promulgate uniform standards for reporting pension assets and liabilities and for disclosing actuarial assumptions used in such calculations. This kind of proposal was suggested in the November 1977 issue of Fortune magazine."

I would appreciate a meeting to discuss with you, or your staff, the reference in the first paragraph attached to the above article.

Sincerely,

Barnet N. Berin

hjs
Attachment

A Marsh & McLennan Company
1211 Avenue of the Americas · New York, NY 10036 · 212 997-8137

33-549 O - 78 - 79

S.2992

My name is Barnet N. Berin. I am a member of the Board of Directors of William M. Mercer, Incorporated, the nation's largest employee benefit consulting firm, with specific responsibility for professional standards. My curriculum vitae is attached. On the basis of my experience and professional background, I believe it important and necessary to point out that the Fortune magazine article, of November 1977, referred to in the announcement of this hearing, is misleading and inaccurate. Given the opportunity, I would be pleased to establish this by a column by column analysis of this article, citing the specific quotations in the article and then the response correcting each for accuracy. Since that would be extraneous to Senator Bentsen's bill, I will simply list the major inaccuracies in this article, briefly, and then comment on the proposal, S.2992.

The major areas of inaccuracies in the Fortune magazine article of November 1977 include the following:

1. Salary increases will exceed interest rates over the next 50 to 75 years (the period implicit in funding methods for pension plans). Few economists will endorse this scenario, since it depicts an entirely different society and likely an entirely different form of government.

2. Based on (1) and using estimates, the author concluded that unfunded liabilities are one-half of what they should be. Using the same approach, in the absence of any inflation, unfunded liabilities would triple. Using the same approach, but introducing double-digit inflation, unfunded liabilities would decrease ten percent. Both results are patently absurd and depend upon the economic forecast in (1) and the rigidity of the mathematics.

3. Unfunded liabilities are amortized, at a rate typically of 7% to 8%, and are <u>not</u> paid in full as consistently presented in this article.

4. Actuaries have increased the salary scale assumption more than the interest rate assumption, in recent years, and <u>not</u> the reverse as stated in the article.

5. Information on actuarial assumptions was published, and available, although the article states that it was <u>not</u> available.

The author of the Fortune's article views can be expressed, in his own words, as follows:

"In terms of disclosure, and the focus of the piece that I did in November, my emphasis is on shareholders. I am not particularly concerned about the ability of people covered by pension plans to collect their benefits."

"A few people wrote after my article appeared and asked if I was advocating the end of define benefit plans. Given the current ground rules of ERISA, I am."

This bill is described as an addition to Section 412 of the Internal Revenue Code of 1954 by adding a new subsection, "within 90 days of the date of enactment of this subsection, the Secretary shall promulgate uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions used in such calculations."

While this is a general statement, we can review what is available and what could be made available simply and directly.

The Present Situation - Information Available

There are four present sources for the basic information required.

1. The Annual Valuation Report.
2. Accounting Opinion 8 Calculation of Vested Unfunded Liability.
3. Schedule B, Form 5500 Information.
4. Footnote to Annual Financial Report.

The first is a technical document, normally quite complete, likely including the remaining three items. The second could stand some tightening up. The third is not generally sought after by those seeking information and is largely technical. The fourth varies but is usually skimpy. All of this information could be considered, simplified, made standard and provide a comprehensive picture of a pension plan's financial status, one that could be followed by the nontechnician.

Proposed Schedule

A separate schedule, reflecting this data, could be made a required part of the valuation report, to be attached to Schedule B, Form 5500 and included as a separate exhibit in the annual financial report.

The information should include:

1. Statement of Funding Method (per ERISA).
2. Actuarial Assumptions (by specific reference to valuation report).
3. Valuation assets and market value. A statement should be appended that valuation assets represent a smoothing of market values.

4. Accrued Liabilities.
5. Unfunded Liability.
6. Reference to actuarial experience (gain or loss) in the year ending on the valuation date.
7. Actuarial reserve for accrued vested pension benefits* (Unit Credit funding method):
   (i) Based on plan's actuarial assumption.
   (ii) Based on PBGC's actuarial assumption in year ending on valuation date.
8. Vested Unfunded Liability equal to item (7)(i) and (7)(ii) less valuation assets, per item (3), with market value footnoted.
9. Company's contribution in the year ending on the valuation date as a dollar amount and as a percentage of payroll.
10. Minimum required contribution and maximum contribution in year ending on valuation date.

Accounting Issues Occasionally Raised

The recognized funding methods specified in ERISA reflect different patterns of funding a pension plan, each chosen to fit the employer's financial forecast. All achieve exactly

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*Ancillary benefits to be included, if significant, based on Unit Credit funding method or one-year-term cost reserve per valuation report.

the same goal. Only the incidence is different. This kind of choice is found in accounting, in the same sense, in the choices available when depreciating fixed assets and also in the methods of valuing inventory. (There are other areas in accounting where there are such alternatives.) Such choice should be retained.

Some accountants take the position that adding the assets of the pension fund to the asset side of the balance sheet and adding the accrued liabilities of the pension plan to the liability side of the balance sheet should be the preferred approach. This would be unfortunate in several respects:

(i) It would disturb accounting statements significantly. Relationships common to accounting and finance, drawn from the balance sheet, would no longer be valid.

(ii) Benefit improvements or a change in actuarial assumptions would have roller coaster effects on financial statements.

(iii) No where else in the world is this type of adjustment made. (The Book Reserve system, used in a few countries, does not involve "real" assets but rather a reserve on the liability side.

(iv) Actually, plan termination liabilities should be employed. These are generally much less than ongoing plan liabilities. For many companies this could produce a surplus but the comments in (i) still applies.

(v) Those who have made these adjustments indicate that financially healthy companies come out about the same, near the top of the list of companies when ranked, as do financially disturbed companies, near the bottom of the list of companies when ranked. This is not a surprise: the private pension plan follows the health of the plan sponsor and not the other way around.

(vi) Pension costs are probability statements. There is no other such item on the balance sheet.

A better approach would be a supporting exhibit on pension costs.

Department of Labor Proposal

The June 14, 1978 statement of Ian D. Lanoff, Administrator Pension and Welfare Benefit Programs, U.S. Department of Labor to the Committee on Finance, United States Senate, includes much that is of interest to the issue of accounting and actuarial disclosure practices in pension funds. Essentially, the approach is to tighten up and expand the Accounting

Opinion 8 calculation. There is much merit in this proposal. The following comments relate specifically to this proposal:

1. ERISA Section 103(d)(6) requirements should be waived permanently. The underlying problem is that the termination priority categories are far too complex. This should be addressed, and the calculation simplified.

2. The plan itself should describe how the accrued benefit is determined. This should be the basis for the calculation. A plan without such a description should be required to have such a clause inserted.

3. Career average and flat dollar pension plans should show only accrued benefits to date. Final pay pension plans should have the choice of either:

   (i) using the final average salary to date and determining an accrued benefit to date.
   (ii) using a prorata part of the projected benefit, with salary scale, as the accrued benefit.

4. The plan's actuarial assumptions should specify interest, mortality, retirement age and any other assumption supporting the Unit Credit calculation.

5. Current value of assets should be replaced by market value of assets.

6. The treatment of ancillary benefits should be made clear.
7. A check list of actuarial methods should refer only to the funding methods which are listed in ERISA Section 3(31).
8. "Guidelines indicating that the assumptions selected should reflect the anticipated experience of an ongoing -- rather than terminating -- plan" needs clarification. Does this mean collecting and publishing statistics on actuarial assumptions? (Greenwich Research Associates, Sixth Annual Report, 1978, pages 81-86, includes an interesting statistical display of actuarial assumptions.)* Or does it mean criteria to be decided as to when actuarial assumptions should be changed. If the latter, this is a technical, complex subject that I have written on and devoted much time to. I would be prepared to expand on this aspect of pension actuarial assumptions, if desired.

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*An independent support for the statement on page 2, item (4)

William M. Mercer, Incorporated

Curriculum Vitae

BARNET N. BERIN

I. EDUCATION

City College of New York: Highest second year honors, Phi Beta Kappa, Magna Cum Laude, B.S. 1951.

Columbia University: M.A. 1953.

Fellow of Society of Actuaries, 1960.

II. PROFESSIONAL

Director-Professional Standards, William M. Mercer, Incorporated, the nation's largest employee benefit consulting firm.

A. Society of Actuaries Committees:

1. Education and Examination -- prepared study materials and examinations for pension sections, 1963-1969.

2. Committee on Pensions -- discussed and recommended solutions for current pension problems, 1969-1973.

3. Committee on Professional Development -- discussed changing times and related problems for actuarial profession, 1970-1973.

4. Committee on Review -- prepared book reviews of professional material related to pensions, 1975-1977.

5. Committee on Retirement Plans, Chairman -- develop continuing education, research activities and seminars, 1977 to date.

B. New York Actuaries Club:

1. Instructor, Pension Mathematics -- established and taught first and succeeding classes in pension mathematics to actuaries in the tri-state area, 1971-1976.

2. Pension Committee -- arranged speakers and programs on matters of professional interest, 1971-1972.

3. Committee on Students' Education -- helped run and monitor actuarial study classes, 1972-1973.

4. Continuing Education Committee -- helped run continuing education seminars, 1974.

5. Nomination and Election Committee -- recommended actuaries for election to club offices, 1975-1977.

C. Teaching Assignments:

City College of New York: Statistics Lecturer, 1952.

Insurance College of New York: Group Insurance Lecturer, 1962.

New School for Social Research: Member of faculty, taught course on pensions, 1974.

D. Member of the Advisory Board:

1. Actuarial Education and Research Fund -- representatives from six actuarial organizations identify issues for study and grant awards to accomplish research, 1974 to date.

2. Bureau of National Affairs -- a professional study group related to government matters in the employee benefits field, 1975 to date.

3. Public Employees' Retirement Systems Study Group -- preparation and organization of a recommendation for a study of Public Employee Retirement Systems, 1976 to date.

4. Bessemer Pension Institute -- a group of 50 large companies that regularly meets and discusses pension issues, 1977 to date.

E. Other Professional:

Actuary-in-Residence
The University of Michigan
Academic Year 1977-78

III. ORGANIZATIONS

Fellow:
Canadian Institute of Actuaries
Conference of Actuaries in Public Practice
Society of Actuaries

Associate:
Institute of Actuaries (United Kingdom)

Member:
Actuaries Club of New York
American Academy of Actuaries
International Actuarial Association
International Association of Consulting Actuaries

IV. PUBLICATIONS

A. Books:

"The Fundamentals of Pension Mathematics," 1971, The Society of Actuaries.

"Pensions: A Guide to the Technical Side," 1973, C.D. Spencer and Associates.

B. Periodicals:

1. "Dividend Model For Noncontributory Deposit Administration Group Annuity Contracts," Society of Actuaries, 1961.

2. "What Is Your Pension Plan Worth?", Pension News, December 1967. (Co-author)

3. "Life Contingencies and Compound Interest -- the Connecting Link," Conference of Actuaries in Public Practice, 1971.

4. "The BAI Interest Rate," The Actuary December 1971.

5. "APB-8 Five Years Later -- Strong Influence Felt," Pension News, 1972.

6. "Pension Funding: A Nontechnical Explanation," American Management Association, 1972.

7. "You and Your Pension," (book review) The Actuary, February 1973.

8. "Women's Liberation and the Female Mortality Rate," The Actuary, October 1973.

9. "The President's Message," Pension News, October 1973.

10. "Pension Mathematics, The Underlying Philosophy," International Association of Consulting Actuaries, Amsterdam, March 1973.

11. "Revenue Ruling 71-446 (Social Security Integration): An Assessment And A Proposal For Change," Conference of Actuaries in Public Practice, Vol. XXIV, 1974-1975.

12. "BAI: One for Two," Pension News, October 1974.

13. "Interest Rates and Salary Scales in Pension Valuations," The Actuary, April 1975.

14. "Corraling The Conglomerates," Pension World, July 1975.

15. "Pension Plans In Difficult Economic Times," Society of Actuaries, April 1976.

16. "The Valuation of Pension Fund Assets," Employee Benefits Journal, Fall 1976.

17. "Pension Actuarial Gain and Loss Analysis," Record, Society of Actuaries, October 1976.

18. "Actuaries Needn't Be The Only Ones to Understand Valuation Reports," Pensions & Investments, August 1977.

19. "From the Pony Express to the Pension Express," across-the-board, The Conference Board Magazine, June 1978.

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Merrill Lynch
Pierce
Fenner & Smith Inc.

August 24, 1978

Honorable Harrison A. Williams, Jr. Chairman
Subcommittee on Labor Committee of the Senate
Committee on Human Resources
United States Senate
Washington, D.C. 20515

Re: Bill S. 3017/Section 274

Dear Senator Williams:

Merrill Lynch, Pierce, Fenner & Smith Incorporated is pleased to offer its comments with respect to Bill S. 3017 which proposes certain amendments to the Employee Income Security Act of 1974.

In connection with the legislative proposal, Merrill Lynch will confine its remarks solely to the second provision of Section 274 of the bill. This provision provides that shares of a pooled investment fund operated by a bank or insurance company and sold to an employee benefit plan are not securities within the meaning of the federal securities laws.

We believe that enactment of this provision of Section 274 would be adverse to the interest of both securities industry and more importantly, to the investing public which it serves. Accordingly, we oppose this measure and respectfully request that Congress refrain from taking any legislative action which would result in its enactment.

Briefly stated, our opposition is based upon two reasons as discussed below.

Federal Securities Law Protections

Merrill Lynch believes that enactment of this provision would strip employee benefit plans of basic disclosure and anti-fraud protections afforded by the securities laws. These essential protections, which are not provided by ERISA, include the application of the anti-fraud provisions of the federal securities laws to pooled investment funds for employee benefit corporate plans, Keogh plans and Individual Retirement Accounts (IRAs) as well as the disclosure requirements as applied to both Keogh plans and IRAs. Specifically, these regulatory controls require that sponsors of pooled investment funds provide Keogh plans and IRAs with prospectuses. Further, they limit the type of advertisements and sales promotional material which sponsors can direct at Keogh plans and IRAs by requiring disclosure of essential information regarding the funds. Moreover, it is the federal securities laws which help ensure against fraud and misrepresentations, through the right of suit, in connection with the purchase of shares of a pooled fund by said plans. Removal of these basic protections would in our view, unfairly disadvantage these plan participants in the critical anti-fraud and disclosure area, essential ingredients to intelligent investment selections.

<u>The Glass-Steagall Act of 1933</u>

The enactment of the second provision of Section 274 of S. 3017 would, contrary to the provisions of the Glass-Steagall Act of 1933, sanction bank entry into the general securities business. Further, such an encroachment would leave banks in the position of selling securities to employee benefit plans, which plans represent an increasingly significant segment broker/dealer customers. Evidence of the popularity of these investment vehicles is demonstrated by the fact that Merrill Lynch presently services approximately 11,000 active IRA (including Corporate IRAs and IRA rollover accounts) and Keogh plans to date. Accordingly, the enactment of this provision would authorize banks to breach the historic separation between commercial banking and the general securities laws.

In summary, we respectfully urge that Congress oppose any action which would result in the enactment of the second provision of Section 274 of S. 3017.

We thank the Subcommittee on Labor for this opportunity to express our views on this important matter.

Sincerely,

Merrill Lynch, Pierce, Fenner
& Smith Incorporated

By: ______________________
Ira M. Lewis, Esq.

IML:ds

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August 11, 1978

Mr. Michael Stern
Staff Director, Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D. C. 20510

Pension Simplification

Dear Mr. Stern:

The prospects of simplyfing the administration surrounding the establishment and maintenance of private pension plans is gratifying, to say the least. I am encouraged by recent action on Senator Bentsen's part and also on the part of Senators Javits and Williams to not only recognize the disastrous effects of ERISA but also in their desire to take action to remedy some of these problems of administration.

Before making my comments, it would be appropriate for me and helpful to you for me to state my qualifications. For the past twenty-six years, I have been a consulting actuary engaged in the design, establishment and continuing maintenance of retirement plans throughtout the entire United States. Currently I am a member of all the nationally recognized actuarial bodies including the Society of Actuaries, the Conference of Actuaries in Public Practice and the Academy of Actuaries. Since 1974 I have been an Enrolled Actuary as defined in the Employee Retirement Income Security Act of 1974. It has been my good fortune to have been involved with some of the country's largest and most profitable corporations in this regard as well as with many small closely held companies in all parts of the country. In many ways it has been as rewarding to have worked on the design problems of a small plan involving a half-dozen employees as it has been in some instances working for an employer with 10,000 employees. Many of the problems are similar and there are enough differences to require some individual creativity. All of this experience has given me an accumulation of observations both pre and post ERISA and I feel that I have truly worked with a representative cross-section of American free enterprise as well as with many public employee plans in the last quarter century.

Principal Objectives of Regulation

The sections of the Internal Revenue code, the multitude of pages of regulations and the many Treasury bulletins and revenue rulings dealing with pension plans have all accumulated

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and been put in place with two objectives in mind, namely:

(1) To insure that the employer has a legitimate tax deduction and is not contributing and taking a deduction for more than is warranted by a true recognition of the liabilities of the plan and

(2) To protect the employees against possible unscrupulous or selfish employers. This protection, largely a result of the Labor Department's Welfare and Disclosure Laws and later, ERISA, protected employees in the following ways:

    (a) Made more employees eligible for participation in the plan at an earlier date than was required by law prior to ERISA.

    (b) Required earlier vesting for employees in their accrued benefits.

    (c) Established minimum adequate funding criteria.

    (d) Saw to it that employees were informed of all the benefits to which they were entitled, including how to get these - how to deal with the employer - how to lose these benefits - how to seek recourse to the labor department when

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necessary and all the other details found in the summary annual report.

In summary, then, the regulations were all established for the propriety of the employer's deductible contribution and the protection of the employees in their benefits.

False Perspectives

It is my contention that the objectives of the regulations had been adequately satisfied prior to ERISA but that somehow the abuses, some of which will always occur even with ERISA, were blown out of proportion and an uninformed or improperly informed Congress took a hot political issue and, watching it gather momentum, stayed with it until we had the most cumbersome and unworkable piece of legislation that has ever been set loose on American industry. It cannot be adequately explained how this tidal wave reached its final gigantic proportions but it has been finally admitted by some of the authors of ERISA that it was ill-conveived and the greatest example of over-kill the country has ever seen. Of course, the same legislators are concerned for their political life and it is never politically wise to admit that you made a mistake. Consequently many of the reforms which should now occur to ease the burden of ERISA on industry will either not be forthcoming or emerge in very watered-down form after a great deal of pain-staking labor. More time wasted!

If we continue to talk about the Studebaker Case or a few other fairly remote instances of inadequate funding in the private pension sector, we will, thereby frighten John Q. Public into thinking that the private pension system is in a state of bankruptcy or disarray. Nothing could be further from the truth by reasonable standards, despite recent articles to the contrary written by businessmen who do not appreciate some of the subtleties of actuarial soundness. Furthermore if we continue to highlight the few cases of abuse by unscrupulous employers, we will generate a fear among employees that they need someone to protect them against their employer.

Studies conducted on a scientific basis by practitioners in the pension field, indicate that the private pension system in the United States is in good shape and its condition has continually improved over the past several decades since its identifiable origination in the middle 1940's. The pension industry is young nad has had some rough time sorting itself out and I suspect that this fact was overlooked by the many people and legislators who would look to the absolute number of deficiencies in the past rather than to the rate at which these deficiencies are being eliminated and the rate at which both employers and employees are gaining a better understanding of pensions and their place in the overall social structure of the country.

Recommendations

Without question, the time has come and the level of understanding has been reached by both employers and employees so that the private pension system can work with a minimum of government regulation. This will mean that many many dollars now being spent in the administrative details surrounding the pension plan can go toward the actual payment of benefits. Further, in a time when our country needs more productivity and less government service, fewer people can be used to police the private pension system.

Specifically, I would recommend that an employer submit his plan to the Internal Revenue Service for advance approval in much the same way he did ten or fifteen years ago. This information required for a Determination Letter is quite comprehensive and includes a communication to employees.

Perhaps now we have advanced enough that we have the machinery and have become accustomed to preparing articulate summary plan descriptions so that employees will be receiving a communication which they can understand. Beyond this I would suggest that no specific set of forms or requirements be imposed upon employers each year for submission to the Pension Benefit Guaranty Corporation, the Labor Department or the Internal Revenue Service. Also I don't believe that the mass of information required to be submitted to employees and other interested parties is required. For the most part this information is not even read by employees and, when read, is seldom understood. Instead, I suggest that the Internal Revenue Service, as it has always done, be authorized when they feel it necessary, to ask any employer to substantiate his tax claim for a particular year. It is also assumed that the Internal Revenue Service would exercise some prudence and only require this when a contribution for a particular year was materially out of line with that of preceding years. Many employers, upon the advice of their attorney, actuary, and their accountant would still be preparing this back-up information for their files and might even submit it with their tax return on a voluntary basis. I think that the Congress would be quite surprised at the number of employers who have been doing this in prior years and will probably continue to do so just for the sake of orderly business administration.

From the point of view of the employee, he always has the right to question his employer as to any information in the plan. If, upon such questioning, he is dissatisfied with the answer or cannot receive an appropriate answer, he would know the machinery whereby he could appeal to the labor department for satisfaction. Again, there is a self-policing mechanism in that as each day goes by, more and more employers are becoming sensitive to the needs of employees and are communicating much more frequently and thoroughly with them on all matters. Furthermore, the competition for all levels of labor in the marketplace is such that the companies are continuing to install and improve their benefit programs and are not only willing to communicate these in detail to employees but are quite proud to do so.

Conclusion

We are in an extremely uneasy economic era in our country's history and what we need for a continuing low-level of unemployment and a reduction in the accelerating rate of inflation is essentially more productivity and less-people performing governmental services at all levels of government. We seem to be following very closely in Great Britain's footsteps and there is certainly no need for us to do so since we still have a great many resources at our disposal to thwart such a condition and we have their example before us, if we need it, as a stimulus. Not only do I think that a substantial portion of the bureaucracy would be eliminated, but I also believe that such a brave and heroic piece of legislation or administration such as the elimination of all of these numerous requirements, would leave the American businessman with a highly positive frame of mind with regard to government and might even help to establish a more direct and open communication and empathy between the employer and the employee in this country of ours.

Admittedly these recommendations are wide-sweeping and would require a great deal of understanding and integrity on the part of the legislators to roll-back so much regulatory machinery and cast a significant vote of confidence in the American businessman.

The private pension system has certainly been taken out of

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the closet in the last half dozen years and exposed to flood lights, probes, and has come into clear view in all its dimensions. Perhaps to this extent, ERISA has served its purpose. The purpose will be better served if ERISA knows the time at which to withdraw and allow the American free enterprise system to try to police itself with its multitude of built-in safety factors.

Besides, we all know because of the publicity given to it, the vast number of people it would take and the large number of years required by this vast number of people to review all of the required reports which are to be submitted to the PBGC, the Internal Revenue Service and the Labor Department by companies with pension, profit sharing and welfare plans each year. Nothing is more aggrevating to the businessman than having to spend so much time and so much money on material, most of which will be stored away and never touched again by human hands until finally destroyed twenty or thirty years in the future.

Thank you for the forum in which to make these comments and, despite their radical departure from the status quo, I hope that they will be given some careful consideration with a back-drop of where we are in the development of business and in our fight against inflation, expanding government and lack of productivity.

Sincerely,

Charles P. Moore

Charles P. Moore

CPM:mb

NATIONAL ASSOCIATION OF MANUFACTURERS

STATEMENT SUBMITTED BY
THE NATIONAL ASSOCIATION OF MANUFACTURERS
for
THE SUBCOMMITTEE ON LABOR
SENATE COMMITTEE ON HUMAN RESOURCES
and
THE SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS
SENATE COMMITTEE ON FINANCE
on
PROPOSED ERISA AMENDMENTS

August 31, 1978

1776 F Street N.W., Washington, D.C. 20006 • Phone (202) 331-3700

STATEMENT SUBMITTED BY
THE NATIONAL ASSOCIATION OF MANUFACTURERS
for
THE SUBCOMMITTEE ON LABOR
SENATE COMMITTEE ON HUMAN RESOURCES
and
THE SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS
SENATE COMMITTEE ON FINANCE
on
PROPOSED ERISA AMENDMENTS

INTRODUCTION

The National Association of Manufacturers welcomes this opportunity to offer its views on pending ERISA legislation 1/ to the Committees on Finance and Human Resources. The NAM is composed of over 12,400 manufacturing and related concerns, eighty percent of which have 500 or fewer employees, and is affiliated with the National Industrial Council which represents another 158,000 private businesses. The NAM represents industrial employers who employ, in the aggregate, over 15 million employees or 78% of all employees employed in manufacturing nationwide, and a large number of its members have one or more retirement plans, many of which are by-products of the collective bargaining process.

At the outset, the NAM wishes to commend the Committees for scheduling these important hearings. ERISA has now been in effect

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1/ The following bills are being considered:

S.250 - To prohibit the reduction of disability payments.
S.901 - The Pension Simplification Act
S.1383 - To clarify the status of the Hawaii Prepaid Health Care Law
S.1745 - The ERISA Small Business Paperwork Reduction and Investment Act
S.2992 - To provide uniform accounting of pension liabilities.
S.3017 - The ERISA Improvements Act of 1978.
S.3193 - The ERISA Paperwork Reduction Act.

for almost four years, and the NAM believes that appropriate measures to simplify its administration, to lessen its paperwork requirements, and to encourage the growth of the private pension system are timely.

This statement contains general comments on ERISA and the private pension system and then discusses various provisions of the bills pending before these committees. Because of the number of bills being considered, this statement does not comment on every provision. The NAM would welcome further opportunity to amplify these remarks or address other provisions through testimony or written comments. For ease of reference, this statement will follow the general topical outline suggested by S. 3017. However, by following this format the NAM is not suggesting the relative order of importance of such topics.

OVERVIEW

Following the passage of ERISA, there was a substantial increase in termination of single employer-sponsored "defined benefit" pension plans throughout the country. While the reasons for such terminations are complex, it is clear that the costs of administering plans and the paperwork requirements of ERISA had a significant impact. The General Accounting Office's recent report issued on April 27 of this year, for example, indicates that reporting and disclosure requirements have been both burdensome and costly to plan sponsors. However, it is also true that recent individual agency actions have lessened the effects of administration and reporting problems although still more can be done.

As these hearings progress, the NAM believes it is important in considering further substantive changes to ERISA to proceed carefully because of the extremely broad and diverse number of pension plans in this country, many of which are affected by a collective bargaining process which has played and will continue to play a unique role in the development of provisions specifically tailored to meet the needs of individual employers and employees. The NAM at the present time opposes major substantive amendments requiring plan changes or constricting the freedom for plan development to meet individual needs. Such activity would discourage both the expansion of existing plans and the creation of new ones.

Moreover, the eventual impact of recent legislative activities on the private pension system is not clear. The Social Security

Amendments of 1977 (P.L.95-216) and the Age Discrimination in Employment Act Amendments of 1978 (P.L.95-256), for example, will affect the private pension system. Social Security changes will have significant fiscal impact while the new mandatory retirement changes have created uncertainty and confusion not only for effects on pension plans and other benefit programs but also for retirement policy in general.

In addition, development of numerous advisory commissions such as one on Social Security authorized by the 1977 Act and the new Presidential Commission on Pension Policy announced by the White House just last month will provide broad reviews of retirement policy in this country. It would be appropriate to await these comprehensive assessments as well as a clearer understanding of recent legislative action before further major policy changes are enacted.

MULTIPLE JURISDICTION

S.3017, introduced by Senators Williams and Javits, would consolidate the administration of ERISA which now involves the Departments of Labor and Treasury as well as the Pension Benefit Guaranty Corporation into a new single agency. S.901, introduced by Senator Bentsen, would allocate jurisdiction over most functions currently shared by the Departments of Labor and Treasury so that Labor will resolve cases involving self-dealing or prohibited transactions and Treasury will resolve all others.

This dual jurisdiction between Labor and Treasury has been, in part, responsible for problems such as delays in promulgation of ERISA regulations and excessive duplication of reports. However, there has been and should continue to be improvement in administration because of the concerted efforts of the respective Departments in reducing such duplication, coordinating filing requirements, and implementing other actions to reduce paperwork.

The President recently sent to Congress a new reorganization plan, similar in many respects to S.901, to reduce further the jurisdictional overlap and paperwork requirements. The NAM supports this plan as an appropriate action to clarify and refine jurisdictional authority and urges these committees to delay action on major legislative changes with respect to jurisdiction until this reorganization plan has been fully implemented. Once a reasonable time has passed for assessment of the results of such a reorganization, a full evaluation will be possible, and the experience will allow for informed policy decisions if further changes are needed.

REPORTING AND DISCLOSURE

The NAM supports efforts to simplify reporting and disclosure requirements under ERISA and, therefore, generally supports the parts of Sec. 221-228 of S.3017 and the provisions of S.3193 which would result in simplified reporting, consolidation of forms, elimination of Summary Annual Reports, and simplified disclosure of participant's benefit rights. These revisions will reduce paperwork, improve administration, and encourage rather than discourage plan creation.

The NAM is concerned with the tax implications involved in the consolidation of plan description and IRS determination application forms. S.3193, for example, provides that "... in order for a plan to qualify under Section 401, the plan must obtain a determination letter from the Secretary granting qualification." The NAM believes this provision should be clarified so that a plan's tax qualification is effective prior to the granting of the determination letter. If it is not, delays in issuance would hinder plan adoptions and amendments. In addition, tax deductions would be available in many cases only when the contributions were recognized as income by the employees.

PENSION PAYMENT REDUCTION

The NAM is opposed to the provision of S. 3017 (Sec. 237) and S. 250 which preclude reductions in pension benefits when workers' compensation awards are made.

Such an offset was approved in Rev. Rul. 66-243, and rejection of it will act as a disincentive to development of disability plans by subjecting employers who ultimately pay the cost of workers' compensation to increased liability. It could allow duplication of benefits and represent a windfall to an employee. If disability benefits plans are eliminated from pension programs, those workers disabled outside of the workplace will be penalized in particular, and there do not appear to be strong reasons for such a major policy change.

JOINT AND SURVIVOR ANNUITIES

Sec. 238 of S.3017 requires a new mandatory benefit for a surviving spouse payable at the death of an employee in the form of a survivor's annuity if the employee is at least 50% vested and dies before collecting. In effect, a new life insurance policy paid for by the employer is mandated. The NAM opposes such a provision because of its potential cost, its impact on established life insurance programs, and its discriminatory effect on single employees.

At the present time, many employers provide similar coverage through group life insurance policies, and ERISA already allows for an optional benefit similar to this provision. The expense for employers not already providing such coverage will be significant in many cases if this provision is made law. In addition, the mandated benefit would often be coordinated with existing group life policies which will add to complexity of administration. If employers reduce the amount of group life insurance coverage to take into account the mandated policy, single employees will lose benefits. Ultimately such a provision will result in reduction of other benefits to offset the increased costs, and it will serve as a disincentive.

FUNDING

Sec. 251 of S.3017 requires employers to take into account all plan provisions including those not yet in force in the employer's funding methods after 12/31/80. While this provision and its rationale are unclear, it appears that it could lead to increased costs, could result in undermining the collective bargaining process affecting many benefit plans in this country, and will add to the complexity of pension law generally.

As the NAM understands the effects of this provision, an employer after 12/31/80, for example, would have to begin funding benefit increases although such increases have not yet become effective, may not become effective for some years into the future, and depending on future events may never take effect. Such a provision would adversely affect the flexibility inherent in the collective bargaining process by restricting the use of phased-in benefit increases. Any economic advantage to an employer for a gradually negotiated phase-in rather than an immediate one will have been lost by this provision. The NAM believes the use of ERISA to impact the bargaining process in this manner is inappropriate.

Moreover, the provision allows a funding account to be adjusted if the provision to become effective in the future does not for some reason. This adjustment process will add to the complexity of administration of pension plans. New regulations will be required for the handling of such adjustments, and other problems will arise in employer decisions interpreting that part of Sec. 251 which exempts from such funding requirements provisions which are "... adopted but contingent on a future event..."

COST OF LIVING ADJUSTMENTS

Sec. 273 of S.3017 directs the Secretary to conduct a feasibility study related to mandating cost of living adjustments for private pension plans. The NAM believes such a study is unwarranted and duplicative of other major "studies" currently being conducted in the federal government.

Last month the President signed an Executive Order creating the President's Commission on Pension Policy to develop national policies and recommendations for retirement, survivor, and disability programs. This order for a broad study of pension policy reflects a growing awareness that one aspect of retirement cannot be discussed in isolation but should include references to all aspects ranging from economic to policy goals. Besides the Presidential Commission, various other councils are either currently at work or being formed to conduct studies of retirement issues, especially in Social Security. Another independent study at this time would be superfluous and an unnecessary expenditure of tax dollars.

SECURITIES LAWS

The NAM supports S.3017 in its provisions (Sec. 271 and 274) to preclude the application of Federal and State securities laws generally to the interest of an employee in a benefit plan but believes that this provision should be further clarified.

The NAM shares the concerns of Senators Williams and Javits as well as many others over the potential impact of Daniel v. International Brotherhood of Teamsters, 561 F.2d 1223 (7th Cir. 1977), cert. granted, 98 S. Ct 1232 (Feb. 21, 1978). This decision exposes retirement trust funds and individual parties to enormous, heretofore unanticipated, liabilities. Moreover, it will introduce more complexity to the pension laws and may result in numerous terminations of pension plans throughout industry while superimposing a third agency for administration of pensions.

Sec. 271 and 274 are intended to remove any doubt that the ERISA preemption provisions preclude application of Federal and State securities laws generally to the interest of an employee in an employee benefit plan subject to ERISA in which participation is "voluntary." Interpretation of the meaning of the term "voluntary" could narrow this exemption. The NAM favors further clarification so that all plans will be shielded except where there are voluntary employee investments in employer securities. Such a clarification would be consistent with Senator Williams' introductory remarks indicating that the securities laws should be applicable only in those instances where plans are designed to invest heavily in employer securities.

TAX CODE PROVISIONS

S.3017 contains major tax code amendments including a deduction for employee contributions to pension plans, a tax credit for "improved" pension plans, and a reducing tax credit for small employers who create new pension plans. S.3288 also contains a tax deduction for employee contributions but provides that an employee may contribute within certain limits to an IRA if the pension plan does not permit employee contributions.

The NAM supports the principle of tax deductions for employee contributions to pension plans but believes the provisions of S.3288 are preferable to S.3017. S.3017 reduces the deduction for employees earning more than $30,000. Such a reduction is not justified. In addition, S.3017 would require that employers accept employee contributions. Such a requirement would involve considerable administrative costs for many employers, costs which in some instances would exceed the amount of the employee contribution.

The two tax credit proposals would be difficult to administer and will discriminate against those plans already "improved" within the meaning of that term and against already existing "small" employer plans.

Sec. 307 of S.3017 prohibits retroactive disqualification of a plan for tax purposes unless there is a finding that the past failure to meet standards resulted from intentional failure or willful neglect. The NAM supports this proposal which affords greater protection for those who make good faith efforts to comply with ERISA.

MASTER PLANS

A new part 6 would be added to Title I of ERISA by S.3017 allowing for creation of a "special master plan" which employers could adopt without being subjected to many of the accompanying administrative details associated with maintenance of a private pension plan. The NAM supports this attempt to encourage the growth of private plans.

UNIFORM ACCOUNTING STANDARDS

S.2992 requires development of uniform standards for calculating and reporting the assets and liabilities of pension plans and for disclosing the actuarial assumptions used in such calculations. The NAM believes that further action on this legislation should be delayed to allow for continuation of activities currently ongoing to resolve issues involved in this complex area. The Department of Labor, the American Academy of Actuaries, the Financial Accounting Standards Board, and the American Institute of Certified Public Accountants are currently reviewing the problems involved in such standardization, and successful completion of their efforts would end the need for, if there is such a need, legislation.

CONCLUSION

The NAM strongly supports those provisions that are calculated to simplify ERISA administration, reduce costs to employers, and encourage the maintenance and development of the private pension system. Appropriate legislative action can be achieved to accomplish those goals without major disruptions to the pension system. The manufacturing community has a vital interest in ERISA developments, and the NAM appreciates the opportunity to discuss these as well as other matters in this field.

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August 18, 1978

Mr. Michael Stern
Staff Director
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Stern:

Pursuant to your notice of July 27, 1978, enclosed please find five copies of a statement of the National Association of Pension Consultants and Administrators, Inc. We request that the statement be included in the record of the joint hearings held on August 15, 16, and 17. If our statement raises any questions, or if you wish to discuss other matters relating to pension simplification, please do not hesitate to contact us.

Thank you.

Harry V. Lamon Jr.
Harry V. Lamon, Jr.
General Counsel

Stanley H. Hackett
Stanley H. Hackett
Associate General Counsel

/vs

STATEMENT
OF HARRY V. LAMON, JR., GENERAL COUNSEL, AND
STANLEY H. HACKETT, ASSOCIATE GENERAL COUNSEL,
SUBMITTED ON BEHALF OF THE NATIONAL
ASSOCIATION OF PENSION CONSULTANTS AND
ADMINISTRATORS, INC., TO THE SENATE HUMAN
RESOURCES SUBCOMMITTEE ON LABOR AND THE SENATE
FINANCE SUBCOMMITTEE ON PENSION PLANS AND
EMPLOYEE FRINGE BENEFITS.
AUGUST 31, 1978

BACKGROUND AND OVERVIEW.

This statement is in response to the Subcommittees' notice of July 27, 1978, requesting comments on the issue of pension simplification. The statement is presented on behalf of the National Association of Pension Consultants and Administrators, Inc. (NAPCA). NAPCA is an organization of some 200 consultants and administrators of, primarily, small employee pension and welfare benefit plans.

The members of NAPCA are committed to the continued viability and growth of a strong, private employee benefit system. To that end, the members of NAPCA supported, and continue to support, the basic objectives of ERISA. However, over the four years since passage, it has become clear that while ERISA's objectives are noble, many of its specific provisions have had unintended results. It is evident that ERISA has resulted in increased costs for many plans, and that it has been a significant factor in the termination of many existing plans, and in the failure of many employers, primarily small employers, to establish new plans.[1]

These conclusions, however, should not be misinterpreted. ERISA was designed to correct problems and abuses of the past and to enhance the protection of the rights of participants and beneficiaries. Some increased costs and complexities were inevitable and justified. One objective of amendments to ERISA should be to identify and address those areas where increased costs and complexities are not justified - specifically, where the costs of compliance exceed the corresponding benefit to participants and beneficiaries.

Moreover, in identifying these areas, it is critical to consider not only the compliance costs placed directly on employee benefit plans and their employer-sponsors, but also the compliance costs placed on those who sell and provide services to plans and sponsors, such as consultants, administrators, and insurance companies. Furthermore, it is critical to recognize that merely shifting reporting, paperwork and other administrative burdens from plans and sponsors to

1. A number of studies and surveys have been made of the impact of ERISA on employee benefit plans. The studies include: Survey of Increased Administrative Costs of ERISA (National Association of Pension Consultants and Administrators, Inc.) (1975); Certified Public Accountants Survey (Retirement Administrators and Designers of America, Inc.) (1977); Pension Consultants Survey (Retirement Administrators and Designers of America, Inc.) (1977); IRS Statistics Based on Determination Letters Issued Pre- and Post- ERISA (On-going); Survey of House Committee on Small Business (1977); Meidinger & Associates, Inc. Survey (1977); General Accounting Office Survey (1977); Senator Robert Dole Survey (1977); Senator Richard Lugar Survey (1977); PBGC Statistics of Terminated Plans (On-going); Price-Waterhouse Survey for the Department of Labor (1978).
Although the survey results are not uniform, and many are not scientifically designed, they do unanimously reflect that ERISA has resulted in increased costs for many plans, and that ERISA has been a significant factor in the termination of many existing plans and in the failure of many employers to establish new plans.

consultants, administrators, and insurance companies, is not sufficient. The costs are still there and ultimately must be born by plans and participants and beneficiaries. Finally, it must be recognized that shifting plan administrative burdens to the Federal Government is no solution either. Someone has got to be paid to do the work.

A second objective of amendments to ERISA should be to enact additional incentives to encourage the establishment of new employee benefit plans and the improvement of existing plans. There is little doubt that the greatest opportunity for expanded plan coverage exists in the small employer sector, and that small employers, and individual taxpayers, are particularly motivated by economic and tax incentives.

A third objective of amendments to ERISA should be to address the problems arising from multi-jurisdiction over the administration and enforcement of laws effecting employee benefit plans. The jurisdiction issue is much broader than the obvious (and widely discussed) issue of the "dual jurisdiction" of the Departments of Treasury and Labor over ERISA. It includes issues relating to the proper role of the states (pre-emption), the Securities Exchange Commission (Daniel v. International Brotherhood of Teamsters), the Pension Benefit Guaranty Corporation, and the Federal Trade Commission (disclosures in connection with Prohibited Transaction Exemption 77-9; disclosures in connection with Individual Retirement Accounts).

We recognize that a comprehensive review and revision of ERISA, addressing all of these objectives, is impractical in the short term. However, we also recognize that certain pressing matters could be addressed immediately. We suggest that an immediate legislative response might include some or all of the following:

1. Small Employer: - expand the definition.

2. Reporting and Disclosure:

   - eliminate the Summary Annual Report.
   - eliminate the Notice to Interested Parties.
   - combine Form EBS-1 with Form Series 5300.
   - require Annual Report (Form Series 5500) once every five years.
   - permit agencies to exercise greater discretion in developing simplified, non-duplicative reporting requirements, particularly for small employers and small plans.

3. Jurisdiction and Administration:

   - address the Daniel issue.
   - prohibit retroactive disqualification of plans for unintentional technical and administrative errors.

4. Incentives: - permit tax deductions for employee contributions to plans.

These items, and others that may be more appropriate for consideration in the future, are discussed in the body of this statement.

I. <u>RECOGNITION OF SMALL PLANS.</u>

<u>The "Small Employer" Defined.</u>

ERISA adopted a concept of "small employers" and "small plans" which originated in the Welfare and Pension Plans Disclosure Act (WPPDA). Under ERISA, an employer is considered "small" if his plan covers less than 100 participants. We believe that the definition is more convenient than realistic. The simple dichotomy of "under 100" and "100 or more" participants simply does not recognize the real differences between the many sizes and types of plans and plan sponsors. A very fundamental difference is that smaller plans and smaller businesses generally have less "in house" sophistication for dealing with plan administration and have less ability to pay for required administrative, accounting, legal, actuarial, and other support services. Every dollar that must be expended in a "support" capacity is one less dollar that could have been applied to benefits. The appropriate administrative agency should have the discretion to respond to these differences in sponsors and plans, and to adopt regulations and guidelines for smaller plans and smaller businesses which emphasize simplicity and reduced costs, and which encourage the continuation of existing plans and the installation of new plans. The starting point for this discretion could be in the definitional sections of ERISA.

<u>Recommendation</u>:

We believe it would be appropriate to expand the definition of "small plans" to include those plans sponsored by employers meeting the Small Business Administration definition of a small business. (See Section 446 of S. 3017).

II. REPORTING AND DISCLOSURE.

The reporting and disclosure requirements of ERISA are another carryover from the WPPDA. However, when combined with the other significant ERISA protections, including minimum standards, funding, fiduciary responsibility and prohibited transactions, they approach "over-kill". In fact, many of the reporting and disclosure provisions are an expensive burden for employers, both in terms of time and cost, with questionable benefit to participants and beneficiaries and the administrative agencies.

The complexity of the reporting and disclosure requirements has had a particularly adverse impact on small employer plans. As various of the previously cited surveys reflect, the fixed dollar costs associated with the implementation of ERISA's reporting requirements is often a disproportionate percentage of pension costs for the small employer.

Recommendations:

1. Generally.

A. Every effort should be made to eliminate duplicative and complex reporting. Legislation should not be so specific or restrictive as to prevent the appropriate administrative agency from exercising reasonable discretion in favor of simplified, non-duplicative reporting requirements. Special consideration should be given to simplified reporting for small employers and small plans. (See S. 3193).

B. Access to plan records and information is a necessary corollary to enforcement of rights of participants and beneficiaries. However, reporting and disclosure should be viewed as a means to an end, and not the end itself. It is our view that the basic objectives could be accomplished more simply and less expensively by requiring employers to keep detailed records for audit by agencies and review by participants and beneficiaries, and by requiring only summary reports to the appropriate administrative agency.

C. Information required for administrative data base needs should be considered separately from information required for ERISA compliance. For example, comprehensive information as to plans could be acquired by statistically sound sampling. It is not necessary for every plan to report every detail every year.

2. Specifically.

A. The Summary Plan Description.

The Summary Plan Description has evolved from a communication vehicle to a legal document. Despite the admonition that the Summary Plan Description be drafted with language calculated to be understood by the average participant, of necessity it will be complex, and invariably will refer to the plan document for further information.

Given that the purpose of the Summary Plan Description is to communicate important plan provisions to participants, as opposed to serving as a legally binding prospectus, we would suggest that its form should not be that of a legal document, but rather an easily-understood booklet which describes the plan provisions in question-and-answer form.

Should the plan participants feel the need for more detailed information, they should be encouraged to examine the actual plan document.

Plan sponsors should not be held liable for unintentional or technical discrepancies. Liability should follow only in cases of actual intent to mislead.

B. Form EBS-1.

Form EBS-1 requires much information that is presently disclosed on Form Series 5300. With respect to qualified plans which seek a determination letter, it would appear that these forms could be combined, with the elimination of Form EBS-1.

C. The Annual Report.

All plans presently must file full compliance returns on an annual basis. We sincerely question whether such full annual data is even assimilated by the agencies, much less utilized. Particularly with respect to small plans, we would urge that the required comprehensive reports not be annual, but on a five year cycle. Participants would continue to have the right, on request, to review plan records. A much abbreviated report or registration statement could be filed annually ("a one pager").

D. The Summary Annual Report.

Distribution to all plan participants of a Summary Annual Report represents another costly procedure of questionable utility. Certainly this information could be made available to plan participants on request.

E. <u>Form Series 5500, Schedule A</u>.

Schedule A information (insurance) should be limited to data that is meaningful, necessary and not susceptible to misinterpretation by sponsors, participants, beneficiaries or the agencies. The entire area of life insurance disclosure is the subject of study by the Federal Trade Commission and the state regulatory bodies. Undoubtedly, it will soon be the subject of study by the Congress. We contend that insurance held in employee benefit plans should be subject to no more and to no less regulation and disclosure than insurance held by other individuals or entities. Our position here is similar to our position regarding other assets or products whose sale is subject to government regulation. The underlying asset or product should be subject to similar regulation, regardless of the buyer. Particular and different regulations (aside from fiduciary responsibility and prohibited transaction provisions) should not be imposed on underlying assets simply because they are held by an employee benefit plan.

With particular reference to Schedule A, Line 3, we have long contended that insurance commissions disclosure should be permitted in the form of percentage of premium on an initial and renewal basis, as opposed to annual dollar amounts. The former gives a "moving picture"; the latter merely a "snapshot". If the former is <u>not</u> mandated by legislation, the agencies at least should have greater discretion to permit it.

F. Notice to Interested Parties.

ERISA Section 2001(a) and IRC Section 7476 require that each employee who qualifies as an "interested party" be notified that a plan has applied for a determination letter from the Internal Revenue Service. Although several methods are suggested for publication or distribution of this notice, it of necessity is written in terms that the average plan participant would have difficulty in understanding.

We question whether the notice serves any useful purpose. If ignored by participants, it is indeed a needless and expensive procedure. Even if not ignored, the decision as to qualification is made by the Internal Revenue Service (or conceivably the Tax Court), not by participants. If the plan meets the minimum standards, it qualifies. Participants cannot impose higher standards than those required by law.

G. Privacy.

A significant amount of information is reported to the administrative agencies. With regard to small plans, it is often relatively simple to review reports made public and to determine compensation levels and other personal data as well as extensive data about the employer. Several companies are presently involved in accumulating and selling detailed and formerly confidential information acquired from ERISA reports. We contend that access to such "identified" information should be limited to those with a legitimate need to know - i.e., to participants and beneficiaries, their representatives, and the agencies. "Identified" information should not be made freely available to competitors or to solicitors.

H. Master and Prototype Plans.

Reporting requirements for "Master" and "Prototype" plans could be substantially simplified by permitting master reporting of information common to the particular plans. (See Section 401 of S. 3017). However, the broader goal of ERISA amendments should be to reduce and simplify reporting requirements for all plans, including individually designed plans.

"Master" and "Prototype" plans fill an important role in the private employee benefit plan universe. However, by their nature they are inflexible and simply cannot be adapted to all situations. Furthermore, they are often installed and administered by mail, with little personal contact of a professional nature. As a result, communications problems often arise between the sponsor, the employer, and the employees, resulting in administrative, interpretative, and procedural difficulties. Administrative and installation costs can vary considerably from plan sponsor to plan sponsor, and with some plans, may equal or exceed the costs of individually designed plans.

More importantly, it must be recognized that the S. 3017 proposal essentially involves a shifting of responsibilities from an employer to a master or prototype plan sponsor. The proposal does not involve an elimination of the responsibilities. While we support the concept of a "special master plan", its limitations must be recognized, and it should not be viewed as the final answer. The answer must be simplified reporting for all plans.

With respect to the "special master plan" program, we would urge that the statutory language be more specific with respect to the responsibilities that are to be shifted to the sponsor. For example, we do not believe it appropriate or workable to shift all fiduciary responsibilities to the sponsor.

I. Simplified Bond Purchase Plans.

The Administration recently announced that the Department of Treasury is introducing a new, simplified retirement income plan for corporate employers purchasing U.S. Retirement Bonds in the names of employees. The Administration has stated that "adoption of this plan will greatly reduce the usual administrative fees and costs associated with the adoption and maintenance of qualified plans, because there are no drafting expenses, no need to file the plan with the Internal Revenue Service, and no need to establish a trust for the plan "thus reducing "... administrative costs of making investments and of determining benefit accruals and payments."

In our view the proposal is a classic example of the "insidious encroachment by men of zeal, well-meaning but without understanding." Such a program might reduce a

2 "The greatest dangers to liberty lurk in insidious encroachment by men of zeal, well-meaning but without understanding." Louis Brandeis, J.

particular employer's administrative costs. However, the work would still have to be done - the administrative details attended to - and someone would have to paid to do it. The proposal, like the "special master plan" proposal, is basically a shifting of work, not a reduction of work. More importantly, the proposal is a further, unwarranted intrusion of the Federal Government into the private sector.

J. Publication of booklet to assist in compliance with ERISA reporting requirements. (S. 3193)

We sincerely question whether such a "booklet" would justify its cost. Employee benefit plans are of infinite variety and complexity, and invariably are modified with time and experience. We question whether any single "booklet" could offer much useful guidance. There already exists a plethora of materials, ranging from services and treatises to booklets, dealing with the administration of employee benefit plans.

III. JURISDICTION.

When pension reform was being considered initially, many in the private sector supported retention in the Internal Revenue Service of the administrative and enforcement functions relating to qualified retirement plans. The reason for such support, primarily, was because the Internal Revenue Service was a known quantity with existing administrative and enforcement capabilities which practitioners felt could fully implement the objectives of ERISA. Most opposed then and now the concept of "dual jurisdiction", although all recognized that it was the result of a legislative compromise and, at the time, was essential to passage of ERISA. However, the experience of dual jurisdiction has reaffirmed that it is not a practical solution to the many problems addressed by ERISA.

Throughout the past four years NAPCA has been intimately involved in dealing with the problems that have arisen under ERISA. The common denominator of a substantial majority of these problems has been jurisdictional uncertainty or jealousy or a simple inability of the administrative agencies to coordinate and make decisions. The problems have been particularly acute in the areas of reporting and disclosure, prohibited transactions and fiduciary responsibility, and the totally different approaches of the agencies to enforcement activities.

We fully recognize that progress has been made in the implementation of ERISA and quite candidly we highly compliment the agencies for the progress to date. However even this much progress comes only after a truly inordinate amount of time, expense and hard work on the part of the Congress, the agencies and the public. It is our considered judgment that the jurisdictional problems remain and that they are institutional. We have no reason to believe that the situation will significantly improve, absent a legislative change.

There appear to be two basic philosophies as to how the dual jurisdiction problem might be addressed. One is the concept of "consolidation of functions" as exemplified by the original Senate proposals, again in H.R. 4340 introduced last year, and most recently in S. 3017. The second is the concept of "allocation of functions" as exemplified by S. 901, now S. 2352, and by the President's Reorganization Plan No. 4 of 1978. NAPCA strongly supports the concept of consolidation as the only realistic long-term alternative for resolving the jurisdictional problems which have so hampered the administration and enforcement of ERISA. The ERISA Advisory Council has recommended a transfer of all administrative and enforcement functions of ERISA to the Department of Labor, with the Internal Revenue Service retaining jurisdiction solely over matters relating strictly to taxation. Essentially, the Advisory Council recommended a scheduled transfer with the most acute jurisdictional problems being addressed immediately and other functions transferred on a step-by-step basis over a reasonable period of time. We are aware of the obvious practical and logistical problems involved in consolidating the administrative and enforcement functions of ERISA in a single agency. We are aware of the particular political problems involved in consolidation in an existing agency as opposed to a new independent agency. For the short term, we have recognized the simple reality that we have multi-jurisdiction in strong agencies supported by powerful constituencies, and that the only practical approach is an allocation or division of responsibilities on a scheduled basis. For the long term, however, we believe it essential that we obtain consolidation of administrative and enforcement functions of ERISA and, indeed, of all employee plans both public and private, the Social Security System and the Pension Benefit Guaranty Corporation (PBGC) under a single agency.

The "dual jurisdiction" debate has focused largely on the implementation problems of ERISA, and they have been and are substantial. However, these problems are but a part of the overall problem, which we view as the failure to have developed a uniform and coordinated national policy dealing with employee plans and retirement security in general. We totally concur with the view that federal, state, local and private pension plans, Social Security, ESOP's, TRASOP's, IRA's and Keogh plans must be viewed as part of the same continuum. We believe the ultimate goal should be the creation of a cabinet level Employee Benefits Commission, or Employee Benefits Administration, with overall responsibility over all private and public retirement plans. We envision that the enabling legislation would maintain "walls of separation" between private assets and public promises so that the former would not be used to fund deficits in the latter, and would also be mindful of Constitutional considerations involving the relationships of the States and the Federal government. This is admittedly a far-reaching proposal. However, we candidly view the jurisdictional problems of ERISA as only a symptomatic part of the overall problem, and we consider such a consolidated "super-agency" as essential to resolution of the overall problem.

Nonetheless, we are aware that the interim solution will be along the lines of the President's Reorganization Plan No. 4 of 1978, and we will work constructively within its framework while carefully and continually evaluating its success. At appropriate times we will advise the agencies and the concerned Congressional committees of our experience and opinions.

IV. ADMINISTRATIVE PROCEDURES.

1. Jurisdiction of Securities Exchange Commission, ("Daniel" Problem).

We support the provisions of S. 3017 which would terminate jurisdiction of the Securities Exchange Commission over employee benefit plans (as opposed to the underlying assets held in such plans). We would urge that the termination of jurisdiction extend to all employee benefit plans, including voluntary eligible individual account plans.

2. Retroactive Disqualification.

ERISA should be amended to prohibit disqualification of employee benefit plans based on innocent administrative error that can be corrected by retroactive allocation or adjustment. (See Ludden v. Commissioner, 68 T.C. No. 7 (8/31/77): Forsyth Elementary Services v. Commissioner, 68 T.C. No. 77 (9/12/77); Section 307 of S. 3017).

3. Declaratory Judgment Procedure.

ERISA should be amended to expand and expedite the existing declaratory judgment procedure by removing administrative impediments and by extending jurisdiction to United States District Courts. (See S. 901).

V. INCENTIVES FOR PLAN FORMATION AND IMPROVEMENT.

We believe the major growth in private pension coverage will come in the small employer/small plan area. Obviously plans are adopted for a number of reasons, but the basic economic incentive of a current tax deduction plus income deferral must be recognized as a primary motivation. At the same time, the influence of various segments of the private pension industry in aggressively promoting the establishment of new plans must also be recognized. To the extent that clear economic incentives are available, and are readily explainable to employers, employers will be encouraged to adopt plans.

Recommendations

1. New Plans. We recommend that additional tax incentives, in the form of additional, "early year" deductions or credits, be given to employers who adopt new plans. (See Section 304 of S. 3017).

2. Improved Plans. To encourage the expansion of coverage and benefits, we recommend that additional tax incentives be given to employers who adopt "expanded" or "improved" plans. For example, if a plan meets the minimum standards embodied in ERISA, the normal deduction for contributions would be granted. As participation, vesting, coverage, and other minimum standards are expanded beyond the minimum, "points" would be given, on a graded basis as expanded, which would convert to additional deductions, up to a maximum of 125%/130% of the current contribution. The

concept is somewhat similar to the additional investment tax credit awarded to TRASOPS, and to H.R. 356 (Goldwater). (See Section 305 of S. 3017). The additional incentives should not be limited to existing plans which are improved. They should also be available to existing plans which meet the higher standards or to new plans which are adopted with the higher standards. The definition of an "improved" plan should be such that it does not discriminate against plans adopted by small employers.

A variation of the proposal with particular relevance to defined benefit pension plans would be to permit additional tax credits or deductions related to the past service liability assumed by a new plan. Given the obvious employee advantages of defined benefit pension plans, we believe proposals encouraging their adoption and expansion should be given particular study. As we refine our own thoughts in this area, we will communicate further with the Subcommittees.

VI. INDIVIDUAL RETIREMENT ACCOUNTS (IRAs)

IRAs fulfill a valuable purpose in providing a mechanism for retirement savings for employees who are unable to participate in qualified plans. However, IRAs must be carefully monitored to insure that they do not have a serious adverse impact on the continued growth of qualified plans. While qualified plans cover employees at all earnings levels, IRAs cover only a single individual, often at a high level of earnings. If the benefits of IRAs are increased, sponsors may be encouraged to terminate plans and to adopt discriminatory, employer-sponsored IRAs.

In another vein, we are very concerned that IRA legislation and regulations have reached a point of complexity which places IRAs beyond the understanding of many of the individuals it was designed to help. Individuals who have established IRAs often fail to realize that participation in a qualified plan for even one day of a tax year will cause them to be disqualified from IRA participation. They are similarly unaware of the severe penalties which occur if an improper contribution is made. A recent decision of the United States Tax Court highlights the unfairness of these complexities and penalties. (see Orzechowski v. Commissioner, 69 T.C. No. 67 (1978).

Recommendations:

1. We recommend that IRAs be restricted as in Section 306 of S. 3017. As an alternative, "proprietors" should not be permitted to establish IRAs unless the "proprietor", as an employer, also maintains an employer-sponsored qualified plan.

2. We recommend that the technical complexities of IRA's highlighted in the Orzechowski case be eliminated.

VII. LIMITED EMPLOYEE RETIREMENT ACCOUNTS (LERAs).

Although related to IRAs, LERAs offer a more appropriate mechanism for encouraging greater plan participation. LERAs should permit plan participants to make deductible contributions to their employer's qualified retirement plan irrespective of the employer contribution and thereby strengthen the "partnership" between employer and employee. Such contributions are fully vested and can substantially improve the ultimate retirement benefit.

We do not believe that compensation limitations on deductible contributions are appropriate nor do we support computing deductible employee contributions as a function of employer contributions. When the inflation levels anticipated for the future are considered with the progressive income tax rate structure, it is readily apparent that such limitations soon become unrealistic, even if reasonable when adopted. We recognize that budget constraints necessarily place some overall limitation on the amount of the deductible contribution. However, we contend that individuals should be encouraged to save for retirement regardless of income level and regardless of the amount of the employer contribution. On the other hand, a legislative mandate that all qualified plans provide for voluntary contributions should be carefully considered.

Recommendations:

We support provisions of S. 3017 permitting deductions for voluntary contributions to employee benefit plans. We do not support the income limitations. We question whether all plans should be required to permit voluntary contributions. We suggest that consideration be given to combining the LERA and IRA provisions as follows: LERAs would be available to plans and participants on a voluntary basis; IRAs would be available to participants whose plans do not provide for LERAs as well as to non-participants; "proprietors" would be precluded from establishing IRAs unless they also maintained an employer-sponsored qualified plan.

The limitations on deductible amounts for IRAs and LERAs should be identical (i.e., $1500).

At a minimum, we strongly endorse S. 3288.

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VIII. <u>NON-QUALIFIED DEFERRED COMPENSATION ARRANGEMENT</u>.

Non-qualified deferred compensation arrangements fulfill a number of valid objectives both from a business standpoint and a retirement standpoint. Although the Administration has withdrawn proposed regulations which would essentially eliminate such arrangements, and although the House of Representatives soundly defeated its subsequent legislative proposals, we are concerned that such proposals will be revived in Senate consideration of H.R. 13511, the Revenue Bill of 1978. The Administration proposals would significantly alter long-standing concepts of cash-basis accounting, and appear to take no accounting of tne role non-qualified deferred compensation arrangements take in the broader spectrum of public and private employee benefit plans. The proposals would have a particularly detrimental impact on small businesses and the self-employed.

<u>Recommendation</u>:

We support Sections 122 and 123 of H.R. 13511 and recommend that no further changes be made in laws dealing with non-qualified deferred compensation arrangements, pending completion of the studies now being conducted in the Congress with respect to public plans, and pending completion of the study of the Presidential Retirement Commission.

IX. FIDUCIARY RESPONSIBILITY AND PROHIBITED TRANSACTIONS.

The fiduciary responsibility provisions of ERISA section 404 should be maintained intact.

We are concerned that the scope of the prohibited transaction provisions of ERISA is overly broad, and that employers and administrators are too often put to unnecessary and expensive burdens to seek administrative approval of transactions which are not only not harmful, but often in the best interest of a plan and its participants and beneficiaries. Furthermore, we strongly question whether it is appropriate to police prohibited transactions by excise taxes.

Recommendation:

We urge a return to the "adequate consideration" standard endorsed in H.R. 2, the original House version of ERISA. If enforcement is a serious problem, we would support simple agency notification procedures of transactions involving parties-in-interest. Enforcement should be by random audit with civil and/or criminal penalties assessed against prohibited transactions. (See also H.R. 7597).

X. INTEGRATION OF PRIVATE PLANS WITH SOCIAL SECURITY

Many employers cannot now afford both Social Security and a generous pension plan. Every dollar that must go toward Social Security is one less dollar that can go toward a private benefit plan.

A vicious cycle has been created as supporters of Social Security point to the inadequate benefits under employer plans and ask for expanded government benefits. The increasing pressure to improve the Social Security system results in a further weakening of the private sector.

Social Security discriminates against the higher paid employees, and as FICA taxes increase, the discrimination is compounded. In our view, integration is necessary and appropriate to provide all employees with total retirement benefits (from the private plan and Social Security) that are approximately equal as a percentage of pay. The Internal Revenue Service and the Congress have long recognized the validity and fairness of this objective.

To abolish integration, or to impose integration requirements that negate the benefits of integration, (see H.R. 12078), in our judgment, would be unfair and would discourage the formation of new plans. Such action could well result in further plan terminations. The "threat" of plan terminations is often used loosely. However, there is clearly a breaking point at which increased government-imposed complexities and restrictions will destroy employer incentive and initiative. We are gravely concerned that too many proposals in the employee benefit area have been offered on an "ad hoc" basis, with little thought given to their relationship to one another or to their impact on the overall benefit sector.

Recommendation:

We recommend that no changes be made in laws relating to integration of Social Security with private retirement plans until completion of the study of the Presidential Retirement Commission.

XI. TECHNICAL AMENDMENTS.

During 1976 and 1977, the ERISA Advisory Council considered several hundred proposed amendments to ERISA. Many of these amendments were technical or corrective in nature and non-controversial. We understand that the Subcommittees have access to the list of proposed amendments and the comments and recommendations of the Advisory Council with respect to the amendments. We strongly recommend that you carefully consider these technical and corrective amendments for inclusion in any ERISA amendments bill.

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August 22, 1978

The Honorable Harrison Williams
United States Senate
352 Russell Senate Office Building
Washington, D.C. 20510

Attention: Steve Sacher

Dear Senator Williams and Mr. Sacher:

Thank you very much for your request on behalf of the Human Resources Committee for our comments on the protections afforded workers and retirees by the Employee Retirement Income Security Act of 1974. We hope the following observations may be useful to the Committee in its consideration of possible legislative changes in the Act.

We are staff attorneys at the National Senior Citizens Law Center in Los Angeles, California, a national support center operating under contract with the federal Legal Services Corporation and charged with expanding and improving the quality of legal representation available to the nation's elderly poor. Since the center's opening in late 1972, a substantial portion of our practice has been devoted to the rights of workers and retirees who participate in private pension plans. Our efforts on behalf of plan participants include working with legal services attorneys throughout the United States in representing their interests, litigation on behalf of retirees whose claims for pension benefits have been denied, and presentation of the views of claimants we represent to public and private bodies concerned with out nation's private pension system. These comments reflect our experience, both before and since the enactment of ERISA, in working to advance the rights of workers and retirees in the foregoing ways.

Our thoughts in preparing these comments had originally focused on two areas of major concern to many of the pension plan participants we represent. These areas are ERISA's special protections of the pension rights of seasonal workers, protections which have to date received insufficient attention from both the Labor Department and the Internal Revenue Service, and the unintended effects of the overbreadth of ERISA's state law preemption provision, which has both under cut valuable state innovations in the employee health benefits field and threatened the rights of spouses of pension plan participants under state marital property distribution laws which have worked fairly and effectively for generations. The serious questions which have arisen in these two areas deserve, in our judgment, the close attention of this Committee. We are including, as part of this statement, a copy of testimony addressed to the special problems of seasonal workers and of state law preemption we submitted to the Labor Department's ERISA Advisory Council in April of this year. We hope that the views outlined in this testimony will be useful to the Committee in its consideration of these extremely important areas. With respect to the preemption question, we would also urge that the Committee carefully consider proposals such as that recently offered by Senator Curtis (R-Nebraska) in S.2018 to limit ERISA's preemptive effect to those state laws which themselves relate to ERISA's substantive provisions.

Despite the importance of the seasonal workers and preemption questions, the focus of the comments we wish to share with the Committee has been broadened substantially by the introduction last May of the ERISA Improvements Act of 1978 (S.3017) by Senators Javits and Williams. The issues raised by S.3017, and the assumptions which apparently underlie it, are of overriding importance to workers and retirees, because they reflect a careful assessment of ERISA's effects to date by its two major Senate sponsors. While we welcome the many provisions of the bill which strengthen and underscore ERISA's guarantees, we are also concerned that other provisions may undermine these guarantees in ways that are both harmful to the interests of the workers and retirees for whom the private pension system exists and entirely unnecessary.

Much of the ERISA Improvements Act appears to reflect an assumption that ERISA may have harmed the private pension system in the United States as much as it has helped it. Perhaps the best example of this apparent assumption is the sponsors' decision to amend the declaration of policy which introduces ERISA by the explicit addition of a policy "to foster the establishment and maintenance of employee benefit plans sponsored by employers and employee organizations", §201. The insertion of this added policy declaration at the very least implies that ERISA has not in fact fostered the establishment and maintenance of employee benefit plans, and may even suggest, however subtly, that ERISA has discouraged and undermined the creation and operation of such plans. If this kind of implication or suggestion is intended by the change in ERISA's declaration of policy proposed by Senators Javits and Williams, we would submit that nothing in ERISA's three-year history supports so disparaging an assessment of its effects.

We are aware, of course, of the many accounts of pension plan terminations, especially terminations involving small plans, which have surfaced since ERISA's enactment. We are also aware of the objections of employers, employee organizations, trustees, and others in the pension industry to some of the requirements imposed on them by ERISA and by such court decisions as Daniel v. The International Brotherhood of Teamsters. We do not dismiss or ignore either reports of plan terminations or the views of the pension industry. At the same time, we would urge that any proposals to cut back on the protections afforded workers and retirees by ERISA be received with caution, in light of the high stakes involved. The private pension system exists for the benefit of its participants and of its participants only, and the largely unorganized voices of plan participants are rarely heard by those institutions which would now urge that ERISA must be amended in order "to foster the establishment and maintenance of employee benefit plans".

ERISA was based on the premise that employee benefit plans deserve public support and subsidies only if they are operated in a manner that is consistent with the highest possible regard for the rights of the workers and retirees in whose name they are established. Our concern is that the problems encountered by the pension industry in implementing ERISA's standards not be resolved by abandoning this premise. It is in this spirit that we offer the following specific comments on the proposed ERISA Improvements Act of 1978.

1. The proposed Employee Benefits Commission.

We are pleased to see that the bill addresses the problem of dual jurisdiction over the enforcement of ERISA in a comprehensive way. The delay and uncertainty caused by concurrent Labor Department and IRS jurisdiction over similar and often identical ERISA provisions has, in our judgment, been harmful to the interests of plan participants and beneficiaries. The most prominent example of harmful delay is the continuing absence of regulations implementing the special protections of the rights of seasonal workers to participate and accrue benefits in pension plans. These rights are guaranteed by part 2 of title 1 of ERISA, over which both the Labor Department and the Internal Revenue Service may properly assert claims of jurisdiction. The absence of regulations has, in effect, meant the absence of any meaningful protection of seasonal workers' rights. With responsibility vested in a single agency, we believe regulations on seasonal industries would have been published long ago.

At the same time, we wonder whether the dual jurisdiction problem can be be solved by the establishment of a New Employee Benefits Commission, or instead by consolidating ERISA enforcement responsibility in a single existing federal agency. The bill's suggestion that a new commission is the better answer will undoubtedly promote comprehensive and fruitful consideration of this problem and is, for this reason at least, welcome.

2. Reporting and Disclosure.

(A) The consolidation and strengthening of provisions which assure plan participants timely access to their records of benefit accrual are a most welcome change. We have represented two workers since the effective date of ERISA's reporting and disclosure provisions who were forced to resort to litigation in order to secure a statement of benefit rights from their respective pension plans and thereby to ascertain whether they had qualified for a retirement benefit. So long as workers and retirees continue to be forced to an adversary relationship with their pension plans, the protections afforded by section 105 of ERISA will remain ineffective. The ten dollar penalty provision proposed by section 221(c)(3) may be a useful curb on negligence in pension plan administrative offices. We fear, though, that a ten dollar penalty may not be a sufficient deterrent to such negligence and would suggest also that a plan participant aggrieved by an unlawful failure to furnish required information be permitted to recover the penalty, whatever its amount, from any person who failed to meet his or her obligations.

The proposed elimination of the summary annual report (section 223) is, in our view, a reasonable step toward meeting the pension industry's demand for less ERISA related paperwork. At the same time, if the summary annual report requirement is to be eliminated, we believe every participant and beneficiary should be entitled to receive each annual report prepared by his or her pension plan, free of charge. The information required to be contained in an annual report, currently set forth at section 103 of ERISA, affords workers and retirees the clearest available picture of their plan's financial situation and of the actuarial assumptions and/or data on which the plan's eligibility and benefit structure are based. If pension plans are truly for the benefit of their participants and beneficiaries, there should be no financial barrier whatever placed between participants and beneficiaries and the essential information contained in every annual report. If, notwithstanding the right of every participant and beneficiary to secure a copy of his or her plan's annual report, a charge for providing the report is permitted, such a charge should never exceed the actual cost to the pension plan of providing a copy of the annual report to a participant or beneficiary who requests it. In many instances, the ten dollar maximum proposed by the bill will violate this principle. In such instances, the only effect of the ten dollar charge will be to deter interested participants and beneficiaries from requesting information they are entitled to know. At a minimum, therefore, we would urge that the amount a pension plan is permitted to charge a participant or beneficiary for his or her first copy of the plan's annual report for a given year be limited to ten dollars or ten cents per page, whichever is less.

If the elimination of the summary annual report may be a salutary change, the proposed extension of the interval between summary plan descriptions from five years to ten years certainly is not. This proposal appears to us to reflect an incomprehensible hostility toward the summary plan description, perhaps the single most useful document made available to active workers under ERISA. A summary plan description that is seven or eight years old may be worse than useless; it may actively mislead a participant who reasonably relies on it. To permit distribution of an obsolete summary plan description when intervening plan amendments, including amendments in eligibility conditions, have been made, is, in our view, unconscionable. We would urge that the provisions of ERISA relating to summary plan provisions be left as enacted in 1974.

An equally harmful amendment is the proposal to permit the Secretary of Labor (or the Employee Benefits Commissioner, as the case may be) completely to exempt an employee benefit plan or class of plans from all reporting and disclosure responsibilities. This kind of wholesale delegation of power to a federal agency would, we believe, represent an irresponsible abdication of Congress' obligations to pension plan participants and beneficiaries. The delegation is grossly overbroad, allowing entire classes of benefit plans, such as, for example, all jointly-administered pension plans, to be exempt from all disclosure responsibilities with the stroke of a pen. Moreover, exemptions granted pursuant to this proposed amendment, would apparently have an indefinite duration. There is not even a suggestion of a time limit within which such an examption, once granted, must be reviewed. There are, lastly, no meaningful instructions to the Labor Secretary of Employee Benefits Commissioner respecting the standards he ought to use in deciding whether an exemption from disclosure responsibilities ought to be granted. The phrases set forth in the amendment as now written, "appropriate and necessary in the public interest" and "consistent with the purposes of this title" are so vague as to invite abuse of the exemption authorization to the complete derogation of the rights of workers and retirees. If it is Congress' view that workers and retirees ought not have a right to be apprised of the basic structure and operating principles of pension plans in which they participate, then perhaps an outright repealer of ERISA's reporting and disclosure requirements ought to be proposed; however, if workers and retirees do enjoy disclosure rights, these rights should not be destroyed through a vague and standardless exemption provision.

3. Participation and Vesting.

The amendments proposed by the Javits-Williams bill to ERISA's participation and vesting standards contain three excellent provisions which we hope may be speedily enacted into law. These provisions, respectively, encourage the establishment of reciprocal agreements among pension plans, assure that a pension beneficiary's receipt of a worker's compensation award or a welfare plan beneficiary's receipt of an increased public benefit, cannot result in a diminution or loss of pension or welfare plan benefits, and most importantly, require every pension plan to provide a surviving spouse's benefit when a worker whose pension rights are vested dies before reaching retirement age.

Since ERISA's enactment, we have been asked to represent at least a dozen retirees aggrieved by one or more of the gaps these proposed changes would fill. The quality of life available to each of these elderly workers or spouses would have been substantially enriched had these provisions been in effect at the time they came to us. Although the encouragement of reciprocity and the protection of benefits from reduction because of awards from external sources are very important, the most crucial of these three valuable amendments is the proposed provision to assure a spouse's benefit. Far too many times, we have been forced to advise an elderly widow that we could not help her because her husband's death divested her interest in his fully vested pension benefit. Death should not be an exception to the vested rights assured by ERISA. Section 238 of the Javits-Williams bill would end an extremely unjust anomaly.

Unfortunately, the proposed amendments to ERISA's participation and vesting standards also contain two provisions which we believe are unnecessarily harmful to the rights of workers and retirees. The first of these provisions would explicitly sanction the use of the so-called "elapsed time" measure of service for participation, vesting, and accrual purposes. Despite the modest administrative convenience the elapsed time rule would afford to some plans, the rule can also easily prevent workers from receiving appropriate credit for the hours of service they perform, and can even result in a worker's failing to qualify for a pension benefit while a co-worker with substantially less total covered hours becomes fully qualified. We would recommend to the Committee the excellent analysis of the adverse effects of the elapsed time rule prepared by Karen Ferguson of the Pension Rights Center in Washington, D.C.

The second inappropriate amendment to ERISA's participation and vesting standards is one which would broaden the authority permitted a pension plan to suspend benefits because of reemployment when a worker retured to work in a trade or craft and geographical area in which he earned pension benefits even if the worker's reemployment is in a different industry. The amendment would also authorize imposition of a penalty for return to work in addition to suspension of benefits. We oppose the extension of suspension authority because it seems to us that it is both unnecessary and in conflict with other important federal employment policies. We oppose, in addition, the penalty provision because we fear it can all too easily be unfairly abused. The proposed expansion of the authority to suspend benefits seems clearly designed to prevent workers who have earned pension benefits in private industry from returning to work in their trade or craft in employment provided by a government agency. Such an expansion not only runs afoul of the idea that pension rights are earned rights to which a worker is entitled once he meets his plan's age and service requirements, but also seems to fly in the face of recent federal legislation protecting federal civil servants from discrimination in employment on account of age until they reach the age of 70. Since the comparable age ceiling in the private sector is age 65, one effect of this new anti-age discrimination legislation will be to encourage private sector retirees to seek employment from the federal government where and when there is a demand for their services. In our view, ERISA should not point in the opposite direction, especially when a private sector retiree's employment in a government job in no way threatens the ability of younger participants in his private pension plan to find work.

The proposed penalty provision, authorizing extension of the permitted benefits suspension beyond the retiree's actual period of reemployment would, we fear, often be unfairly applied. Prior to ERISA's enactment, for example, we represented a number of retirees in relatively long and drawn out ultimately successful claims for pension benefits. During the pendency of our clients' claims, however, economic necessity forced them to continue working in their trade. As a result, when benefits were finally awarded, effective back to the date of initial application, all retroactive amounts, as well as amounts due for the first few months following the final favorable determination, were suspended because of the clients' work during the pre-award period of pension eligibility. The suspension was effected, of course, under color of a plan provision similar to the proposed penalty provision in the Javits-Williams bill. If such a provision is enacted, it will, we think, be very difficult to prevent such unfair suspensions from occurring again.

In sum, we hope that ERISA's current provisions regarding suspension of benefits are left unchanged. But if the authority to suspend is expanded in the way proposed by the Javits-Williams bill, we certainly urge that such expansion is not accompanied by a penalty provision. If anything, we would urge that the harsh effects of a complete benefit suspension be mitigated somewhat by allowing a worker a modest amount of exempted earnings analogous to the exempt amount under the Social Security retirement test before a suspension of his pension benefits may go into effect.

4. Fiduciary Responsibility.

We very much welcome the proposed amendment codifying the obligation of employers to honor collective bargaining agreement obligations to make pension plan contributions. At the same time, we would urge that fiduciaries who are trustees of collectively bargained pension plans not be exempted from liability for breach of fiduciary duty when they fail to make reasonable efforts to correct an employer's failure or refusal to make agreed upon contributions when the trustees have knowledge of the failure or refusal. It appears to us that section 264 of the Javits-Williams bill would improperly exempt trustees from responsibility in this sort of situation.

We are, in addition, pleased to see the encouragement of reciprocal agreements confirmed at section 265 of the Javits-Williams bill, and encouraged by the effort reflected at section 266 to resolve the problems created by unregulated multi-employer trusts (Mets) which have unfortunately flourished in the wake of ERISA's overbroad preemption provision.

5. The Daniel Question.

The Javits-Williams bill's proposed rollback of the decision of the United States Court of Appeals for the Seventh Circuit in Daniel v. International Brotherhood of Teamster, et al., 561 F.2d 1223 (7th Cir. 1977), and especially the bill's attempt to strip the federal courts, both prospectively and retroactively, of jurisdiction over suits modeled on a Daniel theory, seem to us to be a hasty overreaction to a decision that is neither as revolutionary nor as detrimental as its opponents in the pension industry would suggest. In many respects, the principles which underlie the Daniel holding can serve as a modest and effective complement to the reporting and disclosure standards of ERISA.

As active counsel in the Daniel case, both before the Seventh Circuit and now before the Supreme Court (we represent the Gray Panthers who have entered the case as amicus curiae in support of the position of plaintiff John Daniel), we have consistently tried to point out that the obligations which result from acknowledging the applicability of the anti-fraud provisions of the securities laws to private pension plans represent only a limited extension of duties which have long been conceded to exist under the common law of trusts and under section 302(c)(5) of the Taft-Hartley Act, 29 U.S. Code §186(c)(5). Daniel is, at bottom, a disclosure case. The duty of trustees to disclose salient information regarding the structure of a trust to beneficiaries has long been a cornerstone of the common law of fiduciary responsibilities. In addition, completely aside from ERISA's disclosure requirements, the "sole and exclusive benefit" standard of section 302(c)(5) of the Taft-Hartley Act has consistently and without significant controversy been found to preclude trustees of jointly-administered, union negotiated pension funds from denying benefit claims submitted by workers to whom proper disclosure has not been made. See, for example, Burroughs v. Board of Trustees, 542 F.2d 1128 (9th Cir. 1976). With this background, the chief effect of the Daniel holding is to supplement preexisting law by requiring disclosure to covered workers of a readily determinable core of extremely salient actuarial information. The information required by Daniel focuses on the most important question facing a worker who is enrolled in a pension plan: the probability that he will ever qualify for a benefit from that plan. As the Seventh Circuit has rightly pointed out, 561 F.2d at 1250, data necessary to calculate this probability is already available to pension plan actuaries and the calculation and disclosure can be accomplished with an extremely modest additional effort.

Viewed within this context, the Javits-Williams bill's proposal to strip the federal courts of jurisdiction over claims against pension plans based on the anti-fraud provisions of the securities laws unnecessarily undermines an important tenet of our jurisprudence. If the securities laws have, up to now, created federal rights in workers covered by private pension plans, the federal courts, created by Article III of the Constitution, should not be stripped of jurisdiction to provide a remedy for violations of these rights. To withdraw subject matter jurisdiction from courts already adjudicating claims based on a securities law theory, may in fact create a thicket of constitutional problems which ought, if possible, to be avoided. A decision to enter this thicket reflects, moreover, a profound and unwarranted mistrust of the ability of the federal courts to exercise their equitable powers in a rational and responsible manner. If the anti-fraud provisions of the securities laws apply to private pension plans, we should not expect the federal courts to seize on this applicability as a device to destroy the private pension system as we know it. We expect and trust our federal courts to fashion remedies which are sensible, equitable, and which do justice to all parties. We should not assume, as the jurisdiction divestiture proposal of the Javits-Williams bill appears to, that the federal courts have betrayed or will betray this trust. As Senator Williams himself noted, the Supreme Court itself has only recently shown its reluctance to impose massive retroactive liabilities against pension plans in its decision in City of Los Angeles v. Manhart, No. 76-1810, April 25, 1978.

As to the future, the importance of the Daniel holding to pension plan participants and beneficiaries is not that Daniel turns their interests in receiving a pension into an investment or brings that interest within the jurisdiction of the Securities and Exchange Commission. The interest of participants and beneficiaries is rather in maintaining their entitlement to receive, digest, and act upon the particular information required to be disclosed by the Daniel holding. If disclosure can be assured only by bringing private pension plans under the protective umbrella of the securities laws anti-fraud provisions, the guarantees afforded by these provisions should not be preempted by a statute that purports to protect "employee retirement income security". A far better solution, we believe, would be to incorporate the specific disclosure requirements imposed by the securities laws into ERISA itself, thereby assuring workers the protection they deserve while making securities claims irrelevant for the future. Any preemption of the anti-fraud provisions of the securities laws should, we urge, be accompanied by this sort of strengthening of ERISA's own disclosure requirements.

6. Other Administration and Enforcement Questions.

The proposal to institutionalize a permanent representative of small pension plans on the Labor Department's ERISA Advisory Council points up the need, in our judgment, for greater Congressional attention to the Council's structure and activities. As presently constituted, the Advisory Council serves as nothing more than a forum for the exposition of the interests of the pension industry. As such, the assistance the Council can provide to the Labor Department's deliberations is limited by its one-sidedness. We would urge that seats on the Advisory Council be reserved for at least one active worker participating in a pension plan, and for one retiree receiving benefits. Unless this kind of participant and beneficiary representation is assured, we doubt that the Council's contributions are sufficiently valuable to warrant its continued public support.

With respect to preemption of state laws, our views are outlined above and in the accompanying statement submitted with this one. We note that the proposed Javits-Williams bill would do nothing to modify or limit the destructive effects of ERISA's currently overbroad preemption provision. At the very least, we would hope that the bill can be amended to assure that the enforcement of state marital property distribution schemes will not be in danger of preemption.

7. Proposed Internal Revenue Code Changes.

We welcome the proposal set forth at section 303 of the Javits-Williams bill to allow tax deductions for employee contributions to qualified retirement plans. We are pleased also to note the emphasis on encouraging such contributions by workers whose gross incomes are $30,000 or less.

At the same time, we must admit to some skepticism about the proposal set forth at sections 304 and 305 to provide tax credits for the establishment of new, small pension plans and for the adoption of "improvements", presumably by way of more liberal eligibility conditions in existing qualified plans. Tax credits are direct expenditures of public money and should, in our judgment, be allowed only when certain to advance an important public purpose. The public purpose to be advanced by the proposed Javits-Williams tax credit is the increased enjoyment of pension benefits by American workers. Without more specific standards to govern allowance of the credit, we are not certain that this intended purpose will be achieved. For example, in the absence of such accelerated vesting formulae as the 4-40 scheme, proposed (but then withdrawn two years ago) by the Internal Revenue Service, it is by no means assured that a small pension plan established under section 304 will in effect benefit very many of the workers it covers. Similarly, without explicitly targeted results, we fear it is a l too likely that "improvements" of qualified plans under section 305 will prove cosmetic and result in few, if any, additional workers receiving benefits.

Accordingly, we would propose that if tax credits are to be used at all in the private pension area, such credits should be allowed only under the strictest of standards. Credits might, for example, be allowed in the case of a pension plan which provided for full and immediate vesting of all employer contributions made on a participant's behalf. In addition, tax credits might be used to encourage small employers to contribute to (or perhaps even to establish) individual retirement accounts on behalf of their employees. Deployment of tax credit incentives in this manner would not only assure that the benefit of a tax credit flowed to the workers who are its ultimate intended beneficiaries, but would also allow a small employer to contribute to the retirement security of his workforce without undertaking the administrative burden of establishing a qualified pension plan.

8. Summary.

In sum, while we believe the proposed Javits-Williams bill contains a number of amendments which would strengthen the protections which ERISA has introduced, we fear that the overall tenor of the bill betrays an assumption that the balance of rights and obligations may have shifted too far in favor of workers and retirees at the expense of the health of the private pension system as a whole. There is, in our judgment, no serious basis for this kind of an assumption. ERISA was a beginning. In general, the standards it set for protecting the rights of workers and retirees were minimum standards. Amendments to these standards ought to be in the direction of improving and expanding, rather than reducing them. The financial health of the private pension system is, in our judgment, a worthy goal only if that system is also just.

We very much appreciate this opportunity to share our perspectives on proposed legislative amendments to ERISA with this Committee. We wish the Committee well in carrying out its difficult task of overseeing the enforcement and implementation of ERISA.

Sincerely,

Bruce K. Miller
Staff Attorney

Neal S. Dudovitz
Staff Attorney

BKM:NSD:re
Enclosure

S T A T E M E N T

of

NEAL S. DUDOVITZ and BRUCE K. MILLER

to

THE ERISA ADVISORY COUNCIL ON EMPLOYEE

WELFARE AND PENSION BENEFIT PLANS

April 4, 1978
Los Angeles, California

We are staff attorneys at the National Senior Citizens Law Center, a national support center funded by the Legal Services Corporation and charged with expanding and improving the quality of legal representation available to the elderly poor. Since the Center's opening in 1972, a major portion of our work has focused on the rights of workers and retirees covered by private pension plans. We have both assisted Legal Services attorneys throughout the United States in their representation of pension plan participants and undertaken a substantial amount of such representation ourselves. Much of the latter has involved litigation on behalf of workers and retirees whose interests are deeply affected by the Labor Department's resolution of the broad policy issues taken up today by the Advisory Council. We have, for example, extensively pursued litigation on behalf of two groups of employees, construction laborers and cannery workers, with a direct stake in the Department's forthcoming regulations on the treatment of seasonal industries under ERISA. We have also been forced to defend a number of lawsuits in which our clients' community property pension rights, or rights as participants in employer-funded health benefit plans, have been threatened by ERISA's provisions concerning the preemption of state laws. Our comments today reflect judgments we have reached in the course of our participation in this litigation.

The Rights of Workers in Seasonal Industries

The threshold question facing the Labor Department in fashioning a seasonal industries policy under ERISA is unfortunately one which we had hoped would be resolved long before now. That question is whether seasonal workers are entitled to special regulations to protect the rights purportedly guaranteed to all private pension plan participants by ERISA. A number of commentators representing the pension industry have urged that these rights are subject to the discretion of the Labor Department, and worse, that the exercise of this discretion is unnecessary and even improper. Our first and most emphatic recommendation to the Advisory Council is that it remind the Department that this position has no basis in ERISA's statutory language, which is mandatory in its direction to the Secretary to promulgate special "year of service" regulations, and that such regulations are essential if seasonals are to enjoy the protection against forfeitures intended by ERISA to even a modest degree. In the absence of regulations which carefully tailor the definition of a year of service to the circumstances of particular seasonal industries, most seasonal workers will, by virtue of customary work patterns over which they have little or no control, be forced to participate in pension plans which offer them no meaningful opportunity to earn a vested right to benefits.

We believe that the best starting point for a year of service definition which will recognize the interests of all seasonal workers is a premise suggested last August by Dan McGinn

1,000 hours of service per year over any reasonable number of consecutive years, and cannery workers, who almost never manage 1,000 hours in a given year, will nevertheless have a reasonable opportunity to accrue a measure of protection of their pension rights. We wonder, though, whether the particular percentage and measurement period suggested by Mr. McGinn offers sufficient protection to seasonal workers who are either covered by very large plans with almost exclusively non-seasonal populations, or who are saddled with an extremely short annual period of demand for their work. We are not certain just what the appropriate percentage and measurement period ought properly to be and would urge the Advisory Council to recommend that the Labor Department sponsor one or more independent analyses of this question. We do believe, however, that the Department's regulations should, in the short run, be designed to protect the foregoing classes of "worst case" seasonal workers and would accordingly recommend five percent and four years as the appropriate triggers of special seasonal treatment.

Assuming that Mr. McGinn's general approach is adopted, an appropriate definition of a year of service for both vesting and break-in-service purposes must be fashioned for the benefit of workers defined as seasonal by its application. Mr. McGinn has suggested a halving of ERISA's standard 1,000 hour and 500 hour requirements for non-seasonal workers. In our experience, measurement of a year of service by 500 hours and of the amount of work needed to avoid attribution of a break-in-service by 250 hours will indeed adequately serve the interests of many seasonal workers.

But many is not all, nor even most. For example, a significant number of the long term cannery workers we represent would, despite more than ten calendar years of service, never earn a vested right to benefits under a 500 hour standard. The failure of the standard to accommodate the interests of these workers reveals, we think, its underlying shortcoming: the 500/250 hour measure of seasonal workers' eligibility abandons the very functional plan-by-plan, result-oriented approach which Mr. McGinn quite rightly suggests as the appropriate mechanism for identifying seasonal workers. We believe a similar plan-by-plan approach is necessary to assure just treatment of workers so identified. We believe, for example, that there should be a rule which required each plan covering seasonal workers to set the measure of a year of service as the number of hours needed to assure that 75 percent of the workers identified as seasonal by the standard outlined above would, in a normal year, qualify for a year of service. To preserve the parallel relationship to ERISA's basic structure for non-seasonal workers, half of this number of hours would be the amount required to avoid attribution of a break-in-service.

In sum, we believe that Congress' intention to extend the broad protections of ERISA to seasonal as well as non-seasonal participants in private pension plans can best be assured by a definition of seasonal work and by particular service requirements to implement that definition which are tailored to the actual work patterns experienced by populations of seasonal workers measured from pension plan to pension plan. In order to guarantee that all seasonal pension plan participants enjoy the benefits of this kind of approach, we further urge that every pension plan covered by ERISA be required periodically to determine whether it covers seasonal workers and to buttress that determination by the inclusion of appropriate data in its annual reports. If the Advisory Council concurs with these recommendations, we hope it will propose to the Department of Labor that they be reflected in its forthcoming seasonal industry regulations.

Preemption

One of the major issues to surface since the passage of ERISA has been the scope of Section 514 of the Act - the preemption provisions. While the language of the statute appears broad, its meaning is by no means clear as the extensive litigation over its terms demonstrates.

The current problems of preemption revolve around two types of state statutes: 1) health insurance laws and 2) family law. In both circumstances, employee benefit plans have gone to court and sought rulings that state laws are preempted or void. The rationale underlying such attempts has been that application of the state laws in addition to ERISA would create administrative difficulties. We are particularly concerned with these attacks on state laws because they are among the first attempts by employee benefit plans to use ERISA for the purpose of depriving employees of their benefits. Such a result, we believe, is inconsistent with the purposes and intent of ERISA itself.

Although the final answer of the courts on the scope of Section 514 is still outstanding, we believe that this Council can and should take specific action to insure that ERISA does secure employees' benefits. The appropriate course of action depends on the type of state law in question.

A. Family Laws

The relationship of ERISA to state family laws is tangential at best. Yet a considerable number of courts have been confronted with the question of whether traditional and well-accepted laws concerning the division of property among family members is affected by ERISA.

The problem occurs most frequently during the divorce process when the rights of one spouse to the pension benefits of the other spouse is at issue. Usually the spouse without benefits attempts to have the pension plan pay to him or her a portion of the benefits as allowed by state law. This situation occurs in all states, and particularly those using community property concepts.

Many pension plans have strenuously objected to paying a portion of a retiree's benefits directly to the spouse. They contend that such an order by a state family court violates both the preemption provisions of ERISA and the anti-assignment section (29 U.S.C. §1045(d)(1)). If the arguments advanced by these plans are accepted, it will result in a significant number of older persons, particularly women, being deprived of money that they would otherwise be entitled to receive.

We believe that neither Congress nor this body intended such a result. In fact, as numerous courts have held, ERISA itself does not specifically mandate that state family laws be voided.

This problem can be substantially mitigated and many retirees saved from needless litigation by the issuance of interpretive regulations which appropriately explain the scope and limits of the preemption statute. Regulations which would find that family laws, particularly divorce provisions, are not laws which relate to employee benefit plans in prohibitive fashion would tend to defuse the preemption issue. Further, a regulation is needed that determines that obligations and rights of one family member to another's pension benefits, as created by state law, are not assignments or alienation as provided by ERISA. Spouses should not be considered in the same light as commercial creditors. Both of these interpretations are not only consistent with vari s courts' interpretations of ERISA, but also with other federal retirement policies, such as the Social Security Act. We urge this Council to immediately propose such regulations to the Department of Labor.

B. Health Insurance Laws

The issue of preemption of state health insurance laws has received a considerable amount of attention within the pension community. It has also been the subject of numerous federal court decisions and has recently been accepted by the United States Supreme Court for determination next year. However, preemption of state health insurance laws not only has deprived workers of important protections and benefits, but may have stymied the states' ability to create new and unique health insurance provisions. As Mr. Justice Brandeis stated some years ago:

> "To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country." New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

In an area of such great concern as health insurance, this Council should seek to secure the best possible benefits for employees.

The courts have not been uniform in their interpretation of ERISA's preemption provisions in this area. The cases have concerned not only the general preemption language, but also the so-called savings clause which exempts state insurance laws from preemption and the "deemer" clause which prevents a state from deeming a benefit plan to be an insurance company.

The essential problem differs from the family law questions since most of the state laws are designed to affect employee health and welfare plans. However, the state laws cover a much broader area than ERISA. The laws legislate, for example, the nature and type of benefits, as well as maximum benefit levels, none of which are covered by ERISA. Some of the laws attacked by the pension plans, like those in Minnesota, California and Hawaii, are considered model legislation drafted to protect the rights of workers and consumers.

The arguments put forward by plans, if accepted, would create a regulatory void. While ERISA provides specific statutory minimums with regard to the nature of pension benefits, it provides only minimal disclosure and fiduciary protections for health and welfare benefits. As a result, preemption of health insurance laws leaves many workers without the protections of state laws and no corresponding federal legislation to take its place. We believe Congress did not intend or foresee this result.

Although courts may still interpret the statutes to avoid this result, we believe it is time for legislative action which will secure employees all the protection of both federal and state law. A simple change in the preemption statute which allows state laws to be preempted only when in conflict with ERISA would certainly prevent unnecessary harm to many employees.

A statutory amendment of this nature would allow the important ERISA disclosure and fiduciary provisions to govern nationwide, but still allow states to place important controls on health benefits. If Congress later chooses to expand ERISA in a new area not previously covered or to enact National Health Insurance, then corresponding state laws would be preempted. We believe this Council should immediately propose to the Department of Labor that the ERISA preemption statute be so amended. Otherwise, thousands of workers such as those in California and Hawaii stand to lose important health benefits.

We appreciate this opportunity to share our thoughts on some of the issues the Advisory Council is grappling with. We know that none of these issues are easy to resolve and we wish the Council well in its efforts to make sound policy recommendations to the Department of Labor.

Neal S. Dudovitz & Bruce K. Miller
National Senior Citizens Law Center
1709 West Eighth Street, Suite 500
Los Angeles, California 90017
Telephone: (213) 483-3990

NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS

"Putting It All Together For The Engineer"

Address Reply To:
LEGISLATIVE AND GOVERNMENT AFFAIRS
OFFICE OF THE CHAIRMAN

WILLIAMS, H.
1978 SEP -6 AM 10

September 5, 1978

Honorable Harrison A. Williams, Chairman
Subcommittee on Labor
Committee on Human Resources
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

On behalf of the National Society of Professional Engineers, the American Consulting Engineers Council, and the American Society of Mechanical Engineers, whose combined membership exceeds 160,000 individual members and 3,400 engineering consulting firms, I respectfully request that this letter and attached statement on legislation to amend the Employee Retirement Income Security Act of 1974 be included in your Subcommittee's hearing record on this very important topic.

Our societies commend your decision to hold hearings on legislation to amend ERISA and are pleased to advise the Subcommittee of our support of the general thrust of S.2352, S.3017, and S.3193. The engineering profession urges prompt passage of legislation that will alleviate paperwork burdens imposed by ERISA and, to that end, pledges its support.

Very truly yours,

O. A. Tennant

Otto A. Tennant, P.E.
Chairman

COMMITTEE ON
HUMAN RESOURCES
1978 SEP -6 PM 12 01

Enclosure

2029 K STREET N W ■ WASHINGTON, D C 20006 ■ 202/331-7020

STATEMENT OF
THE NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS
THE AMERICAN CONSULTING ENGINEERS COUNCIL
AND
THE AMERICAN SOCIETY OF MECHANICAL ENGINEERS
ON
LEGISLATION TO AMEND THE
EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974
TO JOINT HEARINGS OF THE
COMMITTEE ON HUMAN RESOURCES SUBCOMMITTEE ON LABOR
AND THE
COMMITTEE ON FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS
UNITED STATES SENATE
August 31, 1978

The National Society of Professional Engineers, a nonprofit organization representing 80,000 members engaged in virtually all displines of engineering, the American Consulting Engineers Council, representing over 3,400 consulting engineering firms and the American Society of Mechanical Engineers, representing more than 80,000 individual members, welcome the opportunity to comment on several proposals to amend the Employee Retirement Income Security Act of 1974 (ERISA).

NSPE, ACEC, and ASME commend the members of the Subcommittees for introducing ERISA reform legislation and for scheduling these hearings. We believe that the time is appropriate to review the success of ERISA over the past several years and whether or not Congress' objectives under ERISA have been achieved.

Our profession's interest in these issues stems partially from the nature of our membership. Many engineers are employed in small industry; others are partners or employees of small engineering firms and, therefore, represent the small business community. As your Subcommittees know, small businesses are generally employee-oriented, relying heavily on the talents and productivity of their employees. This is particularly true of engineering firms. It is not difficult to understand, then, why many engineer members of our organizations are particularly concerned with the pension needs and welfare benefits of their employees. But these same members are confronted daily by the regulatory burdens imposed by ERISA, burdens that hit them, the small businessman, hardest. Of course, these burdens also effect other engineers who are not involved in small businesses.

We support the general thrust of pending legislation such as S.2352, S.3017 and S.3193 to simplify compliance with ERISA's provisions, since excessive paperwork burdens and compliance costs have been incurred by many engineering businesses in administering plans.

Our societies continuously receive reports of the problems caused by these excesses. One engineering firm comprised of fewer than 30 people has reported that it is considering abandoning its profit sharing plan rather than going to the expense in time, money and manpower to comply with the mountainous paperwork requirements of ERISA.

Another engineering firm reported that is has already decided to eliminate some specific programs within its operation so that the awesome number of reporting requirements under ERISA and other federal programs can be cut down.

In short, the fact is that the Employee Retirement Income Security Act, in a short time, has become a serious burden to both small and large engineering businesses offering pension plans. Its provisions are extremely complex and sometimes conflicting; and its implementation has proven costly and difficult particularly to small businesses. Since official Department of Commerce statistics show that the vast majority of American businesses are small (employing fewer than 100 employees) and that an overwhelming majority of pension plans are filed for groups of fewer than 100 employees, we feel it is essential that small businesses must be kept in mind as Congress considers the pending legislation to amend ERISA.

NSPE, ACEC and ASME are pleased that President Carter, having recognized the need for simplifying ERISA's reporting and disclosure requirements, signed an Executive Order establishing a Presidential Commission on Pension Policy to study and recommend national policies for retirement plans as part of an overall reorganization program. We await the opportunity to work with the Commission and their report. We also note that he has attempted to further simplify ERISA implementation by attempting to establish a clear and separate authority for the Internal Revenue Service and the Department of Labor in distinct areas of jurisdiction. The President's efforts are commendable and much needed; but they represent only the first step in the resolution of ERISA-imposed burdens. Congress, however, should accept the ultimate responsibility to correct with legislation the administrative and paperwork burdens of ERISA that were imposed by legislation in the first place.

With regard to specific pending legislation, our societies support the provisions of S.2352 which would reform existing structures rather than start from scratch, and which, we feel, would offer the fastest remedial action to establish a clear division of authority between the Internal Revenue Service and the Department of Labor. S.2352 would necessitate neither physical nor personnel relocations and the lines of authority for the IRS and DOL would be drawn so that each would administer provisions which reflect its own particular expertise and interests.

We also support the provisions of S.3017 which deal with simplification of ERISA's reporting and disclosure requirements by exempting or modifying any existing paperwork requirements for employee benefit plans when such actions are consistent with the public interest.

By changing existing requirements, we believe that qualified retirement plans might be made more attractive to a broader segment of employers and the changes might slow the rate of plan terminations such as we mentioned earlier in this statement.

S.3193, which we also support, provides for the elimination of superfluous reporting under ERISA by requiring the filing of annual reports every 5 years instead of every year. In other years, pension plans would file a vastly simplified report. We feel that the constructive impact of this approach, particularly of small company pension plans, would be enormous since it would precipitate significant reductions in reporting time and costs by the employers filing reports as well as administrative personnel within the agencies.

Our organizations offer these comments and recommendations for the purpose of helping your Subcommittees to achieve much needed reform of the pension laws. We wish to assure you of our continued interest in these matters and of our willingness to be of assistance in any way possible.

33-549 O - 78 - 85

New England Life

NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY / 501 BOYLSTON STREET, BOSTON, MASSACHUSETTS 02117 / 617 266 3700

JONATHAN R ALDER C L U
Executive Vice President Marketing

August 25, 1978

The Honorable Harrison A. Williams, Jr.
United States Senate
Russell Senate Office Building - Room 352
Washington, D.C. 20510

Attention: Stephen Sacher, Counsel

Dear Senator Williams:

New England Life ("NEL") chartered in 1835, ranks (on the basis of assets) as the twelfth largest life insurance company in the nation. It writes a complete line of life insurance and annuity contracts, both on an individual and a group basis. NEL has for many years occupied a leadership position in the sale of policies and contracts in the small plan pension market and currently has over 25,500 plans in force. NEL provides most of its services and products, particularly for the smaller plans, through licensed life insurance agents holding full-time contracts with NEL. Many of these agents have specialized in the qualified plan area for many years and maintain comprehensive and complete servicing facilities for the installation and administration of plans. These same agents have been the primary resource in helping these plans come into compliance with ERISA. NEL has made substantial committments of people and money to be able to service our clients under ERISA.

New England Life believes that the private pension system is an essential part of the various methods of providing adequate retirement income for the people of this country. There are several key provisions in the bills before the joint committee which we feel will encourage employers to provide greater coverage and benefits for their employees.

Senator Williams
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REPORTING AND DISCLOSURE REQUIREMENTS

S 3017, sponsored by Senators Williams, Javits and Melcher and S 3193 sponsored by Senator Bentsen will reduce duplicative and unnecessary paperwork for plan sponsors. ERISA did much to strengthen the private pension system, but some of its reporting requirements have been very burdensome and costly, especially for the small employer. This has been a negative factor in the creation of new plans and has been a large factor in the termination of small plans. An attached study prepared for the House Small Business Committee in October, 1977 on the reasons for plan terminations, indicates that over half of the plans surveyed cited reporting and disclosure requirements as the reason for plan termination. We support the proposals which would:

1. eliminate the Summary Annual Report requirement;

2. merge form EBS-1 with the IRS Application for Determination forms (or eliminate form EBS-1 entirely as proposed in the President's Re-organization Plan. No. 4);

3. require that a full Annual Report (the 5500 series) be filed for a plan once every five years, with a simplified Annual Report for years when a full report would not be due;

4. authorize the development of annual reporting forms for different types and sizes of plans;

5. require that an updated Summary Plan Description be furnished to plan participants and beneficiaries every 10 years (instead of every five years as under present law);

6. permit Summary Plan Descriptions to be distributed to new participants 90 days after the end of the plan year;

7. require that actuaries and accountants must rely on the correctness of materials prepared by each other.

We also support the position of the American Council of Life Insurance (ACLI) that certain small plans be eligible for a cost effective substitute to the ERISA actuarial certification requirements. The ACLI recommended, as one of the conditions to its proposal, that plans be limited to only one funding method, i.e. the level annual premium method. Other equivalent funding methods which provide the same protections to plan participants and beneficiaries should also be

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Page 3

permitted, so that as many small plans as possible would be eligible. The Price Waterhouse survey, conducted for the Labor Department, stated that the ERISA actuarial certification requirement is the single largest cost item for plan sponsors. The substitution of this requirement for certain small plans is a necessary step in decreasing costs and administrative complexity for small plans.

SPECIAL MASTER AND PROTOTYPE PLAN

S 3017, sponsored by Senators Javits, Williams and Melcher provides for a special master and prototype plan. We recommend a specific delineation of the duties to be performed by the "master-prototype" sponsor. For example, the "master-prototype" sponsor could be made specifically responsible for the following:

1. preparation of and furnishing Summary Plan Descriptions
2. furnishing participant benefit statements
3. furnishing copies of plan documents and annual reports
4. notifying each employer sponsor of any required annual contributions
5. calculating benefits for terminated or retiring plan participants.

Close physical proximity to plan participants and beneficiaries makes the agent or employee of the "master-prototype" sponsor the logical choice to perform a variety of duties, such as responding to day to day questions about the plan, furnishing Summary Plan Descriptions and other materials on a timely basis, seeing that beneficiary designations are made and that qualified joint and survivor annuity elections are made available.

We join with the American Council of Life Insurance in urging that changes be made so that the labels currently required of the "master-prototype" sponsor, such as "investment manager" "plan administrator" and "named fiduciary" be made optional, rather than mandatory. To require that a "master-prototype" sponsor be investment manager for a plan could place the "master-prototype" sponsor in a conflict of interest role in that it would be the provider of products and at the same time ostensibly an independent investment adviser. The employer sponsor should be permitted to select the particular insurance carrier or other financial institution which makes available a "master-prototype" plan, based on the investments available, the quality of the services and the reputation of the institution.

Although in some instances the "master-prototype" sponsor (or its agents or employees) may be "plan administrator" and "named fiduciary" of the plan, these designations should be optional, rather than mandatory. In certain circumstances, the employer (or its representatives), the plan trustees, or retirement committee may want to assume the designation of "plan administrator" and "named fiduciary." The special "master-prototype" plan will have wide appeal to small employers if the "plan administrator," "named fiduciary" designation is made optional for the "master-prototype" sponsor.

In addition, most agents selling insurance products (and in some instances mutual funds) to pension or profit sharing plans must comply with the conditions of Class Exemption 77-9. Otherwise the sale of these products and the receipt by the agent of commissions would constitute a prohibited transaction under ERISA. One of the conditions of Class Exemption 77-9 is that an agent cannot be "plan administrator," a "named fiduciary" or a fiduciary who is expressly authorized in writing to manage, acquire or dispose of the assets of a plan on a discretionary basis (i.e. an "investment manager"). If the labels currently required of a "master-prototype" sponsor (or its agent or employee) are made mandatory or even optional as we recommend, then - since one condition of the Class Exemption will not be satisfied, agents will not be able to sell insurance products (and in some instances mutual funds) to these plans. Even more importantly, insurance agents could not provide economical services, important for the design, implementation and ongoing administration of plans, especially for small employers. We recommend that the optional designation "plan administrator," "named fiduciary" or "investment manager" be statutorily waived for purposes only of Section V(a) of Class Exemption 77-9 and only for purposes of the special master-prototype plan. This would ensure that the other conditions and protections afforded by the Class Exemption would continue to be applicable and that agents could continue to sell insurance products and mutual funds to these special plans and provide valuable services.

In addition, in order to facilitate the completion of reporting forms on an economical basis, the master prototype sponsor should be specifically permitted to restrict the investments of the plan to investments offered by the "master-prototype" sponsor. The agency should be directed to issue regulations whereby already approved "master prototype" plans could be modified for use under this new program without the necessity of time consuming and costly amendments. Although we are approaching the fourth anniversary of ERISA, New England Life is still awaiting IRS approval of at least one of its prototypes. Delays such as this could indefinitely prolong the day when the benefits to employers of special master and prototype plans

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would be available. The "master-prototype" provisions should also clearly indicate that prototype plans approved by Key Districts for use by employers within that district - so called "field prototypes" should be eligible for this program.

SINGLE ENTRY DATE

S 3017, sponsored by Senators Javits, Williams and Melcher includes a provision permitting plans to utilize a single entry date and a one year eligibility period when eligible employees become plan participants. We support the concept of a single entry date for administrative ease. However the bill would require an employer who adopts this provision to measure an employee's eligibility for vesting and benefit accrual from date of hire. Such a provision has nothing to do with eligibility to participate and would result in more complex and costly administrative procedures, especially for small plans which typically measure vesting credit and benefit accrual on a single uniform basis - such as the plan year - for all participants. The much desired single entry date concept could be accomplished by permitting a plan to utilize a one year eligibility period with a provision that the employee will be covered on the next following anniversary date.

DEDUCTIBLE EMPLOYEE CONTRIBUTIONS

S 3017 sponsored by Senators Javits, Williams and Melcher and S 3140 sponsored by Senator Bentsen would permit employees to make deductible contributions to qualified plans up to certain specified levels. We believe that personal savings should be encouraged as part of an individual's overall retirement planning, along with the basic "floor of protection" provided by Social Security and further enhanced by a private qualified plan. This concept will encourage more personal savings for retirement, the creation of new qualified private plans and new capital formation. We strongly endorse the concept of deductible employee contributions to qualified plans but believe all plan participants should be entitled to participate up to the same levels. We also believe, the existing types of qualified plans for corporations and the self-employed provide appropriate flexibility to meet the retirement planning objectives of businesses, both large and small without imposing any arbitrary limits on the amount of contributions for participants. We therefore feel that introducing a new type of plan, as proposed in S 3140, would be counterproductive. It would introduce further regulatory complication by adding an additional layer of plan qualification requirements to an already complex and confusing set of provisions. What S 3140 seeks to do, namely reduce paperwork, is done directly by the S 3017 proposals without any unintended side effects. The decline of new qualified plans will be reversed and the growth of the private pension system will resume if simplification and economy in terms of paperwork and administrative practices is made available for the types of retirement plans that already exist.

In addition, we believe that current law which permits rollover of a participant's vested benefit to a different qualified plan (or to an IRA) or permitting a plan trustee to purchase a non-transferable annuity contract without adverse tax consequences to the terminated participant, already permits portability of benefits - without the need for the creation of a new type of plan. We would, however, endorse measures to improve and expand the availability of existing procedures, such as eliminating the requirement that rollovers to IRA's can be made only once every three years.

We appreciate the opportunity to express our views on the very important process of amending and improving ERISA. We would welcome the invitation to respond to any inquiries and to be of further assistance.

Sincerely,

Jonathan R. Alder, C.L.U.
Executive Vice President

10-24-77 (BPR) **TEXT** (No. 160) R - 11

HOUSE SMALL BUSINESS COMMITTEE ERISA QUESTIONNAIRE RESULTS

October 1977

COMMITTEE ON SMALL BUSINESS

ERISA QUESTIONNAIRE RESULTS

The Subcommittee on SBA and SBIC Legislation and General Small Business Problems of the House Committee on Small Business sent 7,185 questionnaires to businesses that notified the Pension Benefit Guaranty Corporation during the period June 1976 through April 1977 that they intended to terminate pension plans. The questionnaires were designed to obtain information on the effect of the Employee Retirement Income Security Act (ERISA) on the decision to terminate these pension plans. A total of 1,861 questionnaire responses were received which were suitable for processing. An additional 121 were returned to the Committee by the U.S. Postal Service as undeliverable and an additional 126 were not completed in a format suitable for processing.

The following summarizes the questionnaire and answers to specific questions. Because some businesses did not answer, or gave more than one answer to specific questions the number of responses to the individual questions does not total 1,861.

A. Plan background [1]

Questions 3 and 4. What was the average number of employees participating in the pension plan and full-time employees employed during the fiscal year in which the plan terminated?

Answer. The following summarizes the responses to the question.

Plan size (number of participants)	Pension plan participants: Number of plans	Pension plan participants: Average number [illegible]	Full-time employees: Number of plans	Full-time employees: Average number of full-time employees[2]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total	1,8[illegible]		1,8[illegible]	
Overall average		[illegible]		[illegible]

[2] [illegible]

Question 5. Who was the pension plan designed to cover?

Answer. Of the 1,841 questionnaire responses to this question:

The plan was designed to cover all of the work force (64.8 percent)	1,064
The plan was designed to cover only a portion of the work force; i.e., hourly employees or a particular group of employees (35.2 percent)	577
Total (100 percent)	1,641

Question 6. How was the pension plan established?

Answer. Of the 1,618 questionnaire responses to this question:

They voluntarily started the plan (95.8 percent)	1,560
The plans were started through negotiations with an employee union (3 percent)	50
The plans were started through negotiations with an employee group (0.1 percent)	2
Gave other explanations of how the plans were started (1 percent)	16
Total (100 percent)	1,618

Question 7. During the period of time the pension plan was in operation, how was the plan funded?

Answer. Of the 1,657 questionnaire responses to this question:

The plans were financed entirely by the employer (86.7 percent)	1,420
The plans were financed by employer and mandatory employee contributions (9.4 percent)	158
The plans were financed by employer and voluntary employee contributions (4.2 percent)	48
Another method of plan financing was used (0.8 percent)	13
Total (100 percent)	1,632

Question 8. At its termination, was the plan subject to union negotiation or covered by a collective bargaining agreement?

Answer. Of the 1,641 questionnaire responses to this question, 51 or 3.1 percent said the plans were subject to union negotiation or a collective bargaining agreement and 1,590 or 96.9 percent said they were not.

Question 9. How are the terminated pension plan assets being distributed to plan participants?

Answer. The 1,617 questionnaire responses to this question indicated that one or more of the following asset distribution methods would be used:

Assets would be used to make lump sum payments to persons covered by the terminating plan (58.5 percent)	962
Assets would be used to purchase annuities for plan participants (22.7 percent)	364
Assets would be put into another employer-sponsored pension plan (10.8 percent)	117
Assets would be held in trust for plan participants until benefits were due (5.9 percent)	96
Assets would be taken over by the Pension Benefit Guaranty Corporation (1.2 percent)	20
Other asset distribution methods (7.9 percent)	128
Total (117.8 percent)[1]	[2]1,607

[1] Percent does not add to 100 percent because some businesses indicated more than one method would be used.

[2] Total does not add to 1,617 because some businesses indicated more than one method would be used.

[1] Questions 1 and 2 requested indicative information on the business and are not set forth here.

B. Causes of termination

Question 10. To what extent was the decision to terminate the pension plan caused by any of the listed non-ERISA circumstances?

Answer. The 1,483 questionnaire responses to this question indicated the extent to which one or more of the following non-ERISA circumstances contributed to the decision to terminate the plan.

EXTENT CIRCUMSTANCES CAUSED THE TERMINATION

Non-ERISA circumstances	Little or no	Some	Moderate	Substantial	Very great	Only reason	Total
1. Dissolution of the business						[illegible]	[illegible]
2. [illegible]						[illegible]	[illegible]
3. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
4. Change of ownership	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
5. Adverse business conditions	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
6. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
7. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
8. Lack of employee participation	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
9. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
10. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
11. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
12. Other non-ERISA circumstances	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]

Question 11. Overall, what effect did ERISA have on the decision to terminate the plan?

Answer. Of the 1,629 questionnaire responses to this question:

ERISA had no effect on the termination (20.9 percent)	341
ERISA had little effect on the termination (1.8 percent)	29
ERISA had some effect on the termination (2.8 percent)	38
ERISA had a moderate effect on the termination (5.1 percent)	83
ERISA had a substantial effect on the termination (12.3 percent)	200
ERISA had a very great effect on the termination (23.8 percent)	481
ERISA was the only reason for the termination (29.3 percent)	480
Total (100 percent)	1,629

NOTE.—The 341 businesses that said ERISA had no effect on the plan termination were asked not to answer questions 2 through 11 of and, if on the causes of termination. The following data in this section summarizes the information provided by the 1,288 businesses that said ERISA had an effect on the decision to terminate the plan.

Question 12. To what extent did increased costs due to ERISA affect the decision to terminate the plan?

Answer. Of the 1,288 questionnaire responses to this question:

Costs did not increase (4.2 percent)	55
Increased cost had no effect (3.6 percent)	46
Increased cost had little effect (3.2 percent)	40
Increased cost had some effect (7.4 percent)	94
Increased cost had a moderate effect (6.6 percent)	84
Increased cost had a substantial effect (18.5 percent)	231
Increased cost had a very great effect (31.2 percent)	394
Increased cost was the only reason for terminating the plan (25.1 percent)	319
Total (99.8 percent)	1,[illegible]

NOTE.—Of the 1,288 responses to question 12, the 1,[illegible] that said increased costs due to ERISA had an effect on the termination decision were asked to complete the following six questions. The other 1[illegible] were directed to go to question No. 19.

Question 13. If increased costs due to ERISA were a consideration in terminating the plan, provide estimates of what the following three categories of costs would be with and without ERISA requirements.

Administrative costs—to administer the pension plan annually, including consulting or legal fees, insurance premiums, administrative costs (i.e., recordkeeping), reporting and disclosure to the Government and your employees.

Benefit costs—to provide for annual benefits excluding administrative costs as described above.

Initial costs—to meet ERISA requirements including amending plan documents, obtaining tax qualification, and associated professional fees.

Answer. Following is a summary of responses on the change in administrative and benefit costs and ERISA initial costs.

	Number of responses	Average cost
Administrative costs		
[illegible] ERISA requirements	[illegible]	[illegible]
[illegible] ERISA requirements	[illegible]	[illegible]
Benefit costs		
[illegible] ERISA requirements	[illegible]	[illegible]
[illegible] ERISA requirements	[illegible]	[illegible]
[illegible] initial costs	[illegible]	[illegible]

Question 14. Considering changes in administrative costs resulting from ERISA, indicate the extent of the cost increases for each of the cost items listed.

Answer. Following is a summary of 1,063 questionnaire responses on the listed administrative cost items.

Cost items	Extent of cost increase: Little or no	Moderate	Very large	Data not available	Not applicable	Total
1. Change in [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2. Number of [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3. Fees to [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
4. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
5. Reporting to [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
6. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
7. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
8. Other [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
9. Overall administrative costs Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Question 15. Considering changes in benefit costs resulting from ERISA, indicate the extent of the cost increase for each of the cost items listed.

Answer. Following is a summary of 1,021 questionnaire responses on the listed benefit cost items.

Cost items	Extent of cost increase: Little or no	Moderate	Very large	Data not available	Not applicable	Total
1. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2. Costs of [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
4. Other benefit costs Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
5. Overall benefit costs Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Question 16. For the initial costs resulting from ERISA, indicate the extent of the cost increase for each of the listed cost items.

Answer. Following is a summary of 1,080 questionnaire responses on the listed initial cost items.

Cost items	Extent of cost increase: Little or no	Moderate	Very large	Data not available	Not applicable	Total
1. Amending plan to meet ERISA requirements Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2. Other initial costs Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3. Overall initial costs Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Question 17. Considering changes in the combined administrative, benefit, and initial costs resulting from ERISA, indicate the extent of the changes.

Answer. Of the 1,015 questionnaire responses.

The combined costs represented little or no cost increase (1.0 percent)	10
The combined costs represented some cost increase (4.2 percent)	43
The combined costs represented a moderate cost increase (13.7 percent)	139
The combined costs represented a substantial cost increase (38.9 percent)	395
The combined costs represented a very large cost increase (42.2 percent)	428
Total (100 percent)	1,015

Question 18. Considering the changes in administrative and benefit costs, and initial costs resulting from ERISA, how acceptable or unacceptable is the change in each of the four categories listed?

Answer. Following is a summary of the 963 questionnaire responses.

ACCEPTABILITY OF COST CHANGES

Change in costs	Acceptable: Very	Somewhat	Neither acceptable nor unacceptable	Unacceptable: Somewhat	Very	Total
1. Administrative Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2. Benefit Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3. Initial Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
4. Total of administrative, benefit, and initial Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Question 19. Considering other provisions of ERISA—those without determinable costs—indicate the effect each of the listed items had on the decision to terminate the pension plan.

Answer. Following is a summary of the 1,177 questionnaire responses on the listed undeterminable cost items.

Undeterminable cost items	Effect on termination: Little or no	Moderate	Very large	No experience	Not applicable	Total
1. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
4. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
5. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
6. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
7. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
8. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
9. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
10. Other Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
11. Overall effect of ERISA provisions without determinable costs Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Question 20. Considering the ERISA reporting and disclosure requirements, indicate the effect each of the listed items had on the decision to terminate the pension plan.

Answer. Following is a summary of the 1,185 questionnaire responses provided on the listed reporting and disclosure requirements.

ERISA reporting and disclosure requirements	Effect on termination: Little or no	Moderate	Very great	No experience	Not applicable	Total
1. Annual financial report to the Department of Labor and [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2. Summary annual report to employees Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
4. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
5. Plan description to be filed with the Department of Labor Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
6. Summary plan description to employees Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
7. [illegible] Department of Labor Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
8. Summary of plan modifications to be given to employees Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
9. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
10. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
11. [illegible] Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
12. [illegible] Internal Revenue Service Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

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[illegible]	[illegible]			[illegible]	[illegible]	[illegible]
	[illegible]	[illegible]	[illegible]			
14. [illegible] Pension Benefit Guaranty [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
15. Other	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
16. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

C. Current coverage

Question 21. Which of the listed categories best describes the current status of employees previously covered by the terminated pension plan?

Answer Of the 1,548 questionnaire responses:

A new employer-sponsored retirement plan was established to cover these employees (17.7 percent)	274
A new employer-sponsored retirement plan is expected to be established soon to cover these employees (7.6 percent)	118
A separate but preexisting employer-sponsored retirement plan covering these employees is still in effect (6.5 percent)	100
A separate but preexisting employer-sponsored retirement plan was amended (or will be amended soon) to include these employees (3.1 percent)	48
Some other form of coverage for these employees (9.4 percent)	143
No further employer-sponsored retirement coverage is expected for these employees at this time (55.9 percent)	866
Total (100 percent)	1,548

Question 22. If employer-sponsored retirement coverage is to be continued for those employees previously covered by the terminated plan, which of the following describes the type of plan providing the continuing coverage?

Answer Of the 643 questionnaire responses:

The continuing coverage would be provided by a profit-sharing plan (46.7 percent)	300
The continuing coverage would be provided by a defined benefit plan (9.5 percent)	61
The continuing coverage would be provided by a money purchase plan (11.0 percent)	71
The continuing coverage would be provided by an employer-sponsored individual retirement account plan (18.2 percent)	117
The continuing coverage would be provided by a savings or thrift plan (1.1 percent)	7
The continuing coverage would be provided by an employee stock ownership plan (3.1 percent)	20
The continuing coverage would be provided by a target benefit plan (1.4 percent)	9
The continuing coverage would be provided through some other type of plan or arrangement (9.0 percent)	58
Total (100 percent)	643

Question 23. If retirement coverage is to be continued, to what extent do the listed items describe the reason for switching to a new plan?

Answer Following is a summary of the 505 questionnaire responses.

[illegible]	[illegible]			[illegible]	[illegible]	[illegible]
	[illegible]	[illegible]	[illegible]			
1. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
4. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
5. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
6. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
7. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
8. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
9. [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
10. Other [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

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SENATE FINANCE COMMITTEE STATEMENT ON ACTIONS TAKEN OCTOBER 19 ON PROPOSALS TO RAISE THE PREMIUM RATE FOR SINGLE EMPLOYER PLANS, AND TO POSTPONE COVERAGE OF MULTIEMPLOYER PLANS, AND BACKGROUND PAPERS PREPARED BY COMMITTEE STAFF

(Editor's Note: Statements and background papers on matters unrelated to PBGC's proposals have been omitted.)

4. Pension Benefit Guaranty Corporation Legislative Proposals

Premium increase. -- The Pension Benefit Guaranty Corporation (PBGC) has recommended that the the pension plan termination insurance premium be increased from $1.00 per participant for plan years beginning after January 1, 1978 to $2.25 per participant, on the grounds that the premium increase is needed to provide adequate funding for coverage of single-employer plans.

The Committee instead agreed to postpone action on a premium increase for six months.

Deferral of mandatory insurance coverage for pension benefits under multiemployer plans. -- PBGC has conducted a study of multiemployer plans and has found that plans with aggregate unfunded vested liabilities of between $350 million and $4 billion are experiencing financial difficulties and could be terminated within the next five years. To provide additional time to consider alternative proposals regarding funding requirements for benefit coverage, PBGC has proposed that mandatory insurance coverage for these plans be deferred beyond January 1, 1978, as required under present law.

The Committee agreed with this PBGC recommendation, deferring mandatory coverage until July 1, 1979.

Each of the amendments agreed to by the Finance Committee (items 1, 2 and 3) will be offered as Finance Committee amendments to appropriate House-passed bills.

* * *

Background Papers Prepared by the Senate Finance Committee Staff

October 18, 1977

PBGC PROPOSED PREMIUM INCREASE FOR SINGLE EMPLOYER PLANS

(Prepared by the Staff of the Committee on Finance)

The Pension Benefit Guaranty Corporation (PBGC) has recommended to the Senate Finance Committee an increase in the single employer plan termination insurance premium which the PBGC is authorized to collect annually from single employers that maintain a defined pension plan for their employees from $1.00 to $2.25 per participant.

Under Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), the PBGC was delegated the responsibility of insuring benefits for employees whose employers terminate an existing defined benefit pension plan. The PBGC functions as a self-insurer, collecting the premiums from employers and investing them, using these premiums and investment proceeds, along with employer liability assessed under Title IV of ERISA, to sufficiently fund the benefits to be provided by a pension plan which is terminated with insufficient assets to meet its obligations.

ERISA HEARINGS BEFORE SENATE HUMAN RESOURCES SUBCOMMITTEE ON LABOR AND FINANCE SUBCOMMITTEE ON PENSIONS
AUGUST 15-17 1978

STATEMENT OF PRICE WATERHOUSE & CO.

We are pleased to have an opportunity to submit our comments on S. 3017, the ERISA Improvements Act of 1978, and the related bills which were considered at the hearings. Our comments may be summarized as follows:

1. Dual jurisdiction - We believe that the establishment of an Employee Benefits Commission as proposed in Title I of S. 3017 should be deferred, and that the reorganization plan recently proposed by the Administration should be given an opportunity to work.

2. Minimum standards - We are opposed to the expansion of the joint and survivor annuity requirements as provided in Sec. 238 of S. 3017. We support with reservations the provision of Sec. 232 for determining a year of service for participation purposes on a plan-year basis.

3. Tax deduction for employee contributions - We support with some reservations the provision of Sec. 303 of S. 3017 which would permit tax deductions for employee contributions to tax-qualified and certain other plans.

4. Tax credits for contributions to improved plans and new small business employer plans - While we support in principle the use of tax credits as incentives for the establishment, maintenance or improvement of plans, we do not believe that the specific credits

provided by Sec. 304 or 305 of S. 3017 would be effective for those purposes.

5. IRAs - We oppose the provision in Sec. 306 of S. 3017 which would prohibit owner-employees and officers or 10 percent or more stockholders of a corporation from contributing to IRAs.

6. Accountant's opinion - We oppose as unnecessary and unworkable the provisions of Secs. 226 and 228 of S. 3017, which would impose significant limitations on the scope of the independent public accountant's examination of the financial statements of a plan.

7. Paperwork reduction - We support gererally the various paperwork reduction provisions found in S. 3193 and S. 3017. However, recent Administration initiatives in this regard may make a number of the specific provisions unnecessary.

8. Uniform accounting standards - We oppose the provisions of S. 2992 which would require the Secretary of the Treasury to promulgate uniform accounting standards for calculating and reporting the assets and liabilities of pension plans.

9. Preemption of securities law - We support in principle the provisions of Sec. 274 of S. 3017, which would preempt the application of federal and state securities laws to pension plans.

10. Retroactive disqualification - We support the provision in Sec. 307 of S. 3017 which would prohibit the retroactive disqualification of plans in the absence of willful neglect or intentional disregard of rules by the plan sponsor.

Our detailed comments on each of these provisions follow.

Dual jurisdiction

We believe that the recently-announced Administration reorganization plan, which is similar in most essential respects to S. 901, should be given a trial period to see whether it can alleviate the troublesome dual jurisdiction problems which presently exist. The Administration plan appears to be a well-reasoned approach which should eliminate most of the overlap between IRS and DOL in the really significant areas where the greatest delays and frustrations now occur - exemptions from the prohibited transaction rules, for example.

There are some appealing aspects to the Employee Benefit Commission approach taken in Title I of S. 3017. The potential for developing a cohesive national policy toward the private pension system and having that policy administered by a single government agency has considerable theoretical merit. However, to impose that approach at the present time would be surgery more radical than the problems require.

Creation of a new agency would entail inevitable start-up problems and a period of organizational and personnel instability which would be bound to have adverse repercussions on the private pension community. It would create abrupt change, uncertainty, and confusion anew, just at a time when the pressing need is for a period of stability after the initial adjustments to ERISA.

Although the ultimate results might well be salutary, we do not believe that the risks involved in the transition to a single agency approach would be warranted without at least trying the far less radical approach embodied in the Administration reorganization plan.

Minimum standards - joint and survivor annuities

Sec. 238 of S. 3017 states that in the case of a plan which does not provide for the payment of benefits in the form of an annuity (i.e. some defined contribution plans), upon the death of a 50 percent or more vested participant his account balance must be paid out to his surviving spouse in a lump sum.

In the case of defined benefit plans and other plans which provide for benefits in the form of an annuity, upon the death of a 50 percent or more vested participant his surviving spouse must receive a survivor annuity based on his accrued benefit and commencing at what would have been his retirement date.

In the case of defined contribution plans, the proposal is not contrary to current practice since it is common to pay the account balance of a deceased participant to a beneficiary. However, to preserve needed flexibility there should be no requirement that the account balance be paid to a surviving spouse rather than some other beneficiary whom the participant may have named for good reason, based on overall estate planning considerations. Nor in fairness should any requirement for nonforfeitability in the event of death be applied only to married participants. Finally, distributions in lump sum form should not be mandated, since that could have unfavorable estate tax consequences.

Defined benefit plans are an entirely different matter. Here the participant is not promised an account balance, but rather the benefit or benefits specified in the plan. If the plan does not provide a pre-retirement death benefit (and many do not, other than the contingent spouse benefit required by ERISA), then it is not a question of forfeiting anything in the event of death. It is a question of whether the plan was designed purely as a pension plan, or as a plan intended to provide not only pensions but also ancillary benefits such as a pre-retirement death benefit.

Regardless of whether it is provided under the pension plan or otherwise, a death benefit is fundamentally life insurance. And that is true regardless of whether the benefit is paid as a lump sum or in instalments or as a life income for a survivor.

Life insurance can often be provided more expeditiously outside of the pension plan, particularly through group insurance arrangements. Aside from possible tax advantages, group insurance usually permits the death benefit to be structured in a more meaningful way, particularly for younger employees. If a death benefit is furnished under the pension plan, it will necessarily be tied to the accrued pension benefit, which is a factor not only of compensation but also of age and years of service. In the case of the death of a young employee with a small accrued pension benefit, a death benefit based thereon will not be meaningful. But under a group life plan, that employee can be and usually is furnished with the same protection, relative to compensation, as an older employee.

Not only would the bill require that a death benefit be furnished under the pension plan, inefficiently tied to the vested accrued pension benefit, but it would preclude charging the participant for the coverage through a reduction of his eventual pension benefit. That is, the charge presently permitted for the ERISA-mandated contingent spouse benefit would no longer be authorized.

In the case of an employer presently furnishing adequate pre-retirement death benefits through a group life plan, the proposal would mean adding a superfluous death benefit coverage to the plan. It might try to recoup by offsetting the pension plan death benefit against the group life benefit, but that would be awkward and unusual. It might also recoup by instituting mandatory employee contributions to the pension plan, sufficient to pay for the new mandated death benefit - that would not seem to be prohibited under the bill. But such a move might be poorly received as an employee-relations matter.

Our fundamental difficulty with this provision is that it would hold the right to establish a pension benefit plan hostage to also providing a pre-retirement death benefit for participants. The draftsman of ERISA wisely avoided mandating any particular level or type of pension benefits under a plan, but this provision would violate that approach by now requiring a particular kind of ancillary benefit. Employers on whom the cost impact would likely fall heaviest are those who have provided vesting schedules more generous than the ERISA minimums.

All of this is counterproductive to any goal of encouraging the establishment and maintenance of defined benefit plans. We go further and urge that the needlessly complex and cumbersome present ERISA provisions regarding joint and survivor annuities be repealed, and replaced with a simple requirement that a defined benefit plan must offer a joint and survivor annuity as one of its optional forms of benefit payment.

<u>Minimum standards - year of service</u>

ERISA presently permits all year of service determinations to be made on a plan year basis except the year of service for participation purposes. The present requirement is that the 1,000 hour test must initially be applied to the year ending on the anniversary of the employee's date of hire.

When coupled with the requirement that after completing one year of service, participation must begin on the earlier of the first day of the next succeeding plan year or six months after completing the year of service, the practical effect has been that either a plan must provide for two entry dates a year, or no more than six months of service for participation purposes can be required.

All of this needlessly complicates plan administration, particularly for the small plan. Sec. 232 of S. 3017 commendably would permit the year of service for participation purposes to be tested on a plan year basis. But it would do so only at the price of requiring years of service for vesting and benefit accrual purposes to be tracked on an anniversary date of hire basis. That solves nothing, because it would simply substitute administrative complexity in determining years of service for vesting and benefit accrual purposes for the existing complexity in determining a year of service for participation purposes.

Particularly for the small plan, administrative simplification requires that the 1,000 hour test be capable of being applied on a plan year basis for all purposes under the plan, and that only one entry date per year be necessary.

Presumably Sec. 232 was drafted with the intention of assuring that no employees lose any benefits as a result of using the plan year for participation purposes. We do not quarrel with that objective, but simply suggest that it can be substantially met by permitting the plan year to be used for all purposes. For participation purposes, the year of service test would initially be applied for the plan year during which the employee is hired. If the test is met for that plan year, he should come into the plan as of the first day of the next succeeding plan year. If it is not met, he comes

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into the plan as of the first day of the plan year next succeeding the first plan year for which the test is met.

Compared to the present rule, it is demonstrable that a full-time employee could not be required to wait any longer for participation. In many instances his waiting time would be shortened.

Essentially, if he is hired during approximately the first half of a plan year he will come into the plan as of the first day of the next plan year, which is at most 12 months from date of hire. If hired during the second half of a plan year, he may have to wait until the first day of the second succeeding plan year. But that is no more than 18 months from date of hire, which is not longer than can be required under the present rule.

Only in the case of less than full-time employees, or employees subject to layoff, could the rule which we suggest put off participation for a somewhat longer period than presently permitted. Conversely, in some cases the waiting period could also be shortened - it would depend on the juxtaposition of plan year end and hire date, and the pattern of hours worked. On balance, we doubt that the extent of any adverse effect on participants would be significant - certainly not sufficiently so to offset the overall benefits from simplified plan administration which would be attainable.

Deduction for employee contributions

Sec. 303 of S. 3017 would permit employee contributions to qualified plans and certain government plans to be deducted for income tax purposes, subject to some limitations. We enthusiastically support the basic concept of tax deductibility for employee contributions, which could be extremely helpful in providing increased retirement income for a great many people. The possibilities include:

Facilitating benefit improvements in pension plans by making cost sharing with employees more economically viable.

Encouraging the accumulation of larger benefits in profit sharing plans by providing an incentive for employees as well as employer to contribute.

Enhancing the attractiveness of thrift and savings plans.

Solving the problems presented by participants in qualified plans who want to opt out in order to establish IRAs.

But as presently drafted, Sec. 303 has a number of features which would prevent all of the objectives stated above from being achieved. Some are frankly counterproductive. For example, we believe the following combination of provisions would be a powerful incentive for the termination of small employer defined benefit plans:

The requirement that all qualified plans must accept employee contributions.

The requirement that such contributions be accumulated in separate accounts.

The provision under which the tax deduction would start phasing out at the $30,000 adjusted gross income level, and disappear at the $35,000 level.

The separate account requirement would necessitate superimposing what would be an additional plan, a defined contribution plan, on top of the defined benefit plan. The employer would have to do this in order to continue to maintain the defined benefit plan. And as the crowning blow, the owner or principal executive would probably be unable to deduct any of his own contributions to the plan, because of the adjusted gross income phase out.

We recommend that the separate account requirement be deleted. We see no reason why deductible employee contributions should not be used to fund part of the cost of a defined benefit plan. Since under ERISA an employee's accrued benefit attributable to his own contributions must be fully and immediately vested, employees will be accumulating a vested benefit either way.

Secondly, we recommend that plans not be required to accept employee contributions. The entire emphasis should be on providing an additional incentive for the private plan sector. New mandatory requirements for the maintenance of qualified plan status would be entirely counterproductive to that goal, and would likely be viewed, particularly by the small plan community, as additional ERISA harassment.

Finally, we recommend that there be no adjusted gross income phase out on the ability to deduct $1,000 of employee contributions. In order for the incentive to work, it must be provided to the management people who make the decisions on the maintenance and improvement of plans, as well as to rank-and-file employees.

But if for some reason an income phase out is considered necessary, it should be set at a far higher level than the $30,000-35,000 in the bill. That level would exclude a great many middle-income people who will bear the brunt of the forthcoming social security tax increases without a commensurate increase in their social security benefits. They are also highly vulnerable to inflationary erosion of their private pension plan benefits. It is essential that they be given an additional incentive to provide for their retirement security.

Some have suggested that if the requirement for plans to accept employee contributions is deleted, participants in plans which opt not to accept such contributions should be permitted to contribute like amounts to IRAs instead. We believe, however, that making IRAs broadly available for that purpose could destroy much of the incentive for qualified plans to accept and utilize employee contributions, and could cause an unwarranted proliferation of IRAs established by qualified plan participants.

The real problem which should be addressed is the plight of participants who have not achieved vesting in their accrued benefits attributable to employer contributions to the qualified plan, who may never do so because of job mobility, and who have nowhere else to turn if their employer's plan will not accept employee contributions. We suggest that the IRA rules be changed to the effect that a participant in a noncontributory qualified plan be permitted to contribute to an IRA for any taxable year in which he has not attained any vested interest in a benefit under the plan.

<u>Tax credits for contributions to plans</u>

Sec. 304 of S. 3017 would provide a tax credit for a small business employer which establishes a new qualified plan. The credit would be equal to 5 percent of the tax deductible contributions for the first year, and would phase out after five years.

Sec. 305 would provide a credit for employers who maintain an "improved plan," meaning a plan which permits significantly earlier participation and more rapid vesting than the ERISA minimum standards. The details of determining improved plan status would be left to regulations. The credit would be 5 percent of deductible contributions each year for as long as the plan maintains improved status.

The tax deduction for plan contributions would not be reduced by reason of either credit.

We strongly favor the use of tax credits as an inducement to establish or maintain plans. We believe this type of very visible incentive is badly needed in the small plan sector at present, to deter terminations, encourage new plan formation, and provide a general antidote for adverse reaction to ERISA by small plan sponsors.

Unfortunately, we don't believe that either of the specific credits in S. 3017 would accomplish these goals. The small plan credit would not likely be a strong inducement for new plan formation since it is only temporary and phases out rapidly over the five-year period. It would do nothing for existing plans and hence would not deter terminations.

In our view, what is needed in the small plan sector is a continuing credit for all small plans, new and old, which could be identified as being compensatory for increased administrative costs attributable to ERISA.

A study which we recently completed for the Department of Labor - Assessment of the Impact of ERISA on the Administrative Costs of Small Retirement Plans - demonstrated that economics of scale exercise a major influence on plan administrative costs. Since many types of costs do not vary proportionately with variations in the number of plan participants, per participant administrative costs usually increase sharply as plan size decreases. For example, the study showed that average post-ERISA per participant costs for defined contribution plans varied from $341 for plans with less than ten participants to $75 for plans with 50-100 participants.

Thus we recommend that a continuing credit for small plans, designed to help offset increased administrative costs, be structured on a per participant dollar amount basis, with the per participant amount declining as the size of the plan increases. We believe data is now available which would permit the credit amounts to be structured to produce a planned level of expense reimbursement.

The correlation between administrative costs and annual contributions to a plan is much less precise. Annual contributions under some types of plans are subject to a great degree of latitude - for example, profit sharing plans with discretionary contribution formulas, and flexible amortization periods under defined benefit plans. Thus credits based on annual contributions would be less satisfactory.

As to the concept of a credit for improved plans, we believe it would be horribly complicated to administer fairly and uniformly. Moreover, the correlation between improved participation and vesting rules, and increased plan contributions, is hardly exact. For example, a profit sharing plan which reallocates forfeitures could decrease vesting from ten years to eight years, with no effect on employer costs. The effect would be on participants, with longer service employees losing and shorter service employees gaining.

As another example, one defined benefit plan may have a very generous benefit formula and ten year vesting. A second may have a low benefit formula, but five year vesting and immediate participation. The first plan might have the higher costs, but the second would obtain the credit.

Furthermore, the provision as drafted would seem to grant the credit only to plans being improved currently, and deny it to plans which even prior to ERISA had (and continue to have) more generous vesting and participation rules than the ERISA minimums.

We believe the intent behind the improved plan credit is commendable, but that it is a concept which would be unworkable in practice.

Contributions to IRAs

Sec. 306 of S. 3017 would preclude owner-employees, and officers or 10 percent or more stockholders of corporations, from contributing to IRAs. As we understand it, the reason for this provision is to prevent principals from establishing IRAs instead of maintaining qualified plans which would also have to include their employees.

It should be understood, however, that a great many owner-employees and officer-shareholders are not well-to-do people at all, but individuals of very modest means - small shopkeepers, operators of service businesses and the like. An IRA is probably the easiest and least costly type of retirement plan for those people to establish, and the $1,500 contribution limit is adequate for their needs.

This problem could be partially cured by continuing to permit IRAs for owner-employees and officers and stockholders in situations where the business has no other employees. But that does not take care of the many situations where there are one or a few other employees who are part-time, temporary, or simply do not work for the business long enough to ever vest if there were a qualified plan. It would be tragic to force those businesses to use qualified plans instead of IRAs for the principals, who are in effect the only long-term employees. The likely answer is that there would be no retirement plan at all.

On balance, we believe this provision would do more harm than good, and we urge its deletion.

Accountants' Opinions

We strongly oppose the provisions of Secs. 226 and 228 of S. 3017, which would change Sec. 103(a) of ERISA to state that the accountant "shall" rather than "may" rely on the enrolled actuary, and to state that the accountant's opinion "shall" rather than "need" not extend to statements prepared by regulated banks or insurance companies.

We are in substantial agreement with the comments submitted on these sections by the American Institute of Certified Public Accountants, and shall not repeat them. By way of summarization, however, we would point out that enactment of these amendments would place the accountant in a completely untenable position. Sec. 103(a) of ERISA would still require that the accountant examine the financial statements of the plan in accordance with generally accepted auditing standards, and render his opinion thereon. Generally accepted auditing standards are determined by the accounting profession, but the amendments would place two potentially significant restrictions on the accountant's ability to follow the standards of his profession. The net result would be numerous accountant's "opinions" which in reality would be disclaimers of opinion because of the severe scope restrictions. That is a problem which presently exists due to

ERISA Sec. 103(a)(3)(C), and it will become far worse if the amendments are enacted. We do not believe that a proliferation of this type of "opinion" is in anyone's best interest.

Congress must decide whether it really wants accountants to examine the financial statements of plans in accordance with generally accepted auditing standards and render opinions thereon, or merely wishes the accountant to audit and report on selected plan data and transactions in areas where the other parties - the banks, insurance companies and enrolled actuaries - otherwise must rely exclusively on information obtained from the plan administrator.

Two examples of this are the employee census data which the actuary must use to make his determinations, and benefit payments disbursed by the bank or insurance company based on authorizations received from the plan administrator, who determined benefit entitlement and the amounts thereof.

If Congress wishes the accountant to examine only these and similar areas and render a special report thereon, it should amend ERISA by specifying those areas and deleting the requirement for an examination of the plan financial statements as a whole. If on the other hand, Congress wishes the comfort provided by an examination of the financial statements as a whole in accordance with generally accepted auditing standards, not only should it not enact Secs. 226 and 228 of S. 3017, it should repeal existing Secs. 103(a)(3)(B) and (C) of ERISA.

That would leave it to the accounting profession to work out its differences with the actuarial profession and the banking and insurance community in a matter which would eliminate unnecessary duplication of effort. As detailed in the comments submitted by the AICPA, progress has been made in that area already, and we are sure the remaining difficulties could be satisfactorily resolved.

What Congress should not do is leave the accountant dangling squarely in midair, which is what Secs. 226 and 228 would accomplish.

Paperwork reduction

We have previously testified in general support of S. 3193, the ERISA Paperwork Reduction Act, and submitted extensive comments thereon. We shall not repeat those comments here. We can also support Sec. 223 of S. 3017, which calls for the elimination of the summary annual report (SAR) requirement. We do so because the SAR format presently specified by the DOL regulations is not a very useful document for participants, particularly in the case of defined benefit plans. We doubt that its value to participants is commensurate with the cost of preparation and distribution.

On the other hand, we are uneasy that sufficient attention is not being given to just what periodic information it is really necessary for participants to have, and the costs of furnishing it. The summary annual report and benefit statement provisions need to be considered jointly for that purpose. We find it hard to believe that a participant in a defined contribution plan - at least a vested participant - would not be just as interested in a statement of his account and plan financial statements as would a shareholder in a mutual fund.

We note that the Administration has recently announced new initiatives in the reporting and disclosure area which are similar to some of the paperwork reduction provisions of S. 3193 and S. 3017. These include three year cyclical reporting by small plans, elimination of the EBS-1 form, and revision of the SAR format. We believe that these initiatives should be evaluated in detail before moving forward with any statutory changes in the paperwork area.

Uniform accounting standards

S. 2992 would require the Secretary of the Treasury to promulgate uniform accounting standards for calculating and reporting the assets and liabilities of pension plans. The Financial Accounting Standards Board is moving toward the issuance of a statement on accounting and reporting by defined benefit pension plans, in close consultation with the Department of Labor as well as the AICPA and the American Academy of Actuaries. Accordingly, there is no need for any legislation in this area.

Preemption of securities law

We strongly support legislation which would remove pension plans from both federal and state securities law jurisdiction, thus leaving ERISA as the sole regulatory scheme governing such plans. The obvious over-regulation which would result if the Supreme Court affirms Daniel would produce incalculable harm to the private pension community, and we doubt whether the small plan sector, at least, could survive it.

We would not presume to comment on the details of Sec. 274 of S. 3017, other than to suggest that preemption should extend to all types of plans regulated by ERISA, and not exclude eligible individual account plans in which participation is voluntary.

Some have commented that if Daniel is affirmed, employers who comply with ERISA in good faith have little to fear from private actions under the securities laws, and that the various estimates which have been made of the magnitude of potential liabilities are grossly overstated. We are not competent to judge whether those comments are true or not. We would merely note that the point is largely irrelevant, since the mere threat of having to defend against costly and prolonged litigation under the securities laws would be enough to cause the harm which we fear.

Retroactive plan disqualification

We support provisions such as Sec. 307 of S. 3017, which would place limits on the possibility of retroactive plan disqualification. Sec. 307 would permit retroactive disqualification only where there has been intentional failure or willful neglect on the part of the person or persons maintaining the plan. Those, of course, are subjective tests. A better approach might be to authorize retroactive remedial actions to cure the effects of discrimination or other causes for disqualification. There is limited statutory authority at present for retroactive remedial amendments of plan documents (IRC Sec. 401(b)), but no authority for retroactive remedial action.

For example, the recent Tax Court decision in Forsyth Energy Services involved an employer which inadvertently misapplied a plan's participation provisions, which resulted in some employees not being admitted to participation as early as they should have been. The employer cured the problem retroactively by making additional contributions to make the employees whole, but the court sustained disqualification because of lack of statutory authority for retroactive remedial action.

STATEMENT OF

THE PRINTING INDUSTRIES OF AMERICA, INC.

ON

SENATE BILL S. 3017

BEFORE

THE LABOR SUBCOMMITTEE

OF THE SENATE COMMITTEE ON HUMAN RESOURCES

AND

THE FINANCE, PRIVATE PENSION PLAN

AND EMPLOYEE FRINGE BENEFIT SUBCOMMITTEE

OF THE

SENATE FINANCE COMMITTEE

AUGUST 31, 1978

Printing Industries of America, Inc
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Mr. Chairman, the Printing Industries of America, Inc. (PIA) welcomes this opportunity to comment on S. 3017 and other proposals to revise the Employee Retirement Income Security Act of 1974 (ERISA). PIA, with its headquarters in Rosslyn, Virginia, is a national federation of regional, state, and city trade associations, representing approximately 8300 commercial printing companies throughout the United states. PIA is the world's largest graphics communications association. In the ninety-plus years since its foundation, it has been a leader in the rapid technological growth of this industry, which comprises what is commonly known as "American Printing."

The aggregate sales volume of the commercial printing industry totals approximately 52 billion dollars. Of this figure, PIA members account for over 75 per cent of the sales throughout the United States and employ approximately 350,000 highly-skilled craftsmen. While the industry ranks first in number of individual printing establishments (over 42,000) among the leading twenty five manufacturing industries in the United States, and seventh in total dollar volume payroll, the Printing Industry is essentially an industry of small businesses. Over 31,000 printing companies in the United States consist of 20 or fewer employees. Consequently, it is important to remember that when you think of the Printing Industry, you are not talking about giant corporations with multi-billion dollar payrolls, but of essentially small, family-owned and operated companies stretched across the length and breadth of the United States. The backbone of our industry is the individual entrepreneur who, through hard work, willingness to take a risk, and dedication, has painstakingly built his company from one or two-man operations to small and/or medium size commercial operations.

Among employees in the commercial printing industry, there are a large number covered by collective bargaining agreements which typically include pension coverage; many other employees have pension arrangements through their employers or PIA sponsored programs. There are also a number of employers, particularly among the smaller commercial printing operations, who do not have pension plans for their employees.

We recognize the need for proper pension and benefit plans to assure retirement security for all employees. We are also concerned that ERISA has in many cases made it difficult for employers to initiate and maintain plans or has discouraged the development of adequate pension and benefit coverage by unnecessarily increasing the financial and regulatory burden on plan sponsors. The comments which follow are a reflection on those concerns.

It is apparent that changes must be made in the current ERISA law. It is also probable that the changes necessary to assure adequate pension coverage will not come through the regulatory process. Consequently, legislation along the lines of S. 3017 is necessary. Nevertheless, the comment generated through this year's hearings on ERISA revision legislation provide clear evidence that additional time is necessary for a full exchange of ideas.

ERISA has just reached a stage where plan administrators and participants are becoming familiar with forms, procedures, rights, and responsibilities. It may be a good time for an interim step such as provided by the Administration's reorganization plan so continued study can be given to the final legislation. Therefore, while we support S. 3017 and recognize the need for legislation to correct ERISA, we agree that an interim plan is valuable. The original ERISA bill took four committees and many months to develop; the revisions may require the same attention.

One facet of the reorganization plan which must be watched carefully is the continuation of the dual responsibility of the Departments of Labor and Treasury. This divided responsibility has created problems in the past. We hope the plans announced by Secretary Marshall to clarify the agency responsibilities will be successful because, as most businessmen, the nation's printers are not eager for the establishment of a new federal agency. However, if the jurisdictional problems between Labor and Treasury cannot be resolved, we will support the establishment of a separate agency such as the Employee Benefits Commission as provided for in S. 3017 to administer ERISA.

PIA supports the proposal in S. 3017 to allow employees to deduct up to $1000 from taxable income for contributions to a qualified plan. However, we believe that the income ceiling of $30,000 for the maximum allowable deduction should be raised or eliminated.

Generally, the greatest concern an employee has about his or her retirement comes as he or she nears retirement. This is also a time of peak earnings. In an industry such as commercial printing, it is not uncommon for such skilled craftsmen with years of experience to be earning in excess of $30,000. There seems to be no logic in discouraging these employees from contributing to their retirement security by placing an "earnings ceiling" on the tax incentive program. To the contrary, the federal government should encourage such programs. Obviously, the more financially secure an individual is in his retirement years, the less dependent he or she will be on federal, state or community programs. Also, it is important to point out that the fact that an employee is earning in excess of $30,000 does not mean that he or she has adequate pension coverage. The tax incentive would allow such employees to augment their plan.

There are also tax incentive programs in S. 3017 to encourage the establishment of new plans and the improvement of existing plans. PIA supports these proposals.

We are aware of criticism that such incentives penalize employers who have done a good job in establishing pension plans and reward those who have not. That argument ignores the many employers who have not been financially able to establish plans or who may have received poor advice in the initial establishment of a plan, or who have recently established a business. Also, the argument seems to ignore the fact that the ultimate beneficiary of the tax incentive program is the employee, not the employer. If tax incentives serve the purpose of improving retirement security for employees who might otherwise not be offered such protection, then such incentives should be used.

PIA members involved with benefit plans have expressed concern about financial pressures placed on plan sponsors, administrators, and trustees due to the excessive liability insurance premiums. Such insurance is necessary to protect the administrator and trustees of pension plans from liability for plan failures or whatever employees covered by retirement plans may consider to be poor investing or administration. These premiums paid by plan sponsors are becoming excessive. While the current legislation is not directed toward the insurance premiums per se, the provision of the bill relaxing the so-called "Prudent Man Rule" to allow increased investment of pension funds in small businesses may result in higher liability insurance premiums.

Although we support increased investment in small businesses as a sound addition to any investment portfolio, we ask the Committee to examine the effects of the relaxation of the "Prudent Man Rule" on the liability insurance premiums.

Another area of concern that needs to be addressed by the Committee is the possibility of a cap on PBGC premiums. These premiums have more than doubled since the enactment of ERISA and it has been suggested that the premiums could double again. Also, if there are pension plans that terminate, resulting in a depletion of PBGC funds, there is virtually no limit to what premiums might be. Some review of the extent to which PBGC can increase these premiums should be contained in any final legislation.

In summary, the Printing Industries of America support the basic intent of S. 3017 to encourage the development and expansion of private pension programs. We also support the aims in the bill to reduce reporting burdens and to improve administrative responsibility. While the Administration's reorganization proposal will serve as a good interim step in resolving ERISA difficulties, PIA encourages the ultimate adoption of S. 3017 with appropriate changes as a long range solution.

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September 1, 1978

The Honorable Harrison A. Williams
Chairman, Subcommittee on Labor
Committee on Human Resources

The Honorable Lloyd Bentsen
Chairman
Subcommittee on Private Pension Plans
and Employee Fringe Benefits

United States Senate
Washington, D.C.

Re: Proposed Legislation to
Amend ERISA

Dear Mr. Chairmen:

This statement is submitted for inclusion in the record of the Hearings of the Subcommittee held on August 15-17, 1978, relating to S.3017, S.901, S.3193 and other proposed legislation designed to amend the Employee Retirement Income Security Act of 1974 ("ERISA"). It is submitted on behalf of six major United States life insurance companies: The Prudential Insurance Company of America, The Equitable Life Assurance Society of the United States, John Hancock Mutual Life Insurance Company, Connecticut General Life Insurance Company, Aetna Life and Casualty Company, and The Mutual Life Insurance Company of New York.

These insurance companies play a major role in the administration of pension plans and in the management of pension plan assets. In the aggregate, these six companies account for over $52 billion of pension reserves, more than 50 percent of the total pension reserves held by all U.S. life insurance companies.

This statement relates primarily to S.3017, the ERISA Improvements Act of 1978, inasmuch at it is the most comprehensive effort yet to deal with the multitude of problems that have arisen under ERISA. This effort is clearly an important one. Various studies have shown that since the enactment of ERISA in 1974, pension plans have been terminating at an extraordinarily rapid rate, while the establishment of new plans has slowed markedly. Some of the studies indicate that the burdens of complying with ERISA, including increased funding costs, plan amendments, the reporting and disclosure and other administrative requirements, the increased potential for lawsuits, etc. have been the principal cause of this recent trend. Other studies have pointed to non-ERISA causes, such as inflation and the increased cost of Social Security.

Whatever the reason, it is clear that the traditional incentives for employers to establish and maintain pension plans—the tax incentives built into the Internal Revenue Code and the employee relations aspects of providing fringe benefits—are no longer sufficient for many employers to offset the costs, burdens and potential liabilities of maintaining a plan. This is particularly true for small employers where the tolerance for costs and administrative burdens has never been very high.

We believe this trend can be reversed only by eliminating the problems and unnecessary costs and burdens associated with the maintenance of plans and creating new incentives for employers to establish pension plans. This is not to say that the fundamental rights and protections participants have obtained under ERISA should be diminished. These rights are essential to the financial security of thousands of retirees and millions of active plan participants and their families. But many of ERISA's rules and requirements have created problems and expenses that far outweigh any beneficial purpose such requirements might serve. This situation must be corrected if the growth of pension and other employee benefit plans is to be rejuvenated.

S.3017 can play a major role in this effort. It contains several new incentives for the maintenance of pension plans in the form of tax credits for new and improved plans and tax deductions for employee contributions to tax qualified plans. Other provisions would eliminate many current problems and undue burdens. The bill would simplify and reduce several ERISA reporting and disclosure requirements and would revise the determination letter process. It deals with some of the problems that have arisen in the areas of vesting and funding and would eliminate the prospect that plans might be subject to an additional layer of regulation under federal and state securities laws. Several problems that have arisen in the fiduciary responsibility area are also covered.

In addition, the bill contains a major new program for the creation of special master and prototype plans designed to reduce administrative burdens for small plans. It also attempts to deal with problems that have arisen as a result of the administration of ERISA by more than over government agency.

Generally, we support S.3017. We believe that the proposed amendments to ERISA and the Internal Revenue Code that it contains will eliminate many of the problems that employee benefit plans currently face. However, we also believe that much more can be done. In this regard, careful consideration should be given to including some of the ideas contained in other bills designed to amend ERISA, particularly S.901 introduced by Senator Bentsen, and S.1745 introduced by Senators McIntyre and Nelson. These bills contain numerous provisions that would substantially reduce paperwork burdens for administrators and sponsors of employee benefit plans.

There are, however, a number of other changes that must be made in ERISA in order to complete the effort of eliminating major problems in the operation of employee benefit plans. In brief, our proposed changes and other comments are as follows:

(1) Party In Interest Transactions. The ERISA prohibited transaction

rules should be modified to exempt any transaction from the prohibitions which is entered into on behalf of a plan by an institutional asset manager and is on arm's-length terms.

(2) Definition of "Fiduciary". The ERISA definition of the term "fiduciary" should be amended to make clear that the normal sales presentation made by an insurance agent or broker does not make the agent or broker a plan fiduciary.

(3) Insurance Company General Accounts. We support section 261 of S.3017 which would amend ERISA to clarify that the assets of an insurance company general account do not become plan assets merely by reason of the issuance of a contract to a plan by an insurance company. We recommend, however, that (a) the language of section 261 be modified to clarify that it covers all general account contracts issued by insurance companies, and (b) the section-by-section analysis be revised to make clear that this amendment is merely a clarification of current law.

(4) Investments In Foreign Real Estate. Section 404(b) of ERISA should be amended to permit pension plans to invest in foreign real estate where the assets of the plan are managed by a qualified institutional asset manager which meets specified minimum financial conditions.

(5) Definition of "Party In Interest". The ERISA definition of the term "party in interest" should be modified to eliminate service providers and certain partners, joint venturers and 10 percent shareholders of other parties in interest, who are in no position to influence the operation of a plan.

(6) Prohibited Transaction Exemptions for H.R.10 and Subchapter S Plans. The ERISA prohibited transaction rules should be amended so that H.R.10 plans and plans maintained by Subchapter S corporations can obtain exemptions for customary and necessary transactions.

(7) Special Master Plans. The special master plan program set forth in S.3017 should be modified to (1) reduce further the reporting and disclosure requirements that would be applicable to these plans, (2) revise the rules that would establish the qualifications and duties of master sponsors, (3) permit defined benefit plans to be used as special master plans, and (4) make clear that the special master plan program is not intended to impose new minimum requirements on existing master and prototype plans.

(8) Joint and Survivor Annuity Requirements. Section 205 of ERISA and section 401(a)(11) of the Code should be amended to avoid the elimination of annuity options from defined contribution plans and to simplify application of those rules to defined benefit insurance contract plans.

(9) Deductibility of Employee Contributions to Tax Qualified Plans and Individual Retirement Accounts. Employees should be allowed to make tax deductible contributions to either qualified pension plans or to individual retirement accounts, or both, up to a maximum combined limitation of the lesser of $1000 or 15 percent of compensation.

(10) Dual Jurisdiction. We support the proposal set forth in S.3017 for dealing with the dual jurisdiction problem. We urge that the merits of this proposal be reviewed together with the reorganization plan proposed by the Administration

in order to develop an appropriate long-term solution to this problem.

Prohibited Transactions

S.3017 contains several provisions designed to resolve various isolated problems that have arisen under ERISA's fiduciary responsibility and prohibited transaction provisions. However, in the past four years numerous other problems have developed in this area and many of these remain unresolved. Each of these problems has contributed to some extent to the sharp decline in the growth of new plans and the maintenance of pre-existing plans.

Many of the most difficult problems have arisen under the prohibited transaction provisions. ERISA generally prohibits all transactions between plans and "parties in interest," including fiduciaries, service providers, employers, unions, their affiliates, and others. The prohibitions apply even if the transaction is fair, prudent and in the best interest of the plan and its participants and beneficiaries. However, ERISA contains various exemptions from these prohibitions and authorizes the Labor Department and the IRS to grant administrative exemptions in appropriate cases.

The proper functioning of the exemption provisions is a key element in making the prohibited transaction restrictions a sound regulatory program. However, even though it has been four years since the enactment of ERISA, the Labor Department and the IRS are still unable to process their large volume of often complex administrative exemption applications in a timely fashion. As a result, the prohibited transaction rules have proven to be one of the most unworkable, disruptive and costly aspects of ERISA.

This is particularly true where an exemption application covers a large class of transactions involving the customary business operations of entire industries and the administration of thousand of plans. Applications of this type have commonly taken in excess of two years to process. Examples of major class exemption and related applications which have encountered such delays and are still pending include the insurance company pooled separate account application (filed on November 24, 1974), the insurance agents and brokers application (filed in June, 1975), the insurance company discretionary asset management ruling request (filed in June, 1976), and the guaranteed interest separate account application (filed on April 25, 1977).

Even if, or when, these matters are favorably resolved, they will not deal with the numerous additional problems that continue to arise under the prohibited transaction rules. The following examples are illustrative of some of these problems:

(i) Employer E maintains a plan with respect to which Insurance Company I has established a single customer separate account for a portion of plan assets. Insurance Company X manages another portion of the assets of the E plan. The Insurance Company I wishes to purchase from X a block of debentures (which X holds for investment) of a company unrelated to E for the single customer separate account. The purchase would be a prohibited transaction and, because it involves a single customer separate account, it would not be exempt under the proposed insurance company pooled separate account exemption.

(ii) Employer A maintains a plan which has a more than 5 percent interest in a life insurance company pooled separate account invested in high quality common stocks. A makes a very attractive cash tender offer to the public to purchase the stock of an unrelated public company, some of which happens to be part of the separate account's portfolio. If the account tendered its stock to A for cash, there would be a prohibited transaction which would not be covered by the proposed pooled separate account exemption because the A plan has a more than 5 percent interest in the separate account.

(iii) Employer B maintains a plan which has a greater than 5 percent interest in a life insurance company pooled real restate separate account. B wishes to sell, and the insurance company wishes to buy for the separate account, an attractive piece of real estate which B currently holds for investment. The transaction would be prohibited regardless of its terms and would not be covered by the proposed pooled separate account exemption.

(iv) Employer D maintains a plan which has a more than 5 percent interest in a pooled real estate separate account. D is a leading manufacturer of commercial air conditioning systems and other electrical equipment. The insurance company lets out bids for the purchase of a system in connection with a new office building held by the separate account. D is the lowest qualified bidder and the purchase of the system from D would clearly be a prudent decision. The purchase would, however, be a prohibited transaction not covered by the proposed pooled separate account exemption.

(v) Employer C maintains a plan which has 75 percent of its assets managed by Bank Y and the remaining 25 percent is invested in a pooled separate account maintained by Insurance Company I. Y, on behalf of the C plan, purchases short-term commercial paper issued by S, a more than 50 percent owned subsidary of I. This would be a prohibited transaction not covered by any statutory or administrative exemption.

The prospect of attempting to resolve these and other problems by means of the exemption process with its current unending delays is very discouraging. Although it may be too much to expect that exemptions be processed within, perhaps, sixty days after applications are filed, it is also unreasonable to expect that applicants can wait literally years before action is taken. These delays cast a cloud over many appropriate and prudent business dealings that are often essential to plan operations.

There appear to be several causes for the delays, including the complexity of the rules and the widely diverse transactions they cover, the large volume of exemption applications that have been filed, and the overly narrow interpretation that the Agencies have generally applied to the exemption provisions set forth in the statute. Dual jurisdiction has also played a role in these delays.

It should nevertheless be noted that there have been no cases to our knowledge where the prohibited transaction restrictions have prevented an abusive transaction from occurring which would not otherwise have been prevented by the general fiduciary responsibility rules of section 404 of ERISA. We are also not aware of any enforcement cases where the Government has found it necessary to rely heavily on the prohibited transaction provisions to obtain a remedy for abuses. This is particularly the case where major financial institutions, such as insurance companies, have been responsible for the management of plan assets. In fact, since the enactment of ERISA, when major problems have arisen in connection with the management of the assets of a particular plan, the government agencies have turned to independent, professional asset managers to prevent further abuses.

It has, therefore, been our experience that the prohibited transaction provisions have resulted in over-regulation without providing any corresponding benefits for plans and participants. We believe, moreover, that the delays and problems that have been encountered in the administration of the prohibited transaction rules will continue to disrupt customary plan operations unless the current absolute prohibitions are replaced with a new, more flexible approach that will protect the interests of plan participants and beneficiaries and, at the same time, permit customary transactions to continue without the constant need to obtain administrative exemptions. We urge, therefore, that ERISA be amended to exempt all transactions from the prohibitions if they are entered into (a) on behalf of the plan by an institutional asset manager, and (b) on arm's-length terms.

Definition of "Fiduciary"

The term "fiduciary" is defined in section 3(21) of ERISA to include those persons who have discretionary authority in the administration or management of a plan or who provide "investment advice" for a fee or other compensation with respect to plan assets. The Labor Department and the IRS have stated that the term "investment advice" as used in this definition could, under the facts and circumstances of any given case, include a sales presentation made by an insurance agent or broker in connection with the sale of insurance products (or mutual fund shares) to a plan.

As a result, under current law an insurance agent or broker might become a fiduciary with respect to a plan merely by making a sales presentation to the plan or the plan sponsor (e.g., the employer maintaining the plan). As a fiduciary, the agent or broker would be subject to each of the fiduciary responsibility and co-fiduciary liability provisions of ERISA.

Insurance agents and brokers have been a major factor in the growth of employee benefit plans in the United States. They have actively encouraged employers to establish pension and welfare plans and have provided valuable technical services in plan management and administration, thereby reducing the costs and burdens of maintaining a plan for many employers, particularly small employers. However, the threat of potential fiduciary liability resulting from their normal activities in the sale of insurance products has caused many agents and brokers to phase out their activities in the employee benefits field. The loss of their assistance in the establishment and maintenance of the plans has contributed to the decline in the growth of employee benefit plans in the U.S.

In addition, because it is unclear under what circumstances an insurance agent or broker may become a plan fiduciary by virtue of his sales activities, many agents and brokers, including those who would clearly not be fiduciaries under any reasonable interpretation of ERISA, feel compelled to comply with all of the conditions and requirements of Prohibited Transaction Exemption 77-9 in connection with the sale of insurance products to a plan in order to avoid any possibility of the imposition of excise taxes and other penalties.

This is extremely burdensome not only for agents and brokers, but also for those insurance companies which attempt to ensure compliance with the requirements of the exemption. Because a violation of PTE 77-9 might conceivably lead to rescission of an insurance contract, many insurance companies feel obligated to enforce agent and broker compliance with the exemption. This has proven to be enormously burdensome because of all the paperwork that is required in order to ensure compliance with PTE 77-9. Ultimately, the cost of this paperwork must be borne by the plans which purchase insurance products. Further, in those situations where it is unclear whether an agent or broker is actually a "fiduciary," some companies conservatively require compliance and some do not. This creates competitive problems between companies since most agents and brokers would prefer to sell products for companies which impose the fewest administrative burdens. These competitive problems are inappropriate since they are not based on substantial differences between insurance products, but on different perspectives on the need to comply with ambiguous government regulations.

We believe that these problems can only be solved by an amendment to the definition of "fiduciary" that makes clear that the sales presentation made by an agent or broker or mutual fund salesman will not be considered to be "investment advice" of a type that would make the agent, broker or salesman a plan fiduciary.

Insurance Company General Account Assets

Section 401(b)(2) of ERISA provides that in the case of a plan to which a guaranteed benefit policy has been issued by an insurer, the assets of the plan are deemed to be the policy rather than the assets of the insurer. Because of the variety of types of contracts commonly issued by insurance companies to plans in connection with the funding of pension and welfare benefits, it is frequently difficult to interpret the scope and applicability of the language of section 401 (b)(2). Consequently, in February, 1975, the Labor Department and the IRS jointly stated that if an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general account, the assets of the general account do not thereby become plan assets. Although this was a very helpful clarification of ERISA, questions continue to be raised about the scope of section 401(b)(2).

Section 261 of S.3017 would finally resolve these questions by codifying the Labor Department and IRS position. Although we strongly support section 261, it raises two technical problems. First, by its terms, the amendment appears to apply only to fully insured contracts and not to the variety of other forms of contracts normally utilized by pension and welfare plans. Second, the section-by-section analysis of S.3017 states that section 261 would "broaden" section 401(b)(2) of ERISA. This ignores the Labor Department and the IRS interpretation issued in February, 1975 and raises the question of whether insurance companies are currently complying with ERISA.

Accordingly, we urge that section 261 of S.3017 be enacted with certain technical modifications so that it will cover all general account insurance products issued to plans. We also recommend that the discussion of section 261 in the section-by-section analysis be clarified to indicate that section 261 is intended to adopt the Labor Department/IRS interpretation of section 401(b)(2) of ERISA and that it would not have the effect of broadening section 401(b)(2).

Investments in Foreign Real Estate

Section 404(b) of ERISA prohibits plans from maintaining the indicia of ownership of plan assets outside the jurisdiction of the United States district courts unless authorized to do so under regulations issued by the Department of Labor. The Labor Department has issued regulations which permit plans to hold foreign securities in overseas locations provided that the securities are under the discretionary management or in the actual possession of financial institutions which are regulated in the United States (i.e., banks, insurance companies, investment advisers, and brokerage firms) and which meet certain minimum financial criteria. This regulation does not, however, apply to any assets other than foreign securities.

As a result, section 404(b) of ERISA raises a serious question whether plan assets may be invested in foreign real estate even though this may well be a prudent and otherwise desirable investment for plans. Foreign real estate is one of the many new sources of investment which are attracting interest in the pension fund investment community. It would, therefore, be unfortunate if ERISA had the effect of precluding such investments where they are otherwise determined to be appropriate as plan investments by persons who are experts in the field of pension fund investments.

However, it is frequently unclear what constitutes the "indicia of ownership" of real property. In some cases, it has been deemed to be the property itself; in others, it has been considered to be the deed to the property filed in the local recording office. In either of these cases, it would not be possible to maintain the indicia of ownership of foreign real estate in the United States. Consequently, section 404(b) has had a chilling effect on any plan efforts to make sound and beneficial investments in foreign real estate, even where the plan fiduciary in charge of making plan investment decisions is a professional asset manager skilled in making real estate investments.

In order to solve this problem, we recommend that section 404(b) be amended to permit plans to invest in foreign real estate where plan investments are under the management and control of regulated institutional asset managers, such as banks, insurance companies or investment advisers, which meet certain minimum financial standards designed to ensure that the institution has a substantial presence in the United States. In this regard, the amendment should codify the minimum financial standards for institutional asset managers that are already contained in the Labor Department's regulations on the maintenance of the indicia of ownership of foreign securities outside the jurisdiction of the U.S. district courts.

Definition of "Party in Interest"

The term "party in interest" is defined in section 3(14) of ERISA to include, among others, plan fiduciaries, service providers, employers, unions, officers and directors of these entities, and corporations, partnerships or joint venturers which are more than 50 percent owned by fiduciaries, service providers, employers, unions, etc. Since the definition of "party in interest" is used mainly in conjunction with the prohibited transaction rules, its clear purpose is to encompass those individuals and organizations who may be in a sufficiently close relationship to a plan to influence unfairly the disposition of plan assets for their own benefit so that transactions between them and a plan should be prohibited.

However, the definition includes several categories of persons who as a practical matter are not in any position to influence the disposition of plan assets. These categories include:

(a) Persons who provide ministerial services to a plan on a regular basis, such as janatorial services, telephone services, or the maintenance of heating and electrical systems for buildings which are a part of plan assets, but who are nevertheless parties in interest under section 3(14)(B) of ERISA.

(b) Persons who, under section 3(14)(I) of ERISA, are parties in interest with respect to a plan merely because they are 10 percent or more partners or joint venturers in an entity in which another partner or joint venturer, who happens to be, e.g., an employer with respect to the plan, has a 50 percent or more interest. For example, X is an employer with respect to a plan, and therefore, is a party in interest under section 3(14)(C). X has a 50 percent interest in XYZ, a partnership. Therefore, XYZ is a party in interest under 3(14)(G). Y has a 10 percent interest in XYZ and, therefore, is a party in interest under 3(14)(I). As a result, all transactions between X's plan and Y are prohibited even though Y is clearly in no position to influence the disposition of plan assets merely by reason of his participation in XYZ. This is particularly true where plan assets are managed by a professional asset manager, such as an insurance company.

(c) Persons who, under 3(14)(H), are parties in interest merely because they are 10 percent or more shareholders of a corporation which, in turn, is 50 percent or more owned by an employer or service provider or other party in interest. This situation is similar to (b), except that it applies to corporations rather than partnerships or joint ventures.

(d) Persons who, under 3(14)(I), might be deemed to be parties in interest merely because they have a 10 percent or more interest in a joint venture in which another party in interest has an interest which may be more or less than 50 percent. Although this interpretation of section 3(14)(I) has been rejected by the Labor Department and the IRS, it would nevertheless be incorporated into ERISA by S.3017.

In each of these cases, the definition of "party in interest" includes persons who have no significant relationship to a plan, or whose relationship to the plan does not place them in a position to influence plan operations. Nevertheless, because of this definition, many prudent investment opportunities have been lost by plans. For example, it is common for two oil companies to join together on an equal basis in joint ventures to drill exploratory wells. Under ERISA, not only is the joint venture a party in interest under section 3(14)(G) with respect to each company's pension plan, but each company becomes a party in interest with respect to the other's plans by virtue of section 3(14)(I). Thus, if the plan of one of the oil companies has its assets invested in an insurance company pooled separate account, the account could not invest in debentures issued by the other oil company, even if this investment were entirely prudent for the separate account.

Similarly, if AT&T provides telephone service for buildings owned by a plan, the plan may be prohibited from investing in debentures issued by the Bell System.

We believe that this situation should be corrected by amending ERISA to exclude from the definition of "party in interest" (a) any service provider who provides merely ministerial services to a plan, and (b) any 10 percent or more joint venturers or shareholders of any partnership, joint venture or corporation described in section 3(14)(G) of ERISA. In addition, we urge that the proposed amendment to section 3(14)(I) contained in S.3017 not be adopted since it would unnecessarily broaden the categories of parties in interest in direct opposition to the policy already adopted by the Labor Department and the IRS.

H.R.10 and Subchapter S Plans

H.R.10 plans and plans maintained by Subchapter S corporations are generally subject to ERISA's prohibited transaction restrictions. However, unlike other types of plans, H.R.10 and Subchapter S plans are not permitted to take advantage of any statutory or administrative exemptions when owner-employees or shareholder-employees, or any of their relatives or affiliates, are involved in

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the transaction. See section 408(d) of ERISA. This rule applies regardless of whether the transaction would be in the best interests of plan participants and beneficiaries and protective of their rights. The inability of H.R.10 and Subchapter S plans to obtain exemptions for certain types of prohibited transactions has resulted in the disruption of the day-to-day operations and business relationships of many plans and employers. Common examples of this problem include the funding of plans maintained for the employees of small insurance agencies and the sale of insurance products to an H.R.10 plan by a relative of an owner-employee. However, section 408(d) not only prohibits all such transactions, even though they may be essential to the operation of a plan and fair to all parties concerned, but it precludes plans from obtaining exemptions for such transactions under conditions and safeguards that would ensure protection of the interests of plan participants

Consequently, section 408(d) has proven to be an unnecessary obstacle to the establishment and maintenance of plans. We urge, therefore, that section 408(d) be repealed, or, in the alternative, that it be amended so that, at a minimum, H.R.10 and Subchapter S plans may rely on statutory and administrative exemptions in order to obtain funding with insurance products.

Special Master Plans

One of the basic objectives of S.3017 is to reduce the administrative burdens and costs of maintaining a plan for small employers. The principal approach used in the bill to deal with this problem is the so-called "special master plan." One of the central features of the special master plan provisions of S.3017 is the requirement that the master sponsor become the "plan administrator" and the "named fiduciary" of the plan. The "master sponsor" would also be required to be an "investment manager" within the meaning of ERISA. Generally, this includes a qualified bank, insurance company or investment adviser which agrees to assume discretionary responsibility for the investment of plan assets. S.3017 also contains provisions that would simplify the reporting and disclosure burden for special master plans, including some standardization in the plan description and summary plan description requirements and permission to file annual reports on an aggregated basis. In addition, special master plans could only be defined contribution plans and would have to be approved as to form by the government.

Although we support the purpose behind the special master plan proposal, as presently conceived, it would not do enough to reduce the administrative burdens for small plans and would raise practical problems that would discourage financial institutions from implementing special master plans. The principal flaw in the program is that it attempts to deal with the administrative burden problem not by reducing burdens, but by shifting them to financial institutions. Although employers would no longer be responsible for actually performing plan administrative functions, they would still have to bear the costs of plan administration. Shifting the burden of compliance to financial institutions would not measurably reduce the costs of administering small plans and, therefore, would not greatly encourage small employers to establish plans.

Further, that part of the proposed special master plan program that would require master sponsors to be "investment managers," "plan administrators," and "named fiduciaries," would impose on master sponsors various responsibilities and liabilities that are inappropriate and would discourage many financial institutions from implementing special master plans. For example, although S.3017 would make employers responsible for the information they provide to master sponsors, there is nothing in the bill that insulates master sponsors from being sued as plan administrators because they have prepared or distributed inaccurate reports or disclosure materials. Although master sponsors may not ultimately be liable for such inaccuracies, they would still have to bear the costs of defending such litigation.

In addition, under ERISA the plan administrator is required to furnish a summary plan description to all participants. This function is normally performed by employers by means of hand delivery at the workplace in order to avoid the burden of maintaining accurate current records of employee home addresses. It would, therefore, be inappropriate and unnecessarily burdensome to require master sponsors to perform this function.

Also, applying the plan administrator title to insurance companies would preclude them from relying on Prohibited Transaction Exemption 77-9 to sell insurance products or mutual fund shares to a special master plan. Without the availability of Exemption 77-9, no insurance company could become involved in the special master plan program.

Applying the "named fiduciary" title to master sponsors would also create problems. One of the principal functions of a "named fiduciary" under ERISA is to select and retain investment managers. However, master sponsors will generally not be selecting and retaining others to serve as investment managers for their special master plans. Rather, they will normally manage the assets of the plan themselves. In the case of insurance company master sponsors, contributions will either be placed in the insurance company's general account or the insurance company will manage the assets of the plan in a pooled separate account. On the other hand, it will generally be the employer's responsibility to determine which master sponsor and funding vehicles it will use. Accordingly, master sponsors generally should not be required to be "named fiduciaries" for the purpose of selecting investment managers.

Named fiduciaries are also responsible under ERISA for making decisions on claims appeals. These appeals, however, commonly involve disputes over facts, such as the number of hours of service an employee may have accumulated, the accuracy of which would be the responsibility of the employer under S.3017. Since the master sponsor would be required to rely on facts supplied by employers, the master sponsor is not only the wrong person to decide these appeals, but may inappropriately become involved in frequent benefit claims litigation that will result in unnecessary litigation expenses.

Finally, under ERISA the term "investment manager" applies to persons who manage plan assets on a discretionary basis. In many insurance company master and prototype programs, however, funding is provided through the insurance company's general account. As a result, in many cases the insurance company would not be managing plan assets and would not, therefore, be an investment manager within the meaning of ERISA. We recognize that the intent of this requirement was probably to limit the group of eligible "master sponsors" to qualified financial institutions, such as regulated banks, insurance companies and investment advisers. This would greatly reduce the risks that special master plans would be improperly managed or administered. We believe, however, that the same result can be achieved without raising difficult and unnecessary questions and problems with respect to the management of plan assets.

It should also be noted that by limiting the special master plan concept to defined contribution plans, S.3017 would exclude many employers for whom a defined benefit plan would provide the most suitable retirement program. This would generally be the case, for example, where the employer has employees who are close to retirement age when the plan is established. A defined benefit plan would normally provide higher benefits for these older employees. In addition, because defined benefit plans provide a stated benefit, they make it easier for employees to determine what their minimum financial resources will be after retirement.

Also, by establishing an elaborate regulatory structure for special master plans, S.3017 raises the question of whether existing master and prototype plans would have to be amended to meet the requirements of the bill. For many insurers, such a requirement would be enormously burdensome and costly for both the insurance company and employers currently participating in these plans.

In order to solve these problems, we urge that the following changes be made in the special master plan rules of S.3017:

(1) Reduction in Administrative Burdens: We fully support the provisions of S.3017 that would reduce some of the costs and burdens for small employers of maintaining a plan by, among other things, eliminating the determination letter requirement and permitting aggregated annual reports. However, we believe that more needs to be done to reduce administrative burdens for small plans. In this regard, we support the measures included in the Administration's reorganization plan to eliminate the plan description filing requirement and to require annual reports to be filed only once every three years. We also believe that the proposed annual report for special master plans, which would contain aggregate information for all participating plans, should be modified to eliminate much of the information that is currently asked for in Form 5500. We have seen little evidence to date that the availability of this information has served any useful purpose, particularly in the context of master and prototype plans.

(2) Duties of Master Sponsors. S.3017 would require master sponsors to become investment managers, plan administrators and named fiduciaries, thereby assigning to them many functions which they cannot reasonably be expected to perform. A better approach would be to require the master plan documents to list which functions will be assumed by the master sponsor and which functions will be assumed by employers.

In addition, to the extent that the "investment manager" requirement is intended to impose minimum qualification standards on master sponsors, we believe that this can better be accomplished by merely requiring master sponsors to be one of the categories of institutions listed in the ERISA definition of "investment manager" (i.e., a qualified bank, insurance company or investment adviser) without also requiring the master sponsor to have discretionary authority over plan asset management, as is the case for "investment managers."

(3) Defined Benefit Plans. We believe the special master plan program should not be limited to defined contribution plans, but should also include defined benefit plans.

(4) Existing Master and Prototype Plans. Any implication contained in S.3017 that existing master and prototype plans would be required to comply with the special master plan rules should be eliminated. The committee reports accompanying S.3017 or its successors should clearly indicate that existing master and prototype plan sponsors may decide whether they wish to use existing plans as "special master plans" and how they will achieve compliance with the requirements of the bill.

Joint and Survivor Annuities

Section 205 of ERISA and section 401(a)(11) of the Code provide that a retirement plan which provides for the payment of annuity benefits must provide for the payment of such benefits in the form of a qualified joint and survivor annuity. A qualified joint and survivor annuity is an annuity for the life of the participant's spouse equal to at least one-half of, but no greater than, the particpant's annuity. Under Treasury Department regulations, a plan which has an annuity option must provide retirement benefits in the form of a qualified joint and survivor annuity unless the participant elects otherwise. Plans which provide early retirement benefits are also required to offer participants who continue in employment after early retirement age an opportunity to elect survivor coverage while they are still employed. Detailed procedural requirements must be met in connection with both the post- and pre-retirement elections.

As interpreted by Treasury Department regulations, ERISA requires defined contribution plans that contain an annuity option to be restructured to make a joint and survivor annuity the basic form of benefit under the plan. This is true despite the fact that the vast majority of participants choose to receive these benefits in the lump sum form under which there is no forfeiture of vested benefits. In order to avoid substantial administrative costs for a benefit form which is used by a small minority of plan participants, many plan sponsors have eliminated all annuity options. This means, of course, that participants who desire an annuity will no longer have that option, a result which is totally contrary to the purpose of joint and survivor provisions.

A second problem involves the application of the joint and survivor annuity rules to defined benefit insurance contract plans. Such plans have historically provided a pre-retirement death benefit which equals or exceeds the minimum requirement of ERISA. Nevertheless, since the benefit may not satisfy the technical definition of a survivor annuity, these plans are required to comply with unnecessary notice and election requirements.

Accordingly, we urge that the joint and survivor annuity requirements be modified (1) to apply to defined contribution plans only if a participant selects an annuity option under the plan and (2) to provide that a plan meets the requirements of ERISA if it provides a pre-retirement death benefit which is at least actuarially equivalent to a pre-retirement survivor annuity.

Deductions for Employee Contributions

ERISA currently provides tax incentives for employers who establish qualified pension plans. In addition, ERISA provides for individual retirement accounts (IRA's) to enable employees who are not covered by a qualified plan to set aside funds for their retirement on a tax-favored basis. By establishing an IRA, employees may make annual deductible contributions of the lesser of $1,500 or 15 percent of their wages.

Qualified plans are permitted, but not required, to accept employee contributions. Since allowing employees to contribute to plans often creates an onerous accounting and administrative burden, many plans do not accept employee contributions.

Current law prohibits an employee who is an active participant in his or her employer's retirement plan to maintain an IRA to supplement the retirement benefits provided by the employer. Any contributions made for a year in which a person is an active participant in a tax qualified plan are "excess contributions" and are subject to severe tax consequences.

A qualified plan may allow employees to elect not to participate in the plan. If this option is available, the employee may elect not to participate in his employer's plan, and may establish an IRA instead. However, many plans do not provide this option because doing so may result in the plan's failure to meet coverage requirements and loss of tax qualified status.

Under current law, employees covered by a tax qualified plan have no way to insure that their retirement will be provided for until they have obtained a vested interest in their retirement benefits. Further, an employee who is covered by a qualified plan is not able to supplement the retirement benefits his employer provides, even if those benefits are inadequate. The employee cannot make contributions to the plan unless the plan allows such contributions, and the contributions come out of his after-tax dollars. He cannot establish an IRA unless the plan provides an option of non-participation and he elects not to be covered by the employer's plan.

Section 303 of S.3017 would deal with this problem by requiring that a qualified plan accept employee contributions and treat such contributions as separate accounts. Employees who are active participants in a qualified plan could deduct their contributions to the plan up to an amount equal to the lesser of

$1,000 or ten percent of their compensation includible in gross income. The amount of the allowable contribution would be reduced by twenty percent of the amount by which the adjusted gross income of the taxpayer exceeds $30,000.

We believe that several modifications to S.3017 are necessary to achieve the bill's objective of allowing employees to supplement retirement benefits provided by the employer. A qualified plan should not be required to accept employee contributions. The accounting and administrative burdens on qualified plans that would result are potentially very large. The additional costs involved would decrease the amounts available for retirement benefits.

Instead of requiring qualified plans to accept employee contributions, the legislation should allow employees covered by qualified plans to make deductible contributions to IRA's up to the prescribed limits. By doing so, the legislation would provide employees flexibility in deciding how to supplement their retirement benefits and would not place the substantial burden on plans that would be caused by requiring them to accept employee contributions.

The legislation restricts the deductible contribution to the lesser of ten percent of gross income or $1,000. This proposal should be modified to increase the maximum deduction to the lesser of 15 percent or $1,000 (but should not result in a lowering of current IRA deduction limits). This modification would allow low income taxpayers to make larger contributions. Since the limitation is the lesser of the prescribed percentage of income or $1,000, there would be no additional benefit to persons of middle or high income.

As noted above, S.3017 would reduce the maximum allowable deduction by 20 percent of the amount by which the individual's adjusted gross income exceeds $30,000. This reduction is unnecessary and adds unwarranted complexity to the law. Since the maximum contribution a taxpayer with adjusted gross income exceeding $30,000 could make absent the reduction would be $1,000, there is no possibility of large scale tax avoidance. Further, the reduction necessitates a complicated calculation and makes it impossible for an individual to predict with any degree of confidence how much he can safely contribute to his IRA.

We also note that S.3288, introduced by Senator Dole, would add provisions to the Internal Revenue Code that would permit an active participant in a qualified plan to deduct his contributions to the qualified plan or to an IRA, or to both. The contributions would be subject to a maximum limitation of the lesser of ten percent of compensation includible in gross income or $1,000. The bill provides that the Secretary of Treasury would prescribe reporting requirements for employers and employees.

Although the percentage of limitation in S.3288 should be increased to 15 percent, and any reporting requirements imposed by this bill should not be overly burdensome for employers or employees, overall, S.3288 would accomplish the objective of enabling employees to supplement their retirement benefits without creating an additional burden on qualified plans.

Dual Jurisdiction

Our position on the problems of the dual administration of ERISA by the Labor Department and the IRS is set forth in detail in our statement appearing in the record of Hearings on Oversight of ERISA, October 13, 1977. In that statement, we indicated that dual jurisdiction has adversely affected the administration of ERISA and increased the expense of compliance; that placing sole jurisdiction over ERISA in a single agency appears to be the best means of providing a solution to current problems; but that a division of jurisdiction might be acceptable as a short term solution.

We continue to believe that the single agency approach is the best solution for dealing with the current situation. Accordingly, we recommend that the merits of the approach set forth in S.3017 be considered in connection with a review of the Administration's current reorganization plan to develop a solution that will finally resolve the dual jurisdiction problem in a satisfactory way.

Conclusion

The principal goal of S.3017--to reduce administrative burdens and difficulties in the maintenance of employee benefit plans--is vital to the renewed expansion of employee pension and welfare programs in the United States. Many of its provisions will help to accomplish this goal. However, several additional revisions are needed in ERISA, particularly in the areas of fiduciary responsibility and prohibited transactions, in order to deal with some of the major roadblocks that are currently impeding the efficient and prudent management of employee benefit plans. We therefore strongly urge that the amendments and modifications we have recommended be enacted as a part of any bill that would amend ERISA.

We would be glad to assist the Subcommittee and their staffs in the development of this legislation.

Respectfully submitted,

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COMMENTS AND SUGGESTIONS

IN REGARD TO

BILL S. 3017

ERISA IMPROVEMENTS ACT OF 1978

SUBMITTED BY

NORMAN H. TARVER

TORONTO, CANADA

Hearings held on August 15, 16 and 17, 1978
by the Subcommittee on Labor of the Senate Committee on Human Resources and the Subcommittee on Private Pension Plans of the Senate Committee on Finance.

COMMENTS AND SUGGESTIONS

IN REGARD TO BILL S. 3017

ERISA IMPROVEMENTS ACT OF 1978

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I - PERSONAL INTRODUCTION

Since my retirement at the end of 1975, I have been acting to some extent as a consultant on pension legislation in the United States. Prior to retirement I worked for a large Canadian life insurance company which does more than 50% of its business in the United States. While I was employed by that company, I was involved in the home office in the technicalities of pension plan regulation for over 30 years, originally mostly with Canadian regulations but latterly for about 15 years exclusively with United States regulations.

Over the years, I have written numerous articles discussing United States legislation and regulations and making suggestions in respect to them. In the period while ERISA was being developed, briefs were submitted to various Congressional Hearings. I am still very much interested in pension legislation and regulations, particularly in respect to employees who are not now covered by pension plans.

In recent years, I have been and still am writing for an independent publishing company in Indianapolis, Indiana, which publishes reference materials for the life insurance, mutual fund and banking industries. Included in these writings are three manuals on Keogh Plans, IRAs and 403(b) tax deferred annuity plans.

The suggestions included in this brief are personal suggestions. This brief is not submitted on behalf of any company, association or organization or on behalf of any person. It is purely personal.

II - GENERAL APPROVAL OF BILL S.3017

In general, Bill S.3017 contains many worthwhile proposals for amending the Internal Revenue Code and ERISA. As I wrote in an article that was published in June, without question this Bill is the most important Bill in respect to the private pension plan system that has been submitted to Congress since ERISA became law in 1974. It contains many meaty provisions, some of which are very desirable innovations. However, it is obvious that there should be considerable discussions about the numerous provisions of the Bill in order to work out details.

III - TWO SAD WORDS:- "IF ONLY"

It is sad to realize that many of the problems with ERISA that have become approved since 1974 could have been avoided "if only" many persons interested in the welfare of the private pension plans system had participated positively and objectively in the discussions during the years that ERISA was being developed.

Too many persons took the position that ERISA could not and would not come to fruition and therefore did not participate in its development. Let us not make that mistake again. A Bill (or several Bills) to amend ERISA is bound to become law in the next year or so.

In the article referred to above, I expressed the hope that insurance companies, insurance agents, banks, pension consultants, mutual fund companies and anyone else who is interested in the welfare of the private pension plans system and the employee benefit plans in general will participate in the discussions during the development of Bill S.3017 and the other Bills likely to be submitted by Senators Harrison A. Williams, Jr., and Jacob K. Javits, and others in the coming months.

With these thoughts in mind, I urge the Committees to give the widest possible publicity to the contents of the Bills and to the submissions made to this and other Hearings and that as many Hearings and disucssions as possible be held.

IV - SINGLE REGULATORY AGENCY (TITLE I OF BILL)

Basically the concept of a single regulatory agency is very desirable and, in general, the basis on which the Bill would provide for its establishment and operation is desirable.

However, it is suggested that more consideration should be given to the make-up of the proposed Employee Benefit Commission (EBC). Rather than have the Chairman and the Vice-Chairman be "special liaisons" to the Secretaries of Labor and Treasury, respectively, it is suggested that all of the five Commissioners should be independent of the two Secretaries and that the Chairman and the other four Commissioners should be appointed by the President with approval by the Senate.

If I may, I would appeal to the DOL, the IRS and the Treasury to take a broad statesman-like attitude and to be more concerned with the general good of the private pension plans system and all the employees who participate in it. Similarly I would appeal to the various Committees of the Senate and the House also to take broad statesman-like positions in regard to their work in connection with ERISA, both during the development of the Bills to amend ERISA and later during oversight procedures.

Disclosure to prospective purchasers of IRAs has been and probably will continue to be a problem. The Oversight Subcommittee of the House Ways and Means Committee and the Federal Trade Commission have been much concerned about the adequacy of disclosure. It is suggested that the proposed EBC should be given jurisdiction over IRAs particularly with respect to disclosure.

V- TAX DEDUCTION FOR EMPLOYEE CONTRIBUTIONS (BILL SECTION 303 - CODE SECTION 221)

I have long proposed that active participants in qualified plans should be encouraged to set aside savings for retirement through the use of tax deductions. However, I feel that the tax deductions for such contributions should be closely inter-related with tax deductions for contributions to IRAs. On February 24, 1978, I submitted a brief to Hearings held by the Oversight Subcommittee of the House Ways and Means Committee. I would request that the Senate Committees interested in Bill S. 3017 study the proposals in that brief. Such proposals dealt with the question of inter-related contributions to IRAs and qualified plans.

Under Code Sections 219 and 220 employees benefiting under Code Section 403(b), which permits so-called tax deferred annuities, are barred from establishing IRAs and Spousal IRAs. This is proper, because in practice a so-called tax deferred annuity is, in reality, an individual savings plan. Although technically the employer makes the contribution for a 403(b) annuity, the money for the contribution in almost every case is derived from the employee under a salary reduction agreement. In other words, a 403(b) annuity is very much like an IRA. Therefore an employee already contributing to a 403(b) annuity (even though indirectly) should not be permitted to secure an additional tax deduction under the proposed Code Section 221. Moreover, almost all employees contributing to 403(b) annuities are already participating in a qualified plan or a governmental plan. It is therefore suggested that proposed Section 221(3)(E) be deleted in order to remove the reference to a 403(b)annuity.

Under proposed Code Section 221(b)(2), the $1,000 limit would be reduced gradually to zero in respect to adjusted gross incomes in excess of $30,000. It is suggested that, if a gradual reduction feature is to be included, the reduction should be based on annual compensation rather than an adjusted gross income. An individual normally knows what his or her annual compensation from an employer is long before he or she knows what the adjusted gross income is. The employee would be able to get his compensation figure from Form W-2 but the employee does not calculate the adjusted gross income figure until the tax return form is completed, which could be sometime after the 45-day grace period included in proposed Code Section 221(c)(6) has expired. Therefore it is suggested that "annual compensation" be used in proposed Section 221(b)(2) in place of adjusted gross income.

Proposed Code Section 221 would provide tax deduction in respect to employee contributions to qualified plans. Having secured tax deduction for contributions, the benefits flowing from such contributions must be taxable income. Bill S.3017 seems to contain no provision that would make such benefits taxable. In general, it is suggested that the benefits accruing from employee contributions to a qualified plan should be treated in the same way as a benefit accruing from contributions made by the employer. Therefore, it is suggested that Bill S.3017 should provide for amendments to Code Sections 72, 402 and 403.

VI - SMALL CORPORATE EMPLOYERS (BILL SECTIONS 304 and 305 - CODE SECTIONS 446 and 44D)

The proposal to provide a temporary tax credit to encourage small corporate employers to establish new plans is an excellent concept. Certainly the majority of workers who are not covered by the private pension plans system are employed by small employers so the tax credit should encourage small employers to provide coverage for more workers.

There is a problem as to what constitutes a "small employer". It is my understanding that what the Small Business Administration considers "small" is, in the view of many persons involved in pension work, much larger than "small". The sized employer that needs the most help to a company with fewer than 50 employees, in general. But I hesitate to pick a specific number of employees as a criterion because a company with 10 employees could be so well off that it does not need encouragement whereas a company with 100 employees can be very much in need of help.

Therefore I suggest that all corporate employers regardless of size be given a tax credit with respect to the first "X number" of dollars of annual contributions if they establish improved plans. What the "X numbers" of dollars should be will need to be studied by actuaries and others. In this connection, I would refer the Committees to Bill H.R. 376 submitted by Representative Barry Goldwater, Jr.

VII.- NO IRAs FOR SELF-EMPLOYED INDIVIDUALS AND OTHERS (BILL SECTION 306)

The proposed amendments to Code Section 219(b) and 220(b) which would bar self-employed persons and officers and 10% shareholders from purchasing IRAs and Spousal IRAs is a good idea. Certainly the IRA and Spousal IRA provisions have been abused and existing qualified plans have been abandoned and partially replaced by IRAs and Spousal IRAs for highly paid employees only. I am pleased to see that, after a specific date, future contributions to existing IRAs and Spousal IRAs would no longer be permitted and that there would be no grandfathering of existing IRAs and Spousal IRAs.

VIII - SPECIAL MASTER PLANS (BILL SECTION 401 - ERISA SECTION 601)

It has long been my opinion that the extensive knowledge of pension plans requirements that exists in the life insurance industry should be used much more than it is in the servicing of small pension plans. Similarly the computer and other facilities that the insurance industry possesses should be used to a greater extent.

Therefore the concept in Proposed ERISA Section 601 for Special Master Plans (SMPs) under which insurance companies and other corporations would perform all the service work and take fiduciary responsibilities for the work is desirable in my opinion. Requiring an employer to take full responsibility to furnish exact data is, of course, essential but not beyond the ability of a small employer and certainly much less costly than having to complete and submit reports on his own.

Of course, it must be understood that an insurance company or other service provider cannot be expected to perform all service work for nothing. However, as the SMP would be a package-type of pension plan, the cost of the service work should be reduced considerably.

If a particular employer does not want to use the SMP method, there is no reason why that employer could not establish his own individually designed plan and pay the extra costs that would go along with such plan.

With the probability of steady inflation for years to come, I believe that a defined benefit plan is much better than a defined contribution plan for employees over the long term. Therefore I would urge that an SMP for defined benefit plans be developed and permitted as quickly as possible. There should be no insurmountable problem for such an SMP.

In addition to proposed ERISA Section 601, it will be necessary to include in the Bill a corresponding proposed Code Section, I believe.

IX - PRE-EMPTION OF SECURITIES ACTS (BILL SECTION 274(3))

Although it is probably desirable to pre-empt the Securities Act of 1933 and the Securities Exchange Act of 1934 and related State laws to overcome the problems created by the Daniels case, it is suggested that it is most undesirable to remove from the jurisdiction of those two Acts the interests and participations in a single or collective trust maintained by a bank or in a separate account maintained by an insurance companu.

In essence, a pooled investment fund maintained by a regulated investment company, a single or collective fund maintained by a bank or a separate account maintained by an insurance company are all similar in purpose and operation. Each is used as a pool to receive monies deposited by numerous depositors (individuals or entities). In return for the monies deposited, each depositor receives an interest or a participation in a fund or an account. That is to say each depositor receives a "security" in return for the monies deposited.

Each depositor needs and deserves the protection provided by the Securities Act of 1933 and the Securities Exchange Act of 1934, regardless of which particular type of fund or account he or she selects for his or her deposit. This is particularly so in the case of a depositor who is making a deposit in respect to a Keogh (H.R.10) Plan or an IRA under Code Sections 219 and 220. At present, such a depositor enjoys such protection. However, Bill Section 274(3) would destroy it, except in the case of deposits used to purchase mutual fund shares. Neither ERISA nor the Internal Revenue Code would provide protection equivalent to that provided by the two Acts referred to above, which a depositor now enjoys and needs.

At the present time, the Federal Trade Commission and the House Ways and Means Committee are very much concerned about the poor quality of disclosure in some cases in connection with IRAs. The disclosure that they are concerned about are the circumstances and conditions that apply to taxes and products in respect to IRAs. To remove the existing protection in respect to securities used for IRAs (other than mutual fund shares) would only compound the situation.

Self-employed individuals also need the protection. As the Congress has said in the past, it did not exempt Keogh Plans that invest in interests or participations based on pooled funds of banks or separate accounts of insurance companies, from the protection of the Securities Act of 1933 and the Securities Exchange Act of 1934, because it felt that these plans are complex in nature and because they could be sold to self-employed individuals who are unsophisticated in the securities field.

Therefore I strongly urge that Subsection 274(3) be deleted from Bill S.3017.

ERISA IMPROVEMENTS ACT OF 1978
(S.3017)
COMMENTS OF TIAA-CREF

This memorandum of comments on S.3017 (the "Bill") is submitted on behalf of Teachers Insurance and Annuity Association of America and College Retirement Equities Fund ("TIAA-CREF"), companion organizations forming the nationwide pension system for higher education.

The TIAA-CREF system is nationwide, serving approximately 3000 institutions in the 50 states and the District of Columbia. The system has approximately 500,000 policyholders and serves about 65% of the country's private four-year colleges and universities. These institutions employ approximately 89% of the teachers in all private institutions. The system also serves about 47% of all state tax-supported four-year colleges and universities. These institutions employ approximately 34% of the teachers engaged in that sector of higher education. The system has been approved by 32 states as the basic, optional, or supplemental retirement system for the state-supported institutions of higher education in those states. TIAA provides the fixed annuity, and CREF the variable annuity, component of this nationwide system.

In general TIAA and CREF support the Bill and wholeheartedly endorse its objectives of strengthening and improving private employee pension benefit plans, simplifying their administration and clarifying the extent to which securities and other laws may affect them. We have five comments. Four concern specific sections of the Bill as drafted, and the fifth suggests a new section, as follows:

1. Section 238. Joint and Survivor Annuity
2. Section 274. Preemption
3. Section 231. Reciprocal Agreements
4. Section 221. Disclosure of Accrued Benefits
5. Clarification of Participation Rules for College Faculty Members.

1. Section 238. Joint and Survivor Annuity.

The pre-retirement spouse death benefit provided by Section 238 of the Bill should be payable only to the extent that the participant has not designated someone other than his spouse to receive whatever death benefit the plan provides. With such a change plans already providing a death benefit or its equivalent for any beneficiary designated by the participant would retain their flexibility.

While we support the concept of a minimum death benefit for a surviving spouse, we believe that Section 238 of the Bill as presently drafted would undesirably restrict the choices of participants in plans already providing death benefits. For example, TIAA-CREF annuity contracts provide a full pre-retirement death benefit: if a participant dies before his retirement annuity payments commence, his entire accumulation is payable to his designated beneficiary as the beneficiary elects. Most participants designate their spouses as beneficiaries. However, some participants designate other beneficiaries, for example, when a surviving spouse has independent means or when the participant has made other arrangements for the surviving spouse's financial security.

We believe that this flexibility for the participant should not be eliminated as it would be under proposed Section 238. We suggest that Section 238 be amended to require payment of a pre-retirement death benefit to a surviving spouse only if the participant has not otherwise disposed of his account balance or accrued benefit.

We also suggest that proposed subsection 205(a)(2) of ERISA permit the surviving spouse's benefit of a non-annuity plan to be distributed in a lump sum or in installments, so that the surviving spouse may take advantage of the estate tax exclusion of Section 2039(c) of the Internal Revenue Code of 1954, which no longer applies to lump sum distributions. While this change would primarily benefit defined contribution plans which have dropped the annuity distribution option in order to avoid the joint and survivor annuity requirements, we believe it would be helpful to make it.

Accordingly, we recommend that the first sentence of proposed Section 205(a)(2) of ERISA be amended to read as follows following the words "account balance":

> "(less any part thereof payable under the plan to a beneficiary other than the participant's surviving spouse) shall be distributed to the participant's surviving spouse in the form of a lump sum, or in installments or an annuity commencing, not later than 60 days after the end of the plan year in which the participant died".

and by adding the following paragraph (3) to proposed subsection(b) of Section 205 of ERISA:

> "The survivor's annuity required by paragraph (1) shall be reduced by the actuarial equivalent of any benefit payable under the plan to a beneficiary other than the participant's surviving spouse."

With these amendments a plan which provides no pre-retirement death benefit for participants with 50% vesting will have to provide them with at least the statutory surviving spouse death benefit; but a plan which does provide a pre-retirement death benefit or its equivalent for such participants can take credit for that benefit and can give them freedom of choice with respect to that benefit.

2. Section 274. Preemption.

The exemption from securities law regulation proposed by Section 274 of the Bill should be expanded to cover annuities issued by TIAA and CREF. One way to do this is to expand Section 274 to cover (a) interest and participations in an insurer's general account, (b) all employee benefit plans defined in Section 4(a) of ERISA (such as public educational institutions), whether or not they are excluded under Section 4(b) and (c) variable annuities.

We recommend the following amendments to proposed paragraphs (2) and (3) of Section 514(d) of ERISA:

1. Delete the phrase "and not exempt under Section 4(b)" from paragraph (2);

2. Amend subparagraphs (A) and (B) to proposed paragraph (3) to read as follows:

> "(A) In a single or collective trust maintained by a bank or in a general or separate account maintained by an insurer (including a company issuing variable annuities), and

"(B) issued to or under an employee benefit plan or plans described in Section 4(a);

3. Insert the words "general or" before the word "separate" in the body of the text of paragraph (3) following subparagraphs (A) and (B).

Alternatively, if the foregoing amendments are not feasible, we suggest that proposed Section 514(d)(3) be amended to read as follows to cover TIAA-CREF's unique status (new matter scored):

"(3) Notwithstanding any provision of law to the contrary

(A) an interest or participation

(i) in a single or collective trust maintained by a bank or in a separate account maintained by an insurer, and

(ii) issued to an employee benefit plan or plans described in section 4 (a) and not exempt under section 4 (b); or

(B) a contract issued to or under any employee benefit plan or plans by a life insurance or annuity company organized and operated, without profit to any private shareholder or individual, exclusively for the purpose of aiding and strengthening charitable, religious, educational or philanthropic institutions, by issuing insurance or annuity contracts only to or for the benefit of such institutions, to individuals engaged in the services of such institutions, and to members of the immediate families of such individuals

is not, and shall not be characterized as or deemed to be, a security within the meaning of the Securities Act of 1933, the Securities Exchange Act of 1934, or any law of any State which regulates securities, and such a single or collective trust, separate account or company is not, and shall not be characterized as or deemed to be, an investment company within the meaning of the Investment Company Act of 1940 or any law of any State which regulates investment companies. For purposes of this paragraph, the term 'insurer' shall have the meaning given in section 401(b)(2).".

3. <u>Section 231. Reciprocal Agreements.</u>

Section 231 of the Bill should be amended to provide that proposed Section 209 of ERISA does not apply to a plan funded by portable annuity contracts without cash surrender values.

Since the TIAA-CREF system is a portable pension system within higher education, we support the efforts of the Bill in Section 231 to provide for portable pensions. Under the TIAA-CREF system, a participant may transfer among participating institutions and use the same annuity contracts so that, upon retirement, he looks only to TIAA-CREF for his pension payments.

TIAA-CREF annuity contracts issued under the regular retirement plans at participating institutions do not contain provisions for cash surrender or loans. As a result of the absence of these provisions, the loading charges do not reflect the cost that would be connected with such provisions and investment decisions may be made with the knowledge that funds are committed for an extended period of years. If such a transfer provision applied to the TIAA-CREF system, it would be tantamount to the inclusion of a cash surrender provision. To reflect the cost of such provision, loading charges would probably have to be increased. In addition, the short-term cash needs of TIAA-CREF would increase and this would be reflected in a lower investment return to the participants. Therefore, the application of such a reciprocal transfer provision to the TIAA-CREF system would lower the retirement benefits ultimately received by participants without securing signficant expansion of the portability that they now enjoy.

Section 231 of the Bill should accordingly be amended by adding the following last sentence to proposed Section 209 of ERISA:

> "This section shall not apply to an employee benefit plan to the extent that it is funded by portable annuity contracts without cash surrender values."

4. Section 221. Disclosure of Accrued Benefits.

Section 221 of the Bill should be amended to provide that a plan administrator's disclosure obligations under proposed Section 105 of ERISA can be satisfied by a third party as well as by the administrator.

Section 221 of the Bill amends Section 105 of ERISA to combine in it the provisions now contained in Sections 105 and 209 of ERISA. Proposed Section 105(a) requires the administrator of an employee pension benefit plan to furnish a plan participant or beneficiary with a statement of his benefits on request not more than once a year. Section 105(b) requires the administrator to furnish a similar statement about his vested benefits to any employee terminating his employment or incurring a one-year break in service who is entitled to a deferred vested benefit and who is not paid retirement benefits under the plan during the plan year.

Each year TIAA-CREF mails to every annuity contract holder an annual statement showing the premiums remitted in the prior calendar year, the total accumulations under the contracts at the end of the calendar year and projections of the retirement annuity benefits that would be purchased by such accumulations.

These reports are mailed to each contract holder whether or not premiums are still being remitted and whether or not he or she is participating in a TIAA-CREF retirement plan at that time. Since each participant receives these statements until the time retirement annuity benefits commences, we suggest that it is unnecessary that the plan administrator be required to provide the information in Section 105 if TIAA or CREF provides it.

Accordingly, we recommend that proposed Section 105(a)-(3) of ERISA be amended by inserting the words "or other party" after the word "administrator" and that new paragraph (3) be added to proposed Section 105(b):

> "(3) If an administrator or other party furnishes a report which contains the information required by this subsection, the furnishing of such report shall satisfy the requirements of this subsection."

5. Clarification of Participation Rules for College Faculty Members.

Section 202 of ERISA should be amended to require the Secretary of Labor (or the Employee Benefits Commission) to issue regulations for determining a year of service for educational faculty members to provide that the number of hours of service required for a year of service shall be one-half the minimum number of hours required of full-time faculty members.

In determining years of service for faculty members for participation purposes, colleges and universities have experienced great difficulty. Most colleges and universities have both a permanent full-time faculty and a part-time faculty that is sometimes substantial in size. In some cases colleges and universities have been able to define an eligible employee by a job description that excludes the part-time faculty. This is possible when the full-time faculty is required to perform a number of duties in addition to mere classroom teaching. However, when full-time and part-time faculty have the same general duties, it is difficult to determine when a faculty member has completed a year of service. Counting hours is impractical since there is no way to determine, for example, how many hours of classroom preparation are involved. A possible solution that has been recommended to the colleges is to determine the minimum number of teaching hours required of the full-time faculty and to consider anyone who performs half that number of hours to have completed a year of service. This concept derived from the fact that the general 1000 hours of service test is equivalent to half-time work.

Section 202(a)(1) of ERISA should be amended by adding the following new subparagraph (E):

> "(E) For purposes of this section, in the case of any teacher employed by an educational institution, the term 'year of service' means a 12-month period during which the employee has not less than one-half the minimum annual hours of service required of a full-time teaching employee of such institution. The Secretary shall prescribe regulations to carry out the purposes of this subparagraph."

August 25, 1978

Teachers Insurance and Annuity Association of America
College Retirement Equities Fund

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August 16, 1978

Senator Harrison A. Williams, Jr.,
Chairman, Labor Subcommittee of
Human Resources Committee,
4230 Dirksen Senate Office Bldg.,
Washington, D. C. 20510

COMMITTEE ON HUMAN RESOURCES
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Dear Senator Williams:

I am pleased to enclose the testimony which the International Union, UAW wishes to have included in the record of the hearings on the "ERISA Improvements Act of 1978".

I regret that I am unable to attend the hearings, but I and my staff will, of course, be most happy to respond to any questions which your Committee may have about our testimony.

Sincerely,

Melvin A. Glasser

Melvin A. Glasser, Director,
Social Security Department.

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WILLIAMS, N.J.
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August 15, 1978
Washington, D. C.

Testimony on

HEARINGS ON THE "ERISA IMPROVEMENTS ACT OF 1978"

before

Labor Subcommittee of the Human Resources Committee

and

Subcommittee on Private Pension Plans and

Employee Fringe Benefits of the Finance Committee

United States Senate

In behalf of:

International Union, United Automobile,
Aerosrace and Agricultural Implement
Workers of America, UAW

The UAW appreciates the opportunity to present this testimony in behalf of its approximately 1,400,000 active and 275,000 retired members, whose pensions are directly affected by the operation of ERISA. ERISA is landmark legislation, which has given millions of American workers increased security in their retirement years. Many of the criticisms which have been levelled against ERISA were inevitable because the enactment of ERISA resulted in a major restructuring of the private pension system and not all of its effects could be anticipated.

However, we have continued to believe that the overall thrust of the Act is good. We have urged Congress not to enact in haste so-called "remedial" legislation, which would remove vital protection for workers. The ERISA Improvements Act of 1978, which has now been introduced in Congress, obviously draws on the experience of the past four years since ERISA was enacted, and we support its intentions in most areas. However, we believe that there are some subjects which still need careful analysis and discussion before any new legislation is enacted.

Encouragement of Establishment and Maintenance of Pension Plans

We perceive one of the major thrusts of the bill as an attempt to encourage the continuation, or establishment, of pension plans in order to counteract the adverse effects of ERISA. This is a worthwhile objective, but we believe there should be recognition of the various types of pension plans which are in effect and the different effects of ERISA on each of them. The major division in the pension world is between plans which provide defined benefits and plans which provide for defined contributions. The effects for both sponsors and participants of these two types of plans are entirely different.

For a participant, only a defined benefit plan gives the security of a guaranteed level of monthly income for his lifetime after retirement. A defined contribution plan, on the other hand, accumulates specified contributions up to the date of retirement and leaves the participant to bear all the risks of investment losses to the pension fund. Under a defined contribution plan an adequate income may be provided for the worker who is hired at an early age and stays with the same employer for many years until retirement; but there is no way that this type of plan can adequately provide retirement income to the worker who is advanced in age when the plan is established, even if he has already worked many years for that employer. Similarly, defined contribution plans do not have the flexibility of defined benefit plans, which can provide subsidized surviving spouse benefits or early retirement supplements.

Many sponsors of pension plans which provide defined benefits have recognized that the levels of income at which participants initially retired have not remained adequate because of the ravages of inflation. In many cases, these sponsors have increased the benefits for their retirees. The sponsor who establishes a defined contribution plan never takes responsibilities for providing any level of benefits. This type of plan, then, is not suited to provide additional benefits to former participants after their retirements. Further, the pension plan sponsor who decides to establish or continue a defined benefit plan does so with the knowledge that Title IV of ERISA gives him a potential liability if he later decides to terminate the plan. This additional liability has led some employers with even the most successful businesses to become fearful of continuing their defined benefit plans. Attorneys and accountants often exaggerate this potential liability when advising their clients. In addition, actuaries have not succeeded in their attempts to clarify the limits of that liability. Both factors compound the problem and magnify the concern of plan sponsors.

In summary, because only defined benefit plans provide secure retirement income for all participants who meet minimum service requirements, and because ERISA has created no new commitment for sponsors who elect to maintain defined contribution plans, we submit that any measures designed to encourage the establishment or maintenance of pension plans should be geared to defined benefit plans alone, rather than the total universe of pension plans.

Tax Credits

If Congress decides that a proper way to encourage new pension plans is through additional tax credit, such credit should only be given if a sponsor maintains a defined benefit plan. Since ERISA has not created new commitments for sponsors of defined contribution plans, greater incentives to establish or continue such plans should not be necessary. The bill now before Congress also provides for additional tax credit for so-called "improved plans", which are amended to provide substantial improvements in benefits which significantly exceed the minimum provisions mandated by ERISA. The UAW believes it is important to encourage improvements in pension plans in the future, but similar tax credit should be given

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to plans which already significantly exceed minimum ERISA standards. The proposed legislation would reward some employers with additional tax credits for making improvements in their plans which other employers made years ago.

Master and Prototype Plans

We support the idea of special master and prototype plans, which would again encourage establishment of plans, especially for small employers for whom the great cost of establishing new plans is a considerable deterrent. However, here again, we are concerned that the emphasis is on defined contribution plans, for which provision is made immediately. For defined benefit plans, the only provision is for a Commission to study the feasibility of permitting special master and prototype plans. We see no reason to delay implementation of such a proposal for defined benefit plans, since we are convinced that they are feasible. Similar plans are already in existence.

Since 1965, the National Industrial Group Pension Plan (NIGPP) has made available to small groups of employees covered by contracts negotiated by the UAW, and various AFL-CIO unions, a very simple, basic defined benefit plan administered by a major insurance company. While this particular plan is a multiemployer plan, it shows that the principle of a simple basic plan, under which employee groups can be covered for various benefit levels, depending on contributions, could be established for individual groups by insurance companies and perhaps even by bank trustees. Therefore we urge the Committee to provide for defined benefit master and prototype plans without delay.

Individual Retirement Accounts, Employee Contributions

Since the passage of ERISA in 1974, it has become clear that one group of workers receives minimal benefit from the tax deductibility of money set aside for retirement. This is the group whose employers provide very little retirement income to augment their Social Security benefits. However, the fact that any pension plan exists precludes such workers from taking advantage of establishing their own Individual Retirement Accounts (IRA's).

In response to this inequity, the proposed legislation would provide tax deductions for employee contributions to their employer-sponsored pension plans. We see two major problems with this proposal: first, workers are not permitted to establish their own IRA's, but only to contribute to their employers' plans; second, full tax deductions are provided for workers with adjusted gross incomes up to $30,000, with the deduction phased out by the time adjusted gross income of $35,000 is reached.

Employers may feel less responsibility to provide retirement income for their workers if tax-deductible employee contributions are made to the employer-sponsored pension plans. This is the situation which has developed in Canada. There is also a real danger that emphasis on employee contributions to qualified employer plans will lead employers to <u>require</u> contributions as a condition for participating in plans. Then the low paid worker with too many present financial obligations to make his own contributions would forfeit the chance of even a minimal employer-provided pension.

The UAW favors permitting limited IRA's for employees who are likely to have small pensions. IRA's may be established independently of the employer, which would lessen the danger that employers will feel less responsibility to provide pension benefits. It also makes more sense to establish a funding vehicle separate from the employer in order to facilitate the continuation of contributions as workers change their jobs.

We agree with the contribution limits of $1000 per year of 10 percent of compensation, whichever is lesser. However, we believe that this new tax deduction should be restricted to those who are likely to need additional retirement income. It is likely that the worker with $30,000 to $35,000 adjusted gross income each year is already receiving substantial tax-deferred benefits. Therefore we believe this income limit should be reconsidered by Congress.

We are in favor of the change which would allow no tax deduction for an IRA maintained for an owner employer, an officer or a major stockholder of a corporation. As ERISA is presently written, it is an open invitation to employers, particularly small businesses, to discriminate against the bulk of their employees by providing IRA's for a few favored executives.

Changes in ERISA Minimum Standards

Although at some future time they may become desirable, we have come to the reluctant conclusion that it is not advisable at this time to mandate further significant benefit provisions in any amendment to ERISA. The present standards have been effective only for approximately two years and we have not yet seen their impact. Again, a major consideration must be that most of the required minimum provisions affect only defined benefit plans, so that significant changes may provide another force to accelerate the number of terminations of these plans.

Cost-of-Living Adjustments to Pensions

The UAW shares the obvious concern of this Committee that the disturbing levels of inflation which we have seen in the last few years, and must anticipate for the future, cause a serious problem for retirees who have to manage on fixed incomes. We believe that employers should be encouraged to protect their retirees against the erosion of pension by inflation. The many employers who are able to do so should meet their responsibility to former employees by providing cost-of-living increases. However, forcing all plans to provide cost-of-living protection for pensions, regardless of the employer's ability to fund the benefits, could be a deterrent to the establishment of plans. Therefore, we are forced to conclude that ERISA should not be amended to require cost-of-living increases on all pensions and that there is no reason for the study which is proposed in the ERISA Improvements Act of 1978.

Extension of Joint and Survivor Benefits

Another major change in benefit provisions which the ERISA Amendments Act of 1978 would require is the right of any pension plan participant to elect surviving spouse coverage once his benefit is

50% vested. Again, the UAW is in sympathy with those forces which press for an expansion of the surviving spouse coverage under pension plans. However, we believe that there is a lack of understanding of both the total system of employee benefits provided by employers and the level of benefits which can be provided if there is to be no additional cost to plans.

The Committee might consider that an employer typically provides for various contingencies in the life of his employees through a number of vehicles, preferably using the most efficient vehicle in each case. Thus pension plans are designed for the primary purpose of providing income benefits to employees after they cease work for age retirement or, sometimes, because they become disabled. As a natural extension of this purpose, pension plans now give workers the chance to insure continued income to their spouses if they survive longer than the worker. But group life insurance programs are the only proper vehicle for providing adequate amounts of benefits to the families of workers who die at an early age. We submit that the whole picture of employee benefit programs should be considered before any great change in the ERISA qualified joint and survivor annuity provisions are made.

Further, the Committee should consider the value of any benefit which the proposed extension of the joint and survivor annuity would give to workers and their families. Under the minimum ERISA provisions, there is no requirement that the cost of joint and survivor protection be paid for by the plan sponsor. A worker who elects pre-retirement coverage can have the full cost assessed against his pension when he retires. Even for the present limited period that coverage must be offered by plans, this charge against their pensions is significant enough to deter many workers from electing the protection. Should Congress mandate that the joint and survivor annuity must be in effect for many more years, we believe that the much higher charge could result in only a minimal number of workers making use of the benefit. Even if a worker elects protection for his spouse, the benefit payable if he dies would be reduced by the delayed charge, limited by years of service under the plan and actuarially reduced if it is paid before the worker would have reached normal retirement age. As a result, the amount of money payable is unlikely to be a meaningful benefit.

Workers' Compensation Offsets

We are gratified to see that this bill includes a prohibition against the reduction of pension benefits for amounts payable as the result of workers' compensation awards. Although the UAW has managed to achieve this result through negotiations with many of its major employers, many of our plans for smaller units - and probably the majority of non-negotiated plans - allow an employer to offset pension benefits for workers' compensation awards. Since the compensation award is given as recompense for damage to the worker which has occurred because of the conditions over which his employer has control, we believe that the employer should not be able to seek relief by reducing the worker's pension.

Employee Benefits Commission

The proposed Employee Benefits Commission meets with our approval both in its composition and in the timing of its establishment. We firmly believe that it is necessary to establish a body which has as its prime objective the standards which plans should meet and the investigation of whether those plans are living up to their responsibilities.

Reporting and Disclosure

We are in agreement with the general intent of the changes in the area of reporting and disclosure which are included in the bill. This we see as an attempt to make the requirements for administrators reasonable without removing participants' rights to information which they can understand and in which they are interested.

One of the proposals to which we have given considerable time is the elimination of the requirement that a plan distribute a copy of the Summary Annual Report to participants. A result of this distribution which we have observed among our members -- who, it should be remembered, are a comparatively sophisticated group of participants with a historical interest in the operation of their plans -- has been uncertainty and fear about the solvency of their plans. Often they cannot understand the terminology of the reports or the significance of such items as a very large "unfunded past service liability". Even where the reaction of participants has not been so unfortunate, we have discovered that their lack of understanding has led to disinterest and participants have often simply thrown away the annual reports.

The overriding interest of a plan participant is in the amount of his accrued benefit, whether it be a monthly pension or an accumulated account within the pension fund, and in the percentage of his benefit which is already nonforfeitable. In addition, the participant is likely to be interested in whether the company is making the required contributions to its pension fund. Therefore, in lieu of the information on the Summary Annual Report which has proved of little use to plan participants, Congress might consider requiring annual statements to employees on their accrued pension benefits and the vested percentage of those benefits, instead of leaving an automatic annual distribution to the discretion of the plan administrator; it might also be of value to require a signed statement from the actuary of the minimum contribution required under the terms of the pension plan and a second statement, signed by the trustee of the pension fund, showing the amount which the company has contributed to the pension fund for the corresponding year.

Funding Requirements

There is one proposed change in the rules for funding benefit amendments with which we see a problem. The bill would require that for plan years after December 31, 1980, the funding method must take into account all provisions of a plan "including provisions which have not yet affected any participant as to entitlement to, or accrual of, benefits". Although the explanation of the intent of changes in this bill indicates that this section is designed to avoid problems of pension plans where there is a funding shortfall and future benefit reductions are anticipated, it would surely cause problems in negotiated plans where benefits are increased gradually over the term of a contract. The Internal Revenue Service currently permits these benefit increases to be recognized in the year in which they take effect; however, the provision cited above would remove any discretion from the Internal Revenue Service and require plans to begin funding immediately the ultimate level of benefits under any contract. Therefore we request that this provision be reconsidered.

Application of Securities Laws to Pension Entitlements

The UAW is in agreement with the various provisions of the proposed bill which clearly remove interests in employee benefit plans from the jurisdiction of securities laws. While we share the widespread sympathy of most observers for the plight of workers who failed to receive pension benefits because of unreasonable service requirements in the period before ERISA became effective, and while we may have supported the intrusion of the SEC into the employee benefits area in earlier years to remedy the situation, we believe that such problems will not arise in the future if agencies such as the proposed Employee Benefits Commission, the Department of Labor and the Internal Revenue Service meet the responsibilities with which ERISA has charged them.

NATIONAL INDUSTRIAL GROUP PENSION PLAN

for labor-management groups

BRIEF DESCRIPTION

This is a description of a new pension program which has been developed for small and medium size labor-management groups.

The program operates nationally and offers individualized contribution and benefit levels for each group.

Principal Features

1. Efficient centralized administration at low cost. The Prudential Insurance Company of America has been designated as Administrator to handle all day-to-day details and answer all questions.

2. Simplicity of negotiation.

   Either—parties may agree on contribution rate (cents per hour or dollars per week) and the Administrator will determine the benefit level

   Or—parties may agree on desired benefit level and the Administrator will determine required contribution rate.

3. A standard program, meeting the requirements of the Internal Revenue Service and other government agencies, and providing Normal Retirement, Early Retirement, Disability Retirement and Vesting provisions comparable to those in major industrial plans.

4. Opportunity for improved investment results—including investment in common stocks—available by pooling all investible funds through the facilities of the following major insurance companies:

   Aetna Life Insurance Company
   Bankers Life Company, Iowa
   Connecticut General Life Insurance Company
   The Equitable Life Assurance Society of the United States
   John Hancock Mutual Life Insurance Company
   The Mutual Benefit Life Insurance Company
   The Mutual Life Insurance Company of New York
   The Prudential Insurance Company of America
   State Mutual Life Assurance Company of America
   The Travelers Insurance Company
   The Union Central Life Insurance Company

   (the date each of these companies will begin to receive contributions and become responsible for benefit payments is related to the growth of the program)

5 Application of the administrative savings and improved investment results to provide higher benefit levels than would otherwise be possible for groups of this size.

6 Greater security through "spreading the risk" by combining all elements of experience of the participating groups.

7 Termination Protection. If the employer goes out of business, pensions will be continued to retired employees and will be provided to employees then eligible for Normal or Early Retirement, provided the group has participated for 3 years or more. This protection against loss of benefits due to business failure will gradually be extended until, after 10 years of participation, all employees who have at least 10 credited service units will be protected. In any event, if a group terminates its participation, at least 80% of all contributions made for employees in the group will be applied to provide benefits for members of the group, on a priority basis determined by the plan.

8 Portability of pension credits between participating groups.

9 Coverage available, by agreement of the parties, for employees outside the bargaining unit.

10 Existing plans may participate. If a group adopts this program, credit will be given for any funds brought in.

How Does the Program Work?

The program is directed by a Board composed of equal numbers of representatives of labor and management. The Board sets up all the legal and administrative machinery. For each participating group, there is also a local committee consisting of one member appointed by the union and one by the employer. The Administrator handles the day-to-day activity necessary for the smooth functioning of the program.

Descriptive material explaining the program is available, including all the forms needed to obtain cost or benefit information from the Administrator. Once a group agrees to participate, all necessary documents and forms will be supplied by the Administrator. Attractive employee leaflets will also be furnished.

What Benefits are Provided?

Credit (Service Units)—Credit is given for both past and future service. Normally, one service unit is given for each year of seniority at the time the group first participates. However, the parties may agree, through collective bargaining, on any other uniform method of defining past service. The actual number of service units credited will be used in determining the benefit level.

Future service credit is based on contributions made for each participant. One service unit is credited for contributions equal to 1800 times the hourly contribution rate (or 45 times the weekly contribution rate) with a proportionate adjustment for other amounts. Thus, for example, under a participation agreement with a contribution rate of 10¢ per hour, a participant for whom $200 of contributions were received would be credited with 1.1 service units; if contributions of $150 were received for the same participant, he would be credited with 0.8 service units.

Normal Retirement—A participant who is age 65 or over and has at least 10 service units may retire on a monthly benefit equal to his number of service units times the applicable benefit level.

Early Retirement—A participant who is age 60 or over and has at least 10 service units may retire on a monthly benefit equal to his number of service units times the applicable benefit level, reduced by 5/9 of 1% for each month he is under age 65.

Disability—A participant who is currently employed in a participating group, who has at least 10 service units and who is currently eligible to receive disability benefits under Social Security, will receive a monthly benefit equal to his number of service units times the applicable benefit level.

Termination—Vesting—If, in any period of 3 consecutive years, a participant fails to be credited with at least 0.1 service units, his coverage will be terminated. If, however, he has at least 10 service units at the time of termination, he will be entitled to a deferred vested benefit based on such service units to commence at age 65.

Benefit Examples

Here are some examples of the benefits that could be provided for typical groups with a contribution rate of 10¢ per hour:

Average Age	Average No. of Service Units Credited for Past Service	Benefit Level	Monthly Benefit at 65 for a Participant with 25 Serv. Units	30 Serv. Units	35 Serv. Units
30	4	$3.55	$88.75	$106.50	$124.25
40	10	2.10	52.50	63.00	73.50
50	16	1.30	32.50	39.00	45.50

The above examples assume all employees are males. Benefits would be reduced slightly to recognize percentage of female employees.

How to get more information

Complete the request form and mail it to the following address for additional information:

NATIONAL INDUSTRIAL GROUP PENSION PLAN
P. O. Box 1082
Newark, New Jersey 07101

33-549 1667

GTA-124 Ed 10-68

LITHO in U.S.A.

URW

PETER BOMMARITO, President

KENNETH OLDHAM, Vice President — IKE GOLD, Secretary-Treasurer

UNITED RUBBER, CORK, LINOLEUM AND PLASTIC WORKERS OF AMERICA

AFL-CIO, CLC — 87 SOUTH HIGH STREET — AKRON, OHIO 44308

Area Code 216
376-6181
376-6182
376-6183
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August 1, 1978

COMMITTEE ON HUMAN RESOURCES
1978 AUG -4 PM 4:33

Honorable Harrison A. Williams, Jr., Chairman
Committee on Human Resources
United States Senate
Washington, D.C. 20510

Dear Senator Williams:

I want to thank you for your reply to my letter and the copy of the Congressional Record which contains Senator Javits' and your views pertaining to the "ERISA Improvements Act of 1978".

In compliance with your request attached please find the Memorandum detailing the problems facing all Pension Plans as a result of the passage of the 1978 Discrimination Act Amendments.

Again thank you for your interest and your courteous reply.

Sincerely,

M. George Marinich

M. George Marinich, Director
Pension and Insurance Department

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...LIAMS, N.J.
...-4 PM 12:17

United States Senate
Committee on Human Resources
Washington, D.C. 20510

Senate Bill 3017 titled "ERISA Improvements Act of 1978" in addition to the Proposed Amendments it contains, in my opinion should also address itself to the problems facing all Retirement Plans as a result of the passage of the "1978 Age Discrimination Act Amendments".

Presently the majority of the Retirement Plans in the private sector (those covering the average Industrial and Salary Worker) define the Normal Retirement date as a Participant having attained age 65; however, the compulsory retirement date (under average conditions) must not be defined as any date prior to the Participant's attainment of age 70; neither the "ERISA Improvements Act of 1978" nor the "1978 Age Discrimination Act Amendments" seem to provide anything other than that stated above.

The questions that the "1978 Age Discrimination Act Amendments" bring about are:

(1) Must a participant who desires to continue to work beyond the Normal Retirement date be credited with such continued service for purposes of benefit accrual?

(2) Will the Pre-Retirement 50% J & S Option, if elected, and providing the Participant has an eligible spouse, continue to be in effect until such Participant's actual date of retirement, thereby protecting a non-forfeitable right?

(3) Will all Post-Retirement Options be made available for a Participant's election at the time of application for retirement?

(4) Does an Employer have the right to require any Participant who desires to continue in the employment of the Employer beyond the Normal Retirement date to submit to a physical examination in order to continue employment?

It is my opinion that the "ERISA Improvements Act of 1978" should address itself to the questions stated above, taking the following statements into consideration:

(1) Any Participant who desires to continue his/her employment with the Employer beyond the Normal Retirement date shall for the purpose of benefit accrual be credited with all such service earned until the actual retirement of such Participant, for to do anything contrary would be establishing a double standard.

(2) The Pre-Retirement 50% J & S Option, if elected by a Participant, shall remain in effect until the actual date of such Participant's retirement, unless such option is either revoked by such Participant, or in the event of the death of the Participant's eligible spouse. In no event shall the actuarial reduction charged for the election of such option be greater than 6/10 of 1% (six-tenths of one percent) per year during which this elected option is in force.

U. S. Senate
Committee on Human Resources
Page Two

(3) All Post-Retirement Options contained in a Retirement Plan shall be made available for a Participant's election no earlier than 90 days prior to such Participant's actual date of Retirement. All such Options and the effect of each on the Participant's Pension shall be explained to such Participant in a manner in which he/she can understand. Many Retirement Plans are requiring at least a 3-year election prior to the Normal Retirement date and requesting evidence of good health if Participant does not elect an Option at that time. The right to elect a Post-Retirement Option should be given all Participants in order to protect a non-forfeitable right in the event of the Participant's death to insure that a benefit could be paid to a beneficiary of the Participant's choosing; example: a handicapped child, grandchild, brother or sister, etc.

(4) Any Participant desiring to continue employment with the Employer, beyond the Normal Retirement date, shall continue to remain a Participant and shall be subject to the same conditions applicable to all other Participants.

I realize that perhaps many of the statements made can be considered as bargainable issues between a Bargaining Representative and an Employer; however, there are many people in this Nation of ours who are not represented by Bargaining Representatives and their plight should also be considered.

This document contains my personal views and as a layman I have attempted my best to express them.

Respectfully submitted
for consideration,

M. Geo. Marinich

M. George Marinich, Director
Pension and Insurance Department

MGM:rt
opeiu 339
8/1/78

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August 30, 1978

COMMITTEE ON HUMAN RESOURCES
1978 AUG 32 AM 11 38

Honorable Harrison A. Williams, Jr.
Chairman
Committee On Human Resources
United States Senate
Washington, D. C. 20510

Dear Senator:

It was my pleasure to testify before the Senate Committee On Human Resources in regards to the ERISA Improvements Bill. At that time, I testified in favor of the proposition that plaintiffs should be allowed to pursue pre-ERISA remedies against pension funds that had willfully and flagrantly denied individuals' pensions based upon affirmative acts and misrepresentations. Since testifying before the Committee, it has come to my attention that the defendants in the suit of Marshall v. Fitzsimmons, 78 C 342, MDL 1970, (a suit to recover misappropriated Teamster funds) brought by the Secretary of Labor under the provisions of ERISA have moved to dismiss the Complaint filed by the Secretary on the grounds that the Secretary of Labor has no standing to sue under ERISA (a copy of the Memorandum in Support of the Motion to Dismiss is attached hereto).

The following sentences have been taken from the Memorandum in Support of Defendants' Motion to Dismiss:

> "The Secretary Of Labor Is Without Standing Under Article III Of the Constitution To Maintain This Action Because He Has Not And Cannot Assert An Injury To An Interest Of His Own."
>
> "Without having its own interests at stake, the Federal Government cannot lend its name to a lawsuit for the benefit of private individuals."
>
> "ERISA's Attempt To Confer A Right To Sue Upon The Secretary Violates The Due Process Clause."

It would appear that certain pension funds with a history of total disregard for their membership are maintaining a posture wherein they are attempting to limit pre-ERISA suits, and at the same time, trying to severely limit standing in post ERISA suits.

I think that the Committee should be aware of the posture taken by these pension funds as it points out the necessity for legislation that will insure that the flagrant violators are not allowed to avoid any liability for their misdeeds by severely limiting the basis upon which suits may be brought against them.

We would also respectfully request that the Memorandum in Support of the Motion to Dismiss attached hereto be added to the report of the Committee hearings.

Very truly yours,

Lawrence Walner
LAWRENCE WALNER

LW/dd
enclosures

cc: Honorable Jacob K. Javits

Note: The memorandum in support of the motion to dismiss referred to in Mr. Walner's letter of August 30, 1978, is being held in the files of the Human Resources Committee, 4230 Dirksen Senate Office Building, Washington, D.C. 20510.

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August 29, 1978

The Honorable Harrison A. Williams
Chairman, Subcommittee on Labor
Committee on Human Resources

The Honorable Lloyd Bentsen
Chairman, Subcommittee on Private
Pension Plans
Committee on Finance

United States Senate
Washington, DC 20510

Re: Proposed Legislation to Amend ERISA

Dear Chairmen Williams and Bentsen:

This statement is submitted on behalf of the Western Conference of Teamsters Pension Trust Fund ("WCT Plan") for inclusion in the record of Hearings of the Subcommittees held on August 15-17 relating to S. 3017, S. 901 and other proposed legislation to amend the Employee Retirement Income Security Act of 1974 ("ERISA"). Our statement focuses on S. 3017, the ERISA Improvements Act of 1978.

The WCT Plan is the largest multiemployer plan in the United States. The Plan currently receives contributions on behalf of approximately 670,000 employees working under Teamster collective bargaining agreements with roughly 16,500 employers in 13 western states. Over 80,000 persons are currently receiving benefits under the WCT Plan. As of June 30, 1978, the Plan's total assets exceeded $2 billion and all such assets are on deposit with The Prudential Insurance Company of America pursuant to a group annuity contract. The WCT Plan is administered by 28 trustees jointly representing management and labor pursuant to the Labor Management Relations Act.

The WCT Plan regards the ERISA Improvements Act of 1978 (S. 3017) as a positive and important step toward the resolution of many of the problems which it and other plans have faced in making the transition to compliance with ERISA. This statement presents the views of the WCT Plan on many provisions of the bill which are of particular interest to the WCT Plan and recommends the adoption of additional provisions to deal with other unique and important problems faced by multiemployer plans. Briefly summarized our recommendations for improvements in the bill are as follows:

(1) ERISA should be amended to clearly establish that multiemployer plans may pay the costs of defending trustees and other plan fiduciaries. (p. 4)

(2) Multiemployer plans should be allowed to distribute disclosure materials through employers and local unions. (p. 9)

(3) Multiemployer plans should be allowed to limit service credited for vesting purposes to service performed in covered collective bargaining units. (p. 11)

(4) The prohibited transaction rules should be amended to allow the payment of trustee expenses on the basis of reasonable per diem rates. (p. 12)

(5) Multiemployer plans should not be required to accept the deductible employee contributions proposed by the bill. (p. 14)

(6) The provision requiring courts to allow reasonable attorney's fees and costs where the plan prevails in an action to collect delinquent employer contributions should be expanded to include the enforcement of plan provisions requiring the payment of liquidated damages. (p. 17)

(7) The provision liberalizing the rule concerning the return of mistaken contributions should be expanded to allow the return of contributions not permitted to be made by the Labor Management Relations Act and not made by mistake. (p. 19)

(8) The provision modifying the accrued benefit rules for multiemployer plans should be clarified with respect to the status of deferred vested participants who subsequently return to covered employment. (p. 21)

ERISA SHOULD BE AMENDED TO RESOLVE OTHER IMPORTANT PROBLEMS AFFECTING MULTIEMPLOYER PLANS

The ERISA Improvements Act of 1978 addresses many of the problems faced by multiemployer plans under ERISA. However, we believe that several other important problems affecting multiemployer plans also should be dealt with as soon as possible. These problems are described below and we urge that the Subcommittees adopt our proposed solutions to these problems in their consideration of amendments to ERISA.

ERISA Should be Amended to Clearly Establish that Multiemployer Plans May Defend Suits Against Trustees and Other Plan Fiduciaries

The cumulative impact of ERISA's broad and complex statutory scheme involving the potential for an infinite variety of suits under the guise of alleged breach of fiduciary responsibility, procedural and jurisdictional rules providing broad access to Federal courts, and ERISA's prohibition of exculpatory clauses, has caused many plans to purchase liability insurance against potential liabilities and defense costs of plan fiduciaries.

Earlier this year, the WCT Plan encountered great difficulty in securing any fiduciary liability insurance for its 28 labor and management trustees. This serious problem occurred notwithstanding that no suit alleging scandalous conduct, charges of self-dealing, theft or criminal acts has even been filed against the WCT Plan. While some of the details are discussed in the attached article from The Wall Street Journal, the end result of several months of complex negotiations was that the Plan obtained insurance from the only carrier willing to insure it at an annual premium nearly four times that charged in the in the three prior years.

We believe the experience of the WCT Plan raises important policy issues which directly affect the ability of jointly administered plans to retain and attract labor and management representatives needed to serve as trustees as required by law. The crux of the problem is the potentially significant costs that trustees may incur defending themselves in litigation and the consequent need to obtain insurance even though, if permitted by law, the plan may be better off financially reimbursing such costs. We believe this important problem would be most effectively resolved by enacting legislation which clearly establishes that multiemployer plans may defend suits against plan fiduciaries except where there is sufficient cause for a court to find that the individual fiduciaries have acted in bad faith or in a willful or reckless manner sufficient to warrant severance of their defense.

Before the enactment of ERISA, most multiemployer plans did not purchase liability insurance. Civil actions against such plans were customarily defended by attorneys retained by the trusts, and the state of then current law did not preclude this practice. After ERISA was enacted, as representatives of the Labor Department are aware, the common practice of multiemployer plans was to purchase fiduciary liability insurance for the plan in connection with which individual trustees purchased waiver of recourse coverage at a small charge. However, serious questions have been raised as to whether ERISA generally allows a multiemployer plan to pay for the defense of actions brought against individual trustees. While the Department of Labor has issued several advisory opinions indicating that plans may pay the defense costs of plan fiduciaries in certain cases (subject to repayment if there is a finding of individual liability), these opinion letters are based on the unique facts and circumstances of individual cases and, therefore, may not be applicable to most multiemployer plans and the trustees thereof in the wide variety of suits that may be filed. As a result, the only alternative that provides some measure of security appears to be the purchase of costly insurance, assuming that it can be obtained.

We emphasize that the focus of our concern in this regard is not with the costs of defending acts which are clearly culpable and should reasonably be expected to give rise to personal liability. Rather we are concerned with the costs of defending individual trustees in the much more typical case which does not involve allegations of individual wrongdoing, but calls into question the collective judgement of a board of trustees on a wide range of possible issues involving plan design, amendments, administration and compliance with other Federal laws. The costs of defending a major lawsuit may run into tens or hundreds of thousands of dollars --

quite apart from whether the claim is well-founded or frivolous. The possibility that many such suits may be pending at any point in time is a very real one for a plan of any considerable size.

Under these circumstances, multiemployer plans are faced with a difficult problem. They may purchase insurance,if available,at a great cost to the plan, or they can assume the risk of not being able to retain and attract competent people to serve as trustees. Insofar as the latter "alternative" is concerned, or where insurance is not available, we believe there are few people who would assume the responsibilities as trustees of large multiemployer plans knowing that their personal assets may be exhausted in the defense of a wide variety of lawsuits, most of which ultimately prove to be unfounded.

In view of the potential inability of plans to obtain appropriate insurance against defense costs at a reasonable price or at any price, and the needs of multiemployer plans to retain and attract competent persons to administer them, the resolution of this problem by legislation appears to be the only practical and justifiable solution. Consequently, we strongly urge that ERISA be amended to permit multiemployer trust funds to pay the costs of defending suits against trustees and other fiduciaries unless, in general, there is sufficient cause for a court to find that individual fiduciaries have acted in bad faith or in a willful or reckless manner sufficient to require the court to sever their defense by the plan. In making this proposal in general terms, we note that ample precedent for such principles can be found in various state laws governing indemnification of officers and directors of corporations and in certain Federal laws and regulations. While the precise standard to be adopted will necessarily require careful consideration, the standard must be sufficient to allow honest and sincere fiduciaries to exercise their customary plan responsibilities without fear of personal liability for the costs of defending their decisions.

Alternative Method for Multiemployer Plans to Distribute Disclosure Materials, Limiting Credited Service for Vesting Purposes to Service in Collective Bargaining Units, and Payment of Trustee Expenses Based on Reasonable Per Diem Rates

Last October, in connection with its ERISA Oversight Hearings, we filed a written statement with the Subcommittee on Labor seeking legislative solutions to several major problems affecting the WCT Plan. Of the problems described in our previous statement, we believe those summarized below are appropriate for resolution in connection with the legislation currently under consideration, and we urge their adoption in this regard.

We note that another important problem, involving the need for procedures to allow multiemployer plans to deal with potential adverse effects caused by withdrawing employers, described in our prior statement would be more appropriate for consideration in connection with the subject of termination insurance coverage for multiemployer plans soon to be taken up by the Subcommittees.

1. Alternative Method for Multiemployer Plans to Distribute Disclosure Materials.

We have previously explained the difficult and costly steps the WCT Plan has taken to accumulate and maintain home address records for its approximately 674,000 active participants. These efforts were undertaken at an estimated start-up cost of about $2.5 million and an expected annual maintenance cost of $1 million. To date, these efforts have generated a slightly greater than 50% rate of response and, with the WCT Plan's substantially mobile covered population, it is likely that many of these addresses are already incorrect. The reason for undertaking this major task is to comply with various provisions of ERISA which, as interpreted by Labor Department regulations, effectively require the delivery of disclosure materials (summary plan description, summary annual report, statement of accrued benefits) by first class mail.

We continue to believe very strongly that the possibility that the WCT Plan can ever accumulate accurate home address records for substantially all participants is very remote. We also believe that the method of distribution customarily used by the Plan, i.e., distributing materials to employees through their employers and local union representatives, is likely to reach as many or more participants as the use of the mails--at a substantial savings in administrative burdens and costs.

Consequently, we again urge that ERISA be amended to allow multiemployer plans to satisfy those ERISA disclosure obligations which require automatic contact with participants through the plan administrator's delivery of sufficient copies to employers and local unions who, pursuant to independent statutory requirements, would distribute such materials to participants on a timely basis. At a minimum, we believe ERISA should include reasonable rules which multiemployer plans can rely on for purposes of the existing requirements. Specifically, we recommend that the administrator of a multiemployer plan be considered to satisfy ERISA's disclosure requirements (i) by delivery of the subject document to the participant's last known address or, if no such address has been furnished despite reasonable efforts by the plan to obtain one, (ii) by delivery of the subject document to the participant's last known employer or local union representative who, in turn, would be required to make reasonable efforts to deliver the subject document to the participant.

2. Limiting Credited Service for Vesting Purposes to Service in Covered Collective Bargaining Units.

In our October 1977 statement, we urged that final Labor Department rules which require multiemployer plans to credit for vesting purposes service with an employer which immediately precedes or follows a period of service in a collective bargaining unit covered by the plan be changed by legislation.

We would emphasize that compliance with these rules, if possible at all, is extremely difficult because multiemployer plans are not equipped to keep track of service which is performed outside of a collective bargaining unit for which employer contributions are made to the plan. Compliance with other ERISA requirements, such as the reporting of accrued benefits of vested terminated participants, is complicated considerably by these rules because participants may become vested years after they left a bargaining unit covered by the plan. Moreover, as a policy matter, these rules run counter to the collective bargaining process because they require the maintenance of continuing relationships between employers, union representatives and the plan notwithstanding the absence of any further collective bargaining relationship.

In view of the significant opportunity which multiemployer plans have long provided for employees to accumulate vesting credit notwithstanding frequent job changes, we believe that a balancing of the interests of such plans and their participants supports a reasonable limitation on years of service required to be recognized for vesting purposes to that performed in collective bargaining units for which the employer is currently required to make contributions to the plan.

3. Payment of Trustee Expenses on the Basis of Reasonable Per Diem Rates.

While not of the same magnitude as the problems described above, we believe the adoption of a solution to one problem described in our October 1977 statement would be appropriate in connection with the technical changes proposed under the prohibited transaction rules.

Prior to ERISA, the WCT Plan (and other multiemployer plans) established a single per diem rate with respect to the payment of expenses incurred by trustees in performing their duties. Because section 408(c)(2) appears to prohibit payments for expenses on a per diem basis, the Plan changed its practice and now provides for the direct reimbursement of expenses actually and properly incurred. As a result, Trust expenses have increased considerably. We suggest, therefore, that multiemployer plans at least be permitted to again pay trustee expenses on the basis of per diem rates subject to a reasonableness standard.

COMMENTS ON SPECIFIC PROVISIONS OF S. 3017 */

Preemption of Federal Securities Laws

We strongly support the provisions of the bill which would remove most employee benefit plans from the scope of the Federal securities law and eliminate the potential liability of plans, trustees, etc., for alleged violations of such laws. The WCT Plan is or has been a defendant in at least three Federal court actions involving allegations of Securities Acts violations. As the provisions of the bill recognize, such suits threaten to undermine the economic soundness of plans on the basis of a statutory scheme which both Congress and the employee benefit plan community did not consider applicable when the detailed regulatory framework of ERISA was in the process of development. In our view, the only reasonable solution is to promptly eliminate this additional potential layer of Federal regulations of employee benefit plans as the bill proposes to do.

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*/ We note that the comments below do not reflect our thoughts as to technical or clarifying changes that might be considered in connection with these and other provisions of the bill.

Multiemployer Plans Should Not be Required to Accept Employee Contributions

The ERISA Improvements Act addresses the tension between employer-provided pensions and the IRA program by allowing employees to make a limited amount of voluntary tax-deductible contributions to the qualified plans in which they participate. Qualified plans would be required to accept such contributions.

The WCT Plan agrees that steps to resolve the problems which the IRA program has created for qualified plans should be resolved as soon as possible. However, for multiemployer plans, particularly one as large as the WCT Plan, the requirement that the Plan accept such contributions will substantially increase the burdens of plan administration and will further strain plan recordkeeping capabilities which have already been stretched to the breaking point by ERISA. Accordingly, we strongly recommend that multiemployer plans not be required to accept such contributions. Instead, participants in such plans should be allowed the alternative of making deductible voluntary contributions to an IRA.

The WCT Plan has already expended considerable amounts of time and money in its efforts to develop programs to comply with the plethora of administrative requirements imposed directly or indirectly by ERISA. As noted earlier, attempts to establish and maintain current home address files for disclosure purposes have confronted the Plan

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with major problems and costs. Much time and money has been expended on developing a program for compliance with ERISA's requirements for reporting and disclosure of accrued benefits of terminating participants. Compliance with the detailed joint and survivor annuity election rules represents another layer of administrative complexity created by ERISA.

If the WCT Plan is required to accept voluntary contributions, it could, at the extreme, be faced with accounting, maintenance and investment responsibilities for nearly 700,000 individual accounts. Moreover, new accounts may have to be established for the scores of thousands of persons entering the plan each year. In terms of the number of accounts alone, this would put the WCT Plan in the same category as many of the nation's larger banks and savings and loan associations. The burden and complexity of accounting for all these funds, tracking employees as they move among employers within and without the plan (to prevent multiple or ineligible contributions) etc., would be immense.

In addition to imposing severe administrative burdens on the Plan, the proposed requirement could materially complicate administration by participating employers who may be required to accept and remit the employee contributions to the Plan. Employers contributing to multiemployer plans frequently are small employers with unsophisticated record-keeping practices and limited personnel, and the potential for inadvertent errors and misunderstanding would be great.

It is unclear whether the bill would allow plans to charge the expenses of administration to the accounts of contributing participants. If this is not permitted, the WCT Plan will also be faced with additional expenses which could easily involve millions of dollars annually. Such expenses would have to be paid for through an increase in employer contributions or by a reduction in plan benefits adversely affecting both contributing and non-contributing employees.

We believe strongly that any proposal intended to mitigate the adverse effects of the IRA program on tax qualified plans should not be designed in a way which overwhelms the plans to be helped. In the case of the WCT Plan, this would clearly be the result if it is required to accept employee contributions. Consequently, we believe the most reasonable solution is to allow active participants in multiemployer plans to make their voluntary contributions to IRAs subject to the limits established by the bill. While we assume that the proposal did not include this alternative to avoid subjecting employees to the complexities of the IRA provisions, we point out that allowing IRAs as an alternative also has important advantages to employees, particularly the highly mobile group that participates in multiemployer plans. Specifically, making IRAs available would also make available tax free "rollover" provisions thereby enabling employees to take their contributions with them when they leave their plans. Also, individuals may well prefer to have the control over the investment of their tax deductible funds that the IRA provisions make possible. If the complexities of the IRA rules are the principal concern, it would seem to be more effectively addressed by simplifying the rules governing IRAs.

Improving the Ability of Multiemployer Plans to Collect Contributions from Delinquent Employers

In the statement we filed with the Subcommittee last October, we recommended several measures to better enable multiemployer plans to collect contributions owed the plan by employers under bargaining agreements negotiated with local unions and to enforce related plan provisions. We strongly support the provisions of the bill which (i) would make an employer's obligation to contribute to a collectively bargained plan an obligation enforceable under ERISA and (ii) would require courts to allow reasonable attorney's fees and costs where the plan prevails in such an enforcement action.

While these provisions should encourage employers to meet their contractual obligations on a timely basis, we believe that, as recommended in our October 1977 statement, a similar approach be adopted with respect to plan provisions requiring the payment of liquidated damages (based on a percentage of the delinquency) where employers are nevertheless delinquent. Particularly where a delinquency is long outstanding, it is only through the enforcement of a liquidated damages provision that the plan can be made whole for the costs of collection (other than attorney's fees) and lost investment earnings on the delinquency. Yet, plans have experienced considerable difficulty in securing judicial enforcement of such provisions, ordinarily on the basis of state contract law considerations. We believe it would be consistent with the policy of the bill to further provide for enforcement of plan provisions requiring the payment of liquidated damages (in an amount up to at least 12 percent of the delinquency) with respect to contributions which are not made in accordance with the applicable bargaining agreement, and we urge that such an amendment be adopted.

Refunds of Mistaken and Similar Contributions

The bill would resolve, at least in part, a very common problem of multiemployer plans by amending section 403(c) of ERISA to allow such plans to return contributions made by mistake of fact within one year after the plan administrator knows of the mistake. This provision recognizes that multiemployer plans regularly receive monies mistakenly contributed by employers and that the error in contributions is, more often than not, discovered more than a year after the contribution was made.

The WCT Plan supports this proposed amendment to section 403(c), and believes it should be expanded to allow multiemployer plans to refund amounts it receives in many other common situations but where the contribution probably was not made by "mistake of fact". Generally, these situations involve payments to multiemployer plans which do not satisfy the pension plan exception to the prohibition of the Labor Management Relations Act on employer payments to, and their acceptance by, employee representatives. While this exception would apply to payments to jointly-trusteed pension and other plans provided that "the detailed basis on which such payments are to be made is specified in a written agreement with the employer," (29 U.S.C. § 186(c)(5)(B)) there are numerous cases where employers make payments to the plan which are not provided for in a valid bargaining agreement and which may not in fact have been made by mistake. For example,

(1) An employer or individual may make payments to the plan in order to establish entitlement to benefits where there is no valid collective bargaining agreement in effect which provides for such contributions.

(2) Payments may be made to the plan for persons who are not employees (e.g., they may be non-employed relatives of the employer, a partner in a partnership which has entered into a collective bargaining agreement for its employees, etc.).

(3) Similarly, payments may be made for persons who are employed by the employer but who are not in bargaining unit covered by an agreement which provides for employer contributions.

In these and other situations, the common practice has been to attempt to return the unacceptable payments once their existence has been established. Hundreds of such cases may be discovered each year. In these cases also, reasonable plan audit procedures may not result in discovery of the payments until more than a year after the payment was made.

We believe the bill should alleviate the constraints of section 403(c) of ERISA in all the common situations where that section may be interpreted to prohibit a refund of contributions which is otherwise proper or required. Accordingly, we recommend that the provision of the bill relating to the return of contributions be expanded to provide that, in the case of a payment to a plan which does not satisfy the requirements of section 302(c)(5) of the Labor Management Relations Act, 1947 (29 U.S.C. § 186(c)(5)), the plan administrator may return the payment to the person who made it within one year after the plan administrator determines that the payment does not satisfy the requirements of that section.

Modification of Accrued Benefit Rules for Multiemployer Plans

While technical in nature, the provision of the bill (section 234) which would allow multiemployer plans to apply the "three percent" or "fractional" accrual alternatives by projecting the normal retirement benefit on the basis of the average accrual (employer contribution) rates should resolve an important problem under the accrued benefit requirements. The current rules generally have the effect of requiring a plan to grant retroactive increases in accrued benefits when an employer in a multiemployer plan increases the rate of contributions (and related annual accrual rate) for future periods. This and other features of the current rules are inconsistent with reasonable accrued benefit structures commonly employed in multiemployer plans and which do not involve "back-loading" intended to be prohibited by the rules enacted in ERISA.

It is unclear whether a related potential problem involving the three percent and fractional accrual alternatives would be clarified by the bill. The problem involves individuals who terminate active participation with vested benefits and return to work, many years later, for a short period prior to retirement when plan benefits have substantially increased. It is possible to interpret present law to require plans to pay benefits to these individuals based on the recent increased benefit levels for periods of pre-break participation (as well as for post-break participation) even though the plan only received contributions supporting the much higher benefit levels for a short period. This would present individuals with substantial opportunities for adverse selection that would be extremely detrimental to plans.

While the provision in the bill may be interpreted to resolve this problem, we recommend that it be clarified to more clearly establish that the accrual rules are to be applied separately to years of participation which are separated by a significant break period (e.g., two consecutive one-year breaks in service). Alternatively, if the provision in the bill was intended to resolve this problem, it is important that the accompanying committee report clarify this intention through an example or otherwise.

Funding to Take Account of Future Amendments

Another technical provision of the bill which is important to multiemployer plans is that which would require current funding requirements to be determined on the basis of all plan provisions, including those scheduled to become effective in a plan year after the year of adoption. While we have some reservations as to whether this provision should be applicable to all plans (regardless of the funding method otherwise used), it would allow many multiemployer plans to resolve current funding problems by adopting a plan amendment which would reduce accrued benefits in a later year, thereby avoiding the need to immediately or retroactively reduce accrued benefits. This flexibility is particularly important to such plans because the increased employer contributions needed to avoid an unanticipated funding problem would not be obtainable until collective bargaining agreements are renegotiated (possibly up to three years later).

* * * * * * *

The WCT Plan appreciates this opportunity to present its views on the ERISA Improvements Act of 1978 and the ways in which the bill could resolve other important problems created by ERISA.

Very truly yours,

T. N. McNamara
Pillsbury, Madison & Sutro

Theodore R. Groom
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Attorneys for the Western Conference of Teamsters
Pension Trust Fund

Lloyd's Won't Renew Liability Insurance Of Trustees of Western Teamsters Fund

By JIM DRINKHALL
Staff Reporter of THE WALL STREET JOURNAL

SAN FRANCISCO — Underwriters at Lloyd's of London have refused to renew the fiduciary liability insurance of trustees of the Western Conference of Teamsters Trust Fund.

Also, citing the costs of defending lawsuits, Lloyd's said it wouldn't any longer provide coverage for "any Teamster-affiliated fund."

Lloyd's refused to renew the Western Conference policy even though the fund has $2 billion in assets on deposit with Prudential Insurance Co. of America for investment under a group annuity contract. According to documents, Lloyd's said the Western Conference fund is "an uninsurable risk."

Details of Lloyd's decisions are contained in documents from the Western Conference fund's law firm, San Francisco-based Pillsbury, Madison & Sutro; the fund's insurance broker, Marsh & McLennan Inc., and Lloyd's surplus lines broker, Walker & Co.

Shortly before the Western Conference policy was to expire in April, the union managed to obtain a one-year policy at an almost 300% increase in premium and with a severe restriction on the amount of legal defense fees that would be reimbursable.

Observers say that the difficulty, and in some cases, inability of Teamsters funds to obtain fiduciary liability insurance coverage is causing a serious concern at funds and could precipitate a crisis if trustees resign. At the Western fund, according to documents, many of the 28 trustees planned to resign if they weren't covered.

As reported previously, the much-investigated Teamsters Central States Pension Fund and its related Health and Welfare Fund found its fiduciary liability coverage canceled in March by a unit of Aetna Life & Casualty Co. Since then, according to sources, both funds haven't been able to obtain any coverage and have been searching outside the U.S. for coverage.

A spokesman for the Western Conference confirmed the details of the fund's insurance woes, adding that "our problem is that we always get lumped in with those people at the Central States fund."

Even though Lloyd's said it was aware that the Western Conference is entirely independent from the Central States funds and has an "excellent reputation in the industry and with government agencies," documents say, Teamster funds appear to be "sitting targets for litigation." The underwriters said they were concerned by the "plethora of lawsuits" against Teamster funds in the East and Midwest, particularly the Labor Department's suit filed earlier this year charging former trustees of the Central States Pension Fund with mismanaging fund assets.

According to the documents, the Western Conference's three-year policy expiring last April 17 had a $1 million liability limit at a premium of $66,000. By contrast, the Central States' one-year policy expiring last Feb. 11 had a $5 million liability limit for a premium of $1,149,000.

Following the notice of nonrenewal to the Western Conference, one document shows, the fund's broker, Marsh & McLennan, contacted "all insurance companies known to underwrite fiduciary liability insurance." As a result, Marsh found that only Aetna Casualty & Surety Co., a unit of Aetna Life & Casualty, was willing to consider coverage.

"Following extensive and delicate negotiations," according to one document, Aetna agreed to a one-year, $1 million liability limit policy with a total premium of $200,000. In addition, for another $19,500 payable to Lloyd's, the claims and discovery period under the previous policy was extended for a year. Together, the premiums represent a 278% increase from the annual premium for the prior three-year period.

What most concerned the fund's counsel, though, was the provision in the policy that limits the reimbursement of defense costs to an aggregate $100,000, with anything over that amount paid by the union. According to a source at the fund's law firm, legal fees for defending the Western Conference have "easily been over $100,000 a year."

"It is entirely unreasonable and unrealistic," said Pillsbury, Madison & Sutro in a letter to the U.S. Department of Labor, "to expect such people (fund trustees) to serve as trustees of large multiemployer plans without some assurance that their personal assets won't be used or exhausted to defend a wide variety of lawsuits, most of which prove to be unfounded or even frivolous."

The letter from the fund's counsel to the labor secretary suggests that the Employee Retirement Income Security Act be amended to allow a fund to defend its trustees in lawsuits rather than have that defense provided for through insurance. Among other things, the letter cites the "wasteful" expense of its current insurance and argues that it would be less expense to self-insure its legal costs.

THE WALL STREET JOURNAL, Friday, June 16, 1978

SENATOR
WILLIAMS, N

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COMMITTEE ON

September 7, 1978

The Honorable Harrison A. Williams, Jr.
Room 352 Russell Senate Office Building
Washington, D. C. 20510

Dear Senator Williams:

I understand the ERISA Improvements Act, S. 3017, is currently being marked up for submission to your subcommittee. Section 274 of the proposed bill would amend ERISA to allow Banks to collectively invest Keogh (HR-10) plans, IRA plans sponsored by an employer or a labor union and Internal Revenue Code Section 401 qualified plans without subjecting such collectively invested plans to the registration requirements of the 1933 Securities Act, the 1934 Exchange Act and the 1940 Investment Company Act. I strongly urge that this provision be retained in the final version of S. 3017 when it is reviewed by your subcommittee.

The retention of this provision is absolutely essential if the Banking community is to properly service its customers who are desirous of establishing smaller retirement plans than can be economically individually invested. Although various organizations have raised the spector of unregulated business activity in this area, I am sure that you are well aware of the extensive regulations Banks are subject to on the State and Federal levels other than that provided by the Security Exchange Commission. The passage of S. 3017 containing the collective investment provision would re-enforce the Congressional intent, as evidenced by the original passage of the Employee Retirement Income Security Act of 1974, to provide expanded benefits at nominal costs to the working individuals of the United States and eliminate the costly multiple layers of regulations in this area without decreasing the rights of plan participants.

Thank you for any consideration you are able to give this matter.

Sincerely,

William T. Quillen

William T. Quillen
Senior Vice President

WTQ:alk
cc: The Honorable William V. Roth, Jr.
The Honorable Joseph R. Biden
The Honorable Thomas B. Evans, Jr.

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