REPORT OF THE PRESIDENT'S COMMISSION ON PENSION POLICY

HEARING

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

MAY 15, 1981

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE
84-763 O WASHINGTON : 1981

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FRIDAY, MAY 15, 1981

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON SAVINGS, PENSIONS AND
INVESTMENT POLICY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2221, Dirksen Senate Office Building, Hon. John H. Chafee (chairman) presiding.

Present: Senator Chafee.

[The committee press release and Senator Dole's prepared statement follow:]

[Press Release No. 81-127, Apr. 30, 1981]

FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY SETS HEARING ON REPORT OF THE PRESIDENT'S COMMISSION ON PENSION POLICY

Senator Chafee, Chairman of the Subcommittee on Savings, Pensions, and Investment Policy of the Senate Committee on Finance announced today that the Subcommittee will hold a hearing on May 15, 1981 on the President's Commission on Pension Policy's report, "Coming of Age: Toward a National Retirement Income Policy."

The Committee will hear testimony from the President's Commission on Pension Policy. The Committee also hopes to receive testimony from various interested members of the public on the Commission's findings and the issue of pension and retirement policy generally.

The hearing will be held at 9:30 a.m. on May 15, 1981, in Room 2221 of the Dirksen Senate Office Building.

In announcing the hearing, Senator Chafee noted that the increasing financial pressures on the social security system emphasize the need to examine the relative roles that qualified retirement plans and individual savings should play as sources of retirement income. "While some of the Commission's recommendations have been quite controversial, they have certainly focused attention on an issue which gains in importance as the median age of our population increases."

Requests to testify.—Witnesses who desire to testify at the hearing must submit a written request to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, to be received no later than noon on Friday, May 8, 1981. Witnesses will be notified as soon as practicable thereafter whether it has been possible to schedule them to present oral testimony. If for some reason a witness is unable to appear at the time scheduled, he may file a written statement for the record in lieu of the personal appearance. In such a case, a witness should notify the Committee of his inability to appear as soon as possible.

Consolidated testimony.—Senator Chafee urges all witnesses who have a common position or who have the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Subcommittee. This procedure will enable the Subcommittee to receive a wider expression of views than it might otherwise obtain. Senator Chafee urges that all witnesses exert a maximum effort to consolidate and coordinate their statements.

Legislative reorganization act.—Senator Chafee stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) All witnesses must submit written statements of their testimony.

(2) Written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be delivered not later than noon Thursday, May 14, 1981.

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

(4) Witnesses should not read their written statements to the Subcommittee, but ought instead to confine their oral presentations to a summary of the points included in the statement.

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

Written statements.—Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record of the hearing. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, not later than Friday, May 29, 1981. On the first page of your written statement please indicate the date and subject of the hearing.

Prepared Statement of Senator Dole

Today we have an opportunity to hear the views of the President's Commission on Pension Policy and the views of the public on the issue of pension and retirement policy.

Social security was established in 1939 to provide a minimum floor of retirement income. It was expected that private pensions and personal savings would supplement these minimum retirement benefits. All three sources were considered necessary to provide adequate retirement income. However, social security has been increasing as a share of retirement income. In 1950, social security paid 28 percent of all retirement, disability and survivor benefits. By 1980 social security's share had more than doubled, while the share paid by public and private employee pension plans decreased.

Thirty-five million people around the country now receive social security benefits. More than 115 million working people pay social security taxes with an eye toward receiving future benefits. When the future funding of the system is in question, as it is today, benefits may be placed in jeopardy for the young and old alike. We can no longer be satisfied with piecemeal measures that satisfy immediate needs but neglect the long-term fiscal stability of the system.

Currently, only a relatively small proportion of the retired actually receive income from employee pensions. In fact, less than 50 percent of the current work force participates in an employee pension plan. We must continue to provide substantial incentives for employees and employers to maintain tax qualified retirement plans, in order for employee pension programs to continue to be a major source of retirement income, Employee pension programs provide a necessary supplement to social security. Employee pension programs are also a form of indirect individual savings. Even in today's economy, as inflation takes larger and larger portions of an individual's after-tax income and as after-tax corporate profits fall, we must develop incentives to maintain employee pension programs because they are an essential component of the U.S. retirement income system.

Currently, individual retirement saving is not a significant source of income for most retirees. We must pay greater attention to the gains to be derived from encouraging individuals to save for their own retirement. I have introduced legislation to allow participants in qualified retirement plans to set up an Individual Retirement Account or receive a deduction for contributions to their qualified plans. Allowing employees to deduct contributions to their pension plans should be an efficient way to encourage savings, especially with the use of payroll deduction plans. In addition, Mr. Chairman, I applaud your efforts in this important area and the legislation you have introduced on the Individual Retirement Account concept.

In conclusion, Mr. Chairman, this hearing should provide us with useful comments on the President's Commission's report and the issue of pension and retirement policy generally.

Senator Chafee [chairman, presiding]. The subcommittee will come to order.

This is first time the findings and recommendations of the President's Commission on Pension Policy have been presented to a Senate subcommittee since the work was completed in February.

Likewise, it is the first chance public witnesses have had to critique the Commission's report in a forum such as this.

There are three ways to accumulate retirement income and all three of these were addressed to some extent in the report.

The first, of course, is through social security. There is no question that the social security crisis is with us right today. Persistent inflation has brought that fund to the brink of insolvency, barely 4 years after this committee came forward with very substantial tax increases that were meant to insure the solvency of the fund throughout the balance of this century.

What did it in, of course, is the inflation, which has devalued personal retirement savings and pension benefits so seriously that 60 percent of current retirees now find themselves almost entirely dependent on income from social security, which of course, was never the objective of the Social Security Fund when it was originally established. So obviously, we must tackle head on the problems of the social security system for the benefit of present and future retirees.

We must not pit one generation against another. This shouldn't be an either or situation. Our concern with the integrity of the fund must go further than the immediate crisis confronting the social security system right now. Of course, this committee will be addressing the social security problems later in this calendar year.

The second way in which people prepare financially for their retirement is with personal savings. I have been extremely active in the effort to increase incentives for personal savings—to encourage people to save rather than borrow with an emphasis on saving for retirement.

One way to increase savings for retirement is with the expansion of the eligibility and the tax deductions for IRA (individual retirement account). I have introduced legislation along with Representative Hinson Moore in the House, to accomplish this. We have proposed a $2,000 deduction for a contribution to an IRA. This deduction is not a percentage of one's earnings, but the first $2,000, if one should so choose.

I am increasingly confident that Congress will approve this plan or, one very similar, during this year.

Now the third way in which people accumulate retirement income is through private pension plans. The President's Commission has recommended the substantial expansion to the number of workers in the amount of coverage afforded by private pension plans.

That is one consideration as we look at the distressing fact that only 40 percent of all Americans can expect to have private pension plan coverage when they retire. I must say, I was shocked by that statistic.

It isn't that more aren't in plans, it's that one factor crosses the great mobility of Americans, many of whom failed to stay in a job long enough to accumulate or divest in a private pension plan. I might add that I am an example of this type of situation. I have held so many different jobs and have never stayed in one long enough to qualify for the pension.

Examination of the private pension plans in this country is our purpose here today. The cost is, of course, solely restricted through pensions generally, but with a stress on private pension plans.

By the end of this century, only 20 years from now, the elderly will account for an even greater portion of the Nation's population than they do today.

The number of people over age 65 now is 11 percent of our population. By the year 2000, this figure will increase to 13 percent—close to a 20-percent jump, with an increase to 22 percent of the population soon thereafter when the current baby boom generation reaches age 65.

It seems to me we should seek an increase in private pension plan coverage. The problems addressed in increasing this coverage are substantial, and of course, the report deals with some of those.

Small businesses say they can't afford to provide pension plans. Americans as previously noted are extremely mobile. How do we find them when they move? In addition, coverage of dependents and survivors complicates the issue even more.

I believe it behooves every policymaker to be concerned about the financial security of our future retirees and to be cognizant of the change in demographics in the Nation.

We must do more than simply say this is a difficult problem. I know that each of the subcommittee's witnesses here today has strong views about these problems and the solutions, too.

It is my hope that this hearing will only be the first of many that we hold in an effort to improve the retirement prospects for today's working senior citizen.

So, we welcome the panel. We will start first with Mr. Thomas Woodruff, Executive Director of the President's Commission on Pension Policy.

I am glad to have you here, Mr. Woodruff.

STATEMENT OF THOMAS C. WOODRUFF, EXECUTIVE DIRECTOR, PRESIDENT'S COMMISSION ON PENSION POLICY

Mr. WOODRUFF. On behalf of the Commission, we all appreciate the opportunity to appear before this distinguished subcommittee and to review our findings and recommendations.

I feel certain that you and many in the audience have already seen most of our proposals. We are very grateful for the chance to present them to you today.

In the context of current concerns in Congress on tax cuts and solvency of the social security system, which I believe has major implications for funded employee pension plans as well, I would like to summarize my remarks but ask that my full testimony be entered into the records of this hearing.

Senator CHAFEE. Without objection, it is so ordered.

Mr. WOODRUFF. In addition, I would like to submit three additional documents for the record, so that I don't need to discuss them in my testimony.

The first is an analysis of pension plan coverage in the United States with figures that we are releasing for the first time today, a study of the macroeconomic effects of our recommendation, as well as a review of legislation currently underway in Congress and all the matters of concern to the Commission's final report.

Mr. Chairman, the Commission's final report contains recommendations for a number of broad long-range retirement income goals for the Nation and spells out the relative roles of public and private pension systems, as well as individual efforts in providing this income.

In addition, a number of specific proposals are recommended to meet these long-range goals and to lead us to a transition toward a more balanced retirement income system.

In its review of the major problems facing our retirement programs, the Commission made three major findings.

First, our Nation has become dangerously dependent on pay-as-you-go finance programs. These large tax supported programs have created an imbalance which has serious implications for the future.

Senator CHAFEE. Do you mean that with respect to the social security fund, the outgo is dependent upon the immediate income?

Mr. WOODRUFF. That's right.

Senator CHAFEE. And that it disregards the demographics of the future?

Mr. WOODRUFF. And also current economics is very sensitive. As we realize, given the current shortrun problems, pay-as-you-go programs are also extremely sensitive to current economic conditions, when unemployment rates are high or when inflation is different than a wage growth we can experience short-term funding problems as well.

In addition, the Commission looked very carefully at the question of funded employee pension coverage, and concluded that the lack of coverage in the private pension area is a serious problem for future public policy.

We also find, as you mentioned in your opening remarks, that where individuals are covered, the lack of coordination among programs sometimes results in low benefits for some and other people receive excessive benefits.

Senator CHAFEE. I must ask, is anyone complaining about receiving an excessive benefit? [Laughter.]

Mr. WOODRUFF. Some people I think are complaining, Senator, about those who are receiving excessive benefits.

Senator CHAFEE. I see. That's subjective judgment, I suspect, of what is an excessive benefit.

Mr. WOODRUFF. Senator, we also identified a problem that you mention in your opening statement that inadequate incentives now exist for retirement savings, and there are major inconsistencies currently in a tax treatment of pension benefits.

I would like also to add a fourth that the Commission identified in its final report, and that should be of concern to us today. And that is the fragmentation of the policymaking structure in both the executive and legislative branches of Government makes it very difficult to provide linkage among the various proposals for changes to our retirement and tax policy area.

This inability to provide linkage among retirement policy, tax policy, policy concerned with social security, private pension plans and savings, makes it very difficult to put together a comprehensive package that we feel would lead us out of the overdependency on pay-as-you-go programs.

In response to all of these problems that I have listed and many more that are contained in our final report, the Commission put together a list of over 50 recommendations for change.

Also identified in our report, Senator, the Commission identified the overdependence on Government programs. Last year we estimated about $185 billion in benefits was flowing to about 23 million older Americans. A very substantial amount of money.

The problems associated with transferring such amount——

Senator CHAFEE. What was that sum again?

Mr. WOODRUFF. $185 billion.

Senator CHAFEE. All Government?

Mr. WOODRUFF. Not all Government, some private as well. Currently about 11 percent, I believe, of the population is over the age of 65 and most of those are in retirement, but there are some below that age who are in retirement.

The $185 billion is an estimate of direct retirement income transfers to the elderly through private and public programs. It does not include, Senator, estimates of inkind benefit programs, health programs and others that are sponsored by the Federal Government.

The problems associated with transferring such enormous sums will be magnified in the coming years mainly because of the aging of the population.

Also, a shrinking workforce in the future will be required to support this much larger aged population.

As the population of the country matures, severe strains will be placed on our already overburdened programs. As I mentioned, this is particularly a problem for social security, but it may also be a problem for funded programs that provide for long periods of amortization of benefit increases.

The trends toward earlier retirement and increased longevity——

Senator CHAFEE. Precious few private plans provide for benefit increases that are in any way indexed. Isn't that correct?

Mr. WOODRUFF. That's right. There are very few. I think most estimates are under 5 percent that provide some form of automatic indexing.

There are additional numbers—many private plans have what are called ad hoc benefit increases periodically, though they are not guaranteed. We can anticipate that these would continue to be made.

There is a particular problem, I believe, with the funding of flat benefit plans. Most of these are collectively bargained plans where every 3 years or how ever often the contracts are renegotiated, benefit increases are made, and these are usually amortized over a 3-year period—I mean a 30-year period.

This, in effect, means that we are stretching out of past service benefit increases over many years into the future as well, in these and some other programs that are called funded programs.

The trends toward earlier retirement and increased longevity have serious implications as we well know through the solvency of the social security trust funds. We all know as well that if scheduled payroll taxes and benefit payments remain unchanged, the social security trust funds would be insufficient both in the short term and then in the long term when the baby boom begins to retire.

A Commission household survey of 6,100 households chosen randomly across the Nation, reveals that only about 48 percent of all active workers, 18 years old and older, are presently covered by some type of employer-based pension plan.

In the private sector, this figure is approximately 45 percent for all workers and 54 percent of all workers between the ages of 25 and 64.

More than half or 54 percent of all noncovered workers are men, and 71 percent of noncovered workers work fulltime. Many of noncovered workers earn moderate income that place them in or near the middle of the earned income distribution.

Yet, we do recognize that many of these nonparticipants in pension plans are concentrated in low-wage jobs and in marginal industries.

A large number of noncovered private sector workers, we estimate it at as much as 79 percent, work for establishments that employ fewer than 100 employees. While some of these places of employment are merely subsidiaries of larger corporations, many of these employers still are in lower corporate tax brackets and therefore do not receive the same tax incentives for pension fund contributions as larger employers.

Senator, it is somewhat a similar situation to the progressive tax structure for individuals. For those employers who earn a net income of under $100,000, they receive a tax deduction in effect, below the 46 percent corporate tax rate for earnings above that level. That means that every dollar going in the pension plans for these employers is a little larger bite out of their pockets than those for employers of higher profit margins.

This uneven distribution of employee retirement income benefits and provision of pension programs has already caused serious difficulties and promises to create further problems in the future.

We now see that we have problems both with pension plans and with social security. The question is what should be done.

The Commission concluded that we must as a nation break with past traditions and create a new Federal initiative that would lead to a more balanced program of social security funded pension programs, retirement savings, and earnings as potential sources of income for the elderly.

What is unique about the Commission's report, unlike many other study groups, is that it calls for linkage among all of these areas of concern.

The report calls for greater emphasis to be placed on funded employee pension plans and individual efforts. And we call for reduced emphasis on tax supported Government programs. How do we suggest to do this?

First, we call for a strengthening of the long and short term——

Senator CHAFEE. What do you mean by reduced emphasis on the Government tax supported programs? You are disturbed that such a substantial portion of retirees' income now comes from social security. In other words, they are dependent on social security.

Mr. WOODRUFF. Not only social security, Senator, but also supplemental security income which is a general revenue financed program, food stamps, housing assistance, other means tested programs that primarily flow in large amounts to the elderly because of their low income.

We suggest the solving of short- and long-term financial conditions of social security in several ways.

First, we recommended, as have other groups, a gradual increase in the normal age of retirement under social security. We suggest that this not be done hastily. That it gradually be phased in beginning in the year 1990.

We also suggest that all workers, Federal, State and local non-profit institution workers, be covered on a mandatory basis under social security.

These two proposals by themselves would provide adequate reductions and long-term expenditures by social security and increased money flowing into social security to solve the long-term funding crisis in that system according to current estimates of the actuarial deficits.

Senator CHAFEE. You're saying that the problems of social security solvency would be saved by the gradual extension of the age. What did you say—to 68?

Mr. WOODRUFF. That's right, Senator.

Senator CHAFEE. As well as bringing in the very small group that is now out, such as charitable workers?

Mr. WOODRUFF. Excuse me. Charitable workers, Federal employees, State, and local—I think about 30 percent of State and local employees.

The June 1980 actuarial report of the social security actuaries is the one that is currently being used by the administration in its proposals states that the long-term actuarial imbalance or deficit is about 1.52 percent of payroll. For our report, we used a slightly more pessimistic forecast than that.

These two proposals by themselves, if you made no other changes in social security, would provide for a long-term payroll tax savings of about 1.53 was the estimate we received. There is some margin of error in all of these estimates, but roughly we see the matching of the deficit to the increases called for just by these two proposals.

There may be others that would be needed. There may be some benefit improvements that you would want to make that these two proposals by themselves would take care of the long-term problem according to current forecasts.

We still, of course, would have a short-term problem.

Senator CHAFEE. What did you do about the current existing retirement age of 62?

Mr. WOODRUFF. We recommended, Senator, that the current age of 62—early retirement also be gradually increased to age 65 beginning in 1990.

Our phase-in was a gradual one that would begin in 1990 with the retirement age being delayed 3 months, and it would continue to be delayed 3 months a year for 12 years, so that by the year 2002, the early retirement age would be 65 and the normal retirement age would be 68.

Senator CHAFEE. Would you change the percentage that one's entitled to for early retirement?

Mr. WOODRUFF. We did not recommend that. I do have a discussion in my later remarks about the current administration proposals. We recommend—-

Senator CHAFEE. These recommendations are solely financial recommendations. They don't take into account the views of the work force. Apparently, American workers, discouraging though it might seem, increasingly want to retire early.

Mr. WOODRUFF. That's right, and we believe that we need to slowly begin the process of changing of that trend.

Senator CHAFEE. Despite the views—you don't address trying to make work more attractive in any way or more challenging.

Mr. WOODRUFF. Well, we did, I think, take on a lot Senator. But, we did not suggest specific proposals for making work more attractive.

However, we did suggest, and did consider it in great detail, the employment problems of older workers and the problems of employers in retaining older workers, and suggested some changes—possible changes in unemployment insurance if it's necessary. To keep people in the labor force, we suggested a redefinition of retirement away from a notion of full-time work to full-time retirement to a phaseout of work, so that we keep workers on a voluntary and, if necessary, mandatory basis in the labor force a little longer, both for the financial problems in the system and also to just recognize increased life expectancy among the population.

Senator CHAFEE. As you recall, about 3 years ago we extended the mandatory retirement age from 65 to 70. What came of that? Did many stay?

Mr. WOODRUFF. I think the jury is still out on that. I have heard mixed results. I think most of the studies or just very preliminary studies indicate at least some change but very little change in employment practices.

There also is discussion underway about benefit accruals and pension plans that you may be aware of, between the age of 65 and 70. There are many problems, and I don't think we really know enough now; it's too early, I think, to tell how significant the raise in the mandatory retirement age had.

Certainly, we haven't seen a significant change in the pace of early retirement, though there have been some indications in some months that people have been delaying retirement a little bit probably because of economic conditions rather than any other public policies.

Senator CHAFEE. It seems to me that this is an incredible social problem that goes beyond the financial challenges we face.

Mr. WOODRUFF. Oh, sure; it certainly is.

Senator CHAFEE. As you mentioned, life expectancy has dramatically increased in this Nation. I believe the life expectancy of someone who reaches 70 has increased to something like 10 years. Is that correct?

Mr. WOODRUFF. I'm not that familiar. There may be others in the room who could answer that question. It is true though that average life expectancy has gone up and our proposals to increase the normal retirement age to 68 are actually fairly modest proposals.

Senator CHAFEE. Does any other nation have that?

Mr. WOODRUFF. Not that I'm aware of. No.

Senator CHAFEE. Please proceed.

Mr. WOODRUFF. OK.

Senator, in addition to these long-term problems, of course, there are the short-run problems, and we do address that in our report and I could go into those in question and answer if you care to.

The basic thrust of our report though, doesn't dwell so much on social security, but we concluded in addition to the problems facing social security, that we cannot really solve these problems by only looking at reforms of social security alone. And, as you mentioned in your statement, we place a great deal of emphasis on other alternative income sources.

We recommend, as you may be aware, that Federal legislation should be established to put in place the national minimum funded pension system. We call it a minimum universal pension system. Claude Pepper in the House has introduced legislation similar to our recommendation.

We would finance initially the program solely with employer contributions to either employer sponsored plans or a central clearinghouse. The benefits would be vested after short service and would be carried from job to job.

In our report, we were very sensitive to the situation of employees and owners of small businesses, Senator.

The minimum plan proposed by the Commission would significantly alleviate the administrative complexities often associated with pension plans and, to help mitigate the cost, we propose two things.

That the program be phased in over a 3-year period and that employers would be able to take a tax credit of 46 percent of their required contributions to the plans.

The Commission has also called for favorable tax treatment of voluntary employee contributions to employee pension plans and it also calls for increasing IRA and Keogh limits.

Combined with the minimum universal pension plan proposal, tax incentives for voluntary contributions to retirement plans would, in our opinion, provide a new mechanism for increasing personal savings for retirement.

Mr. Chairman, I had mentioned the term "linkage" in my earlier remarks. We at the Commission attempted to estimate the economic effects of linking all of our major proposals together.

Using a long-term economic growth model that is described in some detail in the submission that we made for the record to the subcommittee, we assimilated the following proposals:

Tax cuts—IRA report calls for tax cuts beginning in 1982 of the order of $30 billion.

A minimum universal pension system—beginning in 1982, we would provide for a 1-percent required contribution by all employers into a funded pension plan. By 1984 this would increase to 3 percent.

Increase in retirement ages—all of our employment and retirement age recommendations would begin to take effect in 1990.

Estimates from this forecasting model indicate that our minimum pension proposals and tax cuts would increase savings in

1985 by as much as $20 billion and by 1990 by as much as $26 billion expressed in 1981 or this year's dollars, so these aren't inflated numbers.

Investment capital by our estimates would increase initially by about 2 to 3 percent and eventually by about 10 percent.

Pension fund balances would increase by an additional 13 to 15 percent under these recommendations.

Senator CHAFEE. I'm not sure I understand this. You're referring to the Commission's tax cut of $30 billion alone. Now how would that work? What's your tax cut recommendation?

Mr. WOODRUFF. We recommend Senator, several types of tax cuts.

The first and probably the largest is the—we called for the tax deductibility of the employees contribution to social security. Next year if current payroll tax rates stay the same, workers will pay about $20 billion in taxes on top of their social security taxes.

Most people don't appreciate this in looking at tax reform and tax cut legislation. We call for people to make a choice between either a tax credit or a tax deduction that would provide a significant tax relief beginning next year.

We also called for the increased IRA and Keogh limits that would have the effect of providing a significant tax increase.

Senator CHAFEE. How much did you recommend on the IRA?

Mr. WOODRUFF. Well we made a general recommendation that these limits should be brought roughly in line with other limits provided by corporate and other pension plans. The Commission chose not to make a specific dollar amount limitation.

Senator CHAFEE. Hasn't there been concern that by expanding the contributions to IRA they will then be looked on as an alternative?

Mr. WOODRUFF. As we emphasized in our report, the notion of linkage, my own feeling is that to institute such a dramatic increase in IRA and Keogh limits by themselves, without putting first in place, this minimum universal pension system, could, in fact, create a very large disincentive for small employers and others not to set up tax qualified pension plans.

This could in the long run lead to even fewer people being covered by those plans.

However, in combination with the minimum pension proposals and the other proposals in our report, it probably makes a lot of sense.

So, I guess my answer to that is in isolation, yes. It probably would create these disincentives and problems, particularly for workers employed by small- and medium-sized companies.

However, if the Commission's other proposals were put in place, it probably would not be a problem that we should be concerned about.

Senator CHAFEE. What does the Commission consider to be adequate retirement income? Is it some percentage of preretirement income?

Mr. WOODRUFF. We have stated in the report that appropriate retirement income goals for the Nation should be the replacement of what we call preretirement disposable income. That is not total preretirement gross income.

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We take out of that preretirement income, taxes, work-related expenses, and also some estimate of what we would expect people should save on their own for their retirement. What we then get from this is a scale of replacement rates depending on your preretirement income level. We include that table in our report and could submit our estimates of what those goals should be for the record, should you desire it.

Senator CHAFEE. Please continue.

Mr. WOODRUFF. OK, Senator. I'll try to be brief.

The one point I wanted to make on the linkage of the tax cut and retirement savings proposals, is that we found in our economic simulations, that by linking tax cuts to these compulsory and voluntary retirement savings efforts, we found a much larger so-called supply side effect to the economy than by providing tax cuts alone. We found a dramatically higher level of savings and investment resulting from these combined policies than from a tax cut policy alone.

We suggest that linkage of tax-cut legislation to compulsory and voluntary funded retirement savings programs may be a much more effective way to provide the needed saving and investment in the economy than tax cuts alone.

I hope that this subcommittee as well as the full Finance Committee will consider incorporating these proposals in the second and third year of the tax-cut legislation that you will soon no doubt consider.

Mr. Chairman, I cannot overemphasize the importance of linkage. The administration's proposals on social security this week point out the dangers, I believe, in piecemeal policymaking.

By only looking at the financial problems of social security, these proposals may lead to unnecessary hardships among the Nation's older workers approaching retirement age.

In addition, these proposals may be very expensive for private sector employers. A majority of private sector employee pension plans are explicitly integrated with social security. The rest, even collectively bargained plans, are at least implicitly integrated with social security.

I would expect that when the benefit formula in early retirement penalties go into effect, the private employers will be forced to increase dramatically their contributions to funded employee pension plans.

I believe this subcommittee should demand that the administration prepare an economic impact statement on the cost to private employers and the loss in total benefits to employees of these social security proposals.

I expect that the various employer groups represented here today might even find that their member firms would be better off under the Commission's mandatory pension program than under the current administration's social security proposals. Certainly the employees would.

In addition, by selecting changes in retirement age policy, Senator, to help with the Federal budget deficit over the next several years, the administration may well have placed the tail on the wrong donkey. Older workers face special health and unemployment problems as you mentioned.

Our Nation's unemployment rate for all workers is currently too high in general.

Most older workers do not have pension or adequate personal savings to help them in their retirement years.

The administration's proposals may leave millions of these workers with no other option than to leave work at substantially lower standards of living.

Yes, we do need, and we emphasize this in our report to begin the process of reversing early retirement trends.

But we must give individuals adequate warning. We must allow employers, as well, adequate time to adjust their employment practices. And we must find alternative sources of income for the Nation's elderly population, and all of this will take time.

In our report, we proposed some changes to the short-term funding problem.

In conclusion, I would like to state that I am extremely pleased with the large number of proposals already introduced in this Congress that address most of the areas of concern identified by the Commission.

While not all of the legislation is consistent with every single recommendation that we made, they seem to reflect an emerging consensus in Congress.

Senator CHAFEE. With this 46-percent tax credit, what would the revenue loss be?

Mr. WOODRUFF. I would have to check my figures on that, but I believe it's somewhere in the order of about $4 to $6 billion. I would have to check my——

Senator CHAFEE. $4 to $6 billion? It would have to be more than that.

Mr. WOODRUFF [continuing]. I'll have to check my figures on that. I could submit that, Senator for the record.

The reason, Senator, for that is that it would only apply to the first 3 percent—under our proposals—the first 3 percent of contributions to a funded plan, and employers who currently earn over $100,000 would essentially have the same deduction.

The 46 percent would primarily benefit small employers who earn less than $100,000 a year. So, it's primarily a way of targeting tax relief to smaller employers.

Senator CHAFEE. They would get the credit back at 3 percent and then they would take a deduction for the balance?

Mr. WOODRUFF. That's right.

Senator CHAFEE. How do you track down an employee who had vested benefits and then disappeared somewhere?

Mr. WOODRUFF. Well, currently that isn't a problem for pension plans. We do not currently have adequate portability mechanisms. We suggested that a portability clearinghouse be established. We didn't specify where though it may make some sense to have that clearinghouse established in the Social Security Administration.

Senator CHAFEE. The clearing house is already tracking these people?

Mr. WOODRUFF. Which is already tracking these people.

Senator CHAFEE. That makes sense. Did you address the condition of municipal pension funds—State and municipal—which are all in terrible condition?

Mr. WOODRUFF. Yes, we helped with several other agencies sponsor several research projects on this. We found that in general the large State pension funds seemed to be on track with funding although there are some who have funding problems, but there is a great deal of variance from a municipal level, and I think that congressional and other Federal concern should be placed on this financial condition of these municipal plans.

Senator CHAFEE. Did you address what's happening in other countries. What happens in West Germany, for example? Do they integrate the private pension plans and the public pension plans with their form of social security?

Mr. WOODRUFF. Yes, Senator. There is a great deal of activity in Germany and other countries to try to get government more involved in improving the saving also, not only the combination of social security and funded plans, but also improving individual savings incentives. There has been some disillusionment, I guess, in Germany recently with their national savings programs, because they're finding that people, once they qualify for the minimum period, which I believe is 7 years, frequently they pull the money out and go out and buy items rather than saving up for retirement and other purposes.

I think we should be concerned in this country when we try to mimmick the experiences of others, be very careful in targeting our savings programs, limiting them to retirement only. I'm very concerned about generalizing the use of IRA's and other retirement accounts for home purchases, education and elsewhere, although I know that's been an interest of yours.

I think we—we have a very serious retirement crisis in this country, and though there are other goals we also want to achieve, we should be very careful in diluting our savings and shifting it out of retirement savings.

Senator CHAFEE. Thank you very much, Mr. Woodruff. What happens with your Commission now? Do you have a termination date?

Mr. WOODRUFF. Yes, Senator. We officially retire on May 24. After that time, the rest is up to you in terms of what happens to our recommendation.

Senator CHAFEE. I believe this is a subject that's going to require, years of national debate. Will we be able to reach you and others for your expertise? You go off the payroll on the 24th. Is that correct?

Mr. WOODRUFF. That's right. The chairman of our Commission, Peter McCullough is chairman of the Board of Xerox and I have both sort of pledged that we will try to be as available as possible in the upcoming years to congressional committees and others who want to consider and discuss these issues.

Some of our other commissioners, Bill Greenough, who's here today, are also active in these issues.

I think the main challenge to you and to the other congressional committees will be an attempt to coordinate the consideration of all of these proposals. As you well know, it's very easy to only consider one proposal at a time. Some of the proposals that we made—

Senator CHAFEE. Those aren't so easy either. [Laughter.]

You modest proposal on integrating the Federal Civil Service Pension System with the Social Security System represents a very dramatic change in the pension system of the country.

Mr. WOODRUFF. That's right, and none of the problems are easy, and I didn't mean to imply that, but I think that some of the proposals by themselves may not make sense because of the effects that they would have on people or businesses or whatever, and I think that the challenge must somehow try to come to grips with the fragmentation of decisionmaking, both in the executive branch and in the committee structure in Congress to try to coordinate consideration of many of these proposals.

I think now you have before you a real opportunity in the next 3 years, given that many of our proposals are linked to offsetting tax reductions. It's really a unique opportunity in the next 3 years to link some of the overall tax cuts that seem desirable now with targeted retirement savings——

Senator CHAFEE. If there's anything that is targeted, it's the IRA retirement proposal that Congressman Moore and I have introduced. However, you've indicated your disapproval of this proposal.

Mr. WOODRUFF. No, I indicated Senator, that perhaps in isolation to some of the other recommendations, if we were to raise the limits too significantly to approaching, for instance, the corporate plan limits, then we might have some of these negative——

Senator CHAFEE. Are you referring to the incentives for private pension plans?

Mr. WOODRUFF. That's right.

Senator CHAFEE. I would suggest that though it may not be popular this year to talk about compulsory programs, that perhaps the second and third year of this tax that at least consideration be given to linking some tax reductions to the minimum universal pension system.

We appreciate what the Commission has done, Mr. Woodruff, and your work. Obviously, you and Mr. McCullough are the resident experts on this. We will certainly be in touch with you.

Mr. WOODRUFF. Thank you very much.

[The prepared statement of Mr. Thomas C. Woodruff and a report by the President's Commission on Pension Policy follow:]

STATEMENT OF

THOMAS C. WOODRUFF

EXECUTIVE DIRECTOR

PRESIDENT'S COMMISSION ON PENSION POLICY

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

SENATE FINANCE COMMITTEE

MAY 15, 1981

I appreciate the opportunity to appear before this distinguished subcommittee and to review the Commission's findings and recommendations. While I feel certain that you have already heard some of our proposals, I am grateful for the chance to present them to you in contex of current concerns in Congress concerning tax cuts and the solvency of the social security system.

The President's Commission on Pension Policy was asked to examine the nation's retirement, survivor and disability systems in order to develop recommendations which would relieve current problems and help these systems meet identified goals. Over the past two and a half- years we have completed some 50 research projects and held over two dozen hearings on these issues.

In developing our recommendations we sought advice from hundreds of experts, interested individuals and groups, private and public sector organizations, Congress, and the many executive branch agencies directly involved with retirement income programs. Our recommendations are the culmination of these efforts.

The Commission's final report contains recommendations for a number of broad, long-range retirement income goals for the nation and spells out the roles of public and private pension systems as well as individual efforts in providing this income. In addition, a number of specific proposals are recommended to meet these long-range goals and to lead us through the transition to a balanced retirement income system.

In its review of the major problems facing our retirement income programs, the Commission made three major findings:

- o Our nation's retirement programs are dangerously dependent on pay-as-you-go programs. These large tax-supported programs have created an imbalance which has serious implications for the future.

- o Private pension coverage is lacking for many. And, where individuals are covered, the lack of coordination among programs results in very low benefits for some, while others receive excessive benefits.

- o Inadequate incentives exist for retirement savings and there are major inconsistencies in tax treatment of pension benefits.

In response to these problems, the Commission has made nearly fifty recommendations that would, if adopted, lead to a shifting of dependency on pay-as-you-go financed federal programs such as social security, welfare and in-kind benefit programs to a balanced system of employee pensions, social security, and individual effort.

The Nature of the Problem

Taken together the nation's retirement income systems now deliver over $185 billion in benefits to about 23 million older Americans.

The problems associated with transferring such enormous sums to the elderly will be magnified over the next 20 years as the number of people over age 65 increases sharply in proportion to the younger working population. After the turn of the century, an unprecedented shifting of older workers into retirement will begin to take place as the so-called "baby boom" generation grows older. Quite literally, this country's population will be coming of age.

A smaller shrinking workforce in the future will be required to support a larger growing aged population. And, pension payments will be stretched out as greater numbers of retirees live longer in retirement.

As the population of the country matures, severe strains will be placed on our already overburdened retirement income system. The strain will be particularly severe for pay-as-you-go systems like social security. Even under the Social Security Administration's most optimistic estimates, the worker-retiree ratio by the early part of the next century will cause severe financing problems for the system. The implications are especially severe as social security is responsible for a growing proportion of retirement benefits.

In 1950 social security paid 28 percent of all of the retirement, disability and survivor benefits. By 1980, its share of benefit payments had more than doubled.

The trends toward earlier retirement and increased longevity have serious implications for the solvency of the social security trust funds. If scheduled payroll tax rates and benefit payments remain unchanged, the social security trust funds will be insufficient under reasonable economic and demographic assumptions to support the retiring baby boom generation.

The nation has become too dependent on pay-as-you-go programs to provide retirement income for older citizens. In addition, there is an uneven distribution of retirement savings and employee pensions among American workers that has prevented these two types of retirement income from becoming reliable income sources.

A Commission household survey of 6,100 households chosen randomly nationwide reveals that only 48 percent of all active workers 18 years old and over are presently covered by some type of employer-based pension. In the private sector, only 45 percent of all workers (and 54 percent of those ages 25-64) are currently pension plan participants and only half of that number are currently vested in employee plan benefits.

More than half, 54 percent, of all noncovered workers are men, and 71 percent of the noncovered worked full-time. Many of the noncovered earn moderate incomes that place them in or near the middle of the earned income distribution (see Chart 1).

Chart 1

WHICH WORKERS ARE NOT COVERED BY PENSION PLANS?

In 1979, 49.4 million workers were not covered by a pension plan:

- 54% of these were men, 46% were women
- 71% of them worked full time, 29% part-time
- 68% were over age 25 and 51% of noncovered were over 25 and have one or more years of service with their employer
- 8.2 million are employed in the public sector
- 38.1 million are wage and salary workers in the private sector

Of private sector noncovered wage and salary workers:

- 77.9% worked in three main industries:
    - 31.9% from trade
    - 27.7% from service
    - 18.3% from manufacturing
- 29.9% earned less than $5,000 in 1978
- 36.4% earned between $5,000 and $10,000 in 1978
- 19.2% earned between $10,000 and $15,000 in 1978
- 14.6% earned over $15,000 in 1978
- 79.0% were in firms with fewer than 100 employees
- 7.5% were in firms with 500 or more employees
- Approximately 90% were not members of union

Source: ICF Inc. Analysis of May 1979 Current Population Survey Data. President's Commission on Pension Policy staff estimates. These numbers include imputed values.

Yet, nonparticipants tend to be concentrated in low-wage jobs and in marginal industries. A large number of noncovered private sector workers, approximately 79 percent, work for establishments that employ fewer than 100 workers. Many of these employers are in lower corporate tax brackets and therefore do not receive the same tax incentive for pension fund contributions as large employers.

This uneven distribution of employee retirement income benefits has already caused serious difficulties and promises to create further problems in the future.

One class of workers fares reasonably well in retirement because it can count on social security, as well as employee pensions and some personal savings. Another class of retirees has failed to become eligible for employee pension benefits and therefore must rely primarily on social security benefits. Inability to vest is often the result of lengthy pension plan service requirements, job mobility, or the lack of a pension plan at a worker's place of employment.

Commission Proposals

The major objective of retirement income policy should be to insure that today's retirees and tomorrow's elderly are able to maintain a reasonable standard of living in their later years. Workers should not have to experience a sudden drop in their standard of living upon retirement. The Commission believes that individuals should be able to maintain their preretirement standard of living during retirement years. A number of factors, including income tax rates, work-related expenses, and preretirement savings, should be taken into account in determining retirement income necessary to maintain living standards.

Inflation has a disruptive impact on retirement income. While social security, federal employee, and military pensions are indexed to the Consumer Price Index, the impact of inflation on nonindexed forms of retirement income is devastating. The Commission wants to encourage private as well as state and local government plans to provide some form of inflation protection for retirees. However, at this time the Commission feels that the overall lack of employee pensions for individuals is a far more pressing problem than providing full inflation protection for the few who are able to qualify for benefits. The absence of such benefits for a large segment of the workforce has successfully prevented a coordinated, balanced retirement income program.

The Commission endorses the concept of adjusting social security retirement benefits to changes in prices, but questions whether the CPI accurately reflects the consumption patterns of the retired population. Therefore, the Commission recommends that the Bureau of Labor Statistics be directed to establish a separate cost-of-living index for the retired.

The Commission believes retirement income should come from a balanced retirement income program composed of social security, employee pensions, savings, and earnings. Income from social security should be available to all retired workers and their families. It should be supplemented by income from employee pensions. In addition, individuals should be encouraged to supplement retirement income through individual effort in the form of savings and employment. Other sources, such as food stamps, housing assistance or other in-kind benefits, which have attempted to bridge the income gap in recent years should be utilized only when other primary sources fail.

Social Security

The Commission endorses the current role of social security in providing a minimum floor of protection for the aged. The program combines the goals of individual equity and social adequacy. On the one hand, there is a relationship between individual earnings and cash benefits. On the other hand, the program is partly redistributive, targeting benefits to those most in need.

However, major changes must be made in the social security system. The social security financing structure must be reinforced. . Social security's benefit structure must be responsive to increases in life expectancy and to social changes which have occurred since its inception.

The most serious problem facing social security is its ability to pay for benefits promised by the program. The Commission recommends raising the retirement age and extending social security coverage as a means of improving the long-term financing of social security.

A gradual phase-in of an increase in the normal retirement age to age 68 in the year 2002 is urgently necessary and can be justified for several reasons. First, the average expectation of life has increased substantially since the social security system was adopted in 1935. Those retiring at age 68 in 2002 will have several more years in retirement than those retiring at age 65 had in the past.

Second, workers are generally healthier and many jobs for most 65-68 year olds are less strenuous today than in the past.

When the "baby boom" generation retires there would be a severe strain on the financing of the social security program if the retirement ages stay as they are today. Raising the retirement age by three years would substantially alleviate this problem.

Since current workers already may have made plans contingent upon receiving social security benefits at age 65, the Commission recommends no change in the retirement age prior to 1990.

The Commission, I believe, would object strenously to any abrupt change in the early or normal retirement age benefits as proposed earlier this week by the Administration. Such a change would penalize the most vulnerable members of our society: those now approaching retirement who will soon be dependent on social security as their sole source of income. Many of these low and moderate income workers face uncertain job possibilities and uncertain health. The Commission recognizes that the generalization of vastly improved health will not be enjoyed by all workers. Therefore the Commission stresses that benefits must be provided for those who cannot work for health reasons.

By extending social security benefits to those future workers who would not otherwise be covered, the problem of the much debated windfall benefit will be eliminated, reducing the system's long-term actuarial deficit by about 30 percent. Extension of coverage will reduce benefit gaps for workers who do not remain in government employment for a sufficient number of years to qualify for benefits.

In response to social security's short-term difficulties, the Commission has recommended borrowing among the social security trust funds and accelerating the scheduled social security payroll tax increases. The allocation of social security taxes between old age and survivor benefits, disability benefits, and hospital insurance has been changed over the years and deficits and surpluses have developed in the separate funds in uneven patterns. Thus, if necessary, interfund borrowing can be used to smooth out fluctuations. The Commission's recommendations would take care of the short term problems in social security without the drastic measures suggested by the Administration.

The Commission believes social security benefits should continue to be financed solely by equal payroll taxes from the employees and employers. The Commission recommends against the use of general revenues to finance social security. This has been the practice since the start of the social security system in 1935 and has provided employees with a feeling of direct participation in the program and a right to benefits. But social security cannot provide all retirement income. Also, keying expected payments to expected tax revenues provides some restraint on increasing benefit levels.

Table 1 shows estimates made by the Social Security Administration's Office of the Actuary on how the Commission's proposals will help solve the long-term actuarial deficit facing social security. Long term estimates such as these are extremely sensitive to changes in economic and demographic conditions. These estimates show that even with the benefit improvements recommended by our report, most of the deficit is eliminated under our proposals. With these suggested improvements the deficit is eliminated.

The Commission also recommends that employee contributions to social security receive favorable tax treatment through refundable tax credits or tax deductions. Inclusion of social security benefits as taxable income should be phased in. And, as this recommendation takes effect, the social security earnings test would be eliminated.

Even with the acceleration of the payroll tax rates, the Commission's proposals would reduce the total social security tax burden facing workers by about $20 billion in 1982. The Commission clearly recognizes that in order to eliminate the problem of retirement income benefit gaps and overlaps , the tax treatment on various types of retirement income and contributions must be made more consistent.

This effect of this recommendation would be to subject retirement income from all sources to the graduated income tax and remove the

Chart 2

ILLUSTRATIVE IMPACT OF COMMISSION PROPOSALS ON LONG-TERM SOCIAL SECURITY DEFICIT (EXPRESSED AS A % OF PAYROLL)[1]

1. Current Long-term Actuarial Balance	−1.58%[2]
2. Raise Retirement Age (65-68)	+1.20%
3. Universal Coverage (Windfalls eliminated)	+ .53%
4. Move 1985 Tax Schedule to 1982	+ .02%
5. Earnings Sharing at Divorce with Inheritance	− .01%
6. Inheritance	− .18%
7. Increase Social Security Special Minimum Benefit	− .1 %
8. Remove Earnings Test	− .16%[3]
9. LONG-TERM ACTUARIAL BALANCE	−0.24%

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[1] These estimates are intended to illustrate the probable impact of Commission recommendations. The exact values of these estimates are highly dependent on the details and the implementation of the specific proposals adopted. Estimates for items 2 through 8 show the estimated impact of each proposal individually with respect to current law. Item 9 shows the estimated impact if all of the proposals were adopted, including their interactive effects.

[2] Present law expenditures and tax rates are based on Office of Management and Budget mid-session review assumptions leaded into the intermediate assumptions of the 1980 Social Security Trustees Reports, modified to include the effects of Public Law 96-403, Public Law 96-473 and Public Law 96-499 and to reflect several minor changes in the short range period.

[3] This estimate is highly sensitive to assumptions about increased labor force participation of older workers due to this and other proposals. Also, this proposal is highly interactive with the others. If items 2 through 7 were adopted, the additional cost to the trust funds of removing the earnings test would drop to .09 percent of payroll. Additional revenue to the Treasury due to this and other social security tax proposals are not included in this estimate.

Source: Special tabulations for the President's Commission on Pension Policy by Office of the Actuary, Social Security Administration.

earnings test which is essentially a 50 percent tax on earned income above the specified limits. Generally low income retirees receiving retirement income solely from social security would not pay any new taxes.

Currently, employee contributions to social security are made from after tax dollars, and all benefits are received tax-free. The tax-free nature of the benefits is one of the reasons why many have argued that the social security earnings test needs to be retained.

Yet the earnings test is a serious work disincentive and discourages able workers from remaining in the workplace. The Commission belives that earnings can play a vital role in providing retirement income and removal of the test will increase the role of this retirement income source.

In this regard, the Commission has concluded that the definition of "retirement" itself may need changing. Today, retirement is thought of as the transition from full-time employment to full-time leisure. This abrupt change in life-style can dramatically affect individual retirees. In addition, sudden and complete removal from the labor force, particularly if it occurs below the normal retirement age, may create undesirable financial dependency on our retirement and income transfer programs.

While recognizing the desire of most Americans to full retirement at a given age, the Commission believes that individuals should be encouraged to remain in the workplace and therefore has recommended ways to encourage work opportunities for older Americans.

In addition to elimination of the earnings test, the Commission recommends that information on alternative work patterns be encouraged and developed through research and demonstration programs in existing federal employment programs. Job retraining and job redesign for older workers in private industry also should be encouraged.

The Commission also recommends that the social security system be amended to recognize the vastly changing role of women in our society.

The Commission suggests that earnings sharing approach be used in cases of divorce. And, that inheritance of earnings credits be provided to surviving spouses of two earner couples. The Commission recommends that earnings sharing should not be used for the purpose of disability.

Divorced and widowed persons are disproportionately represented among the aged poor. In addition, social security can deliver unequal retirement and survivor benefits among retired couples who have the same earnings history. The Commission's two recommendations would simultaneously enhance the adequacy and equity of benefits for these groups, thereby reducing dependency.

The Commission believes that other programs to supplement social security's basic floor of protection must be substantially increased if preretirement living standards are to be maintained in retirement. The most comprehensive recommendations of the Commission are directed toward strengthening the employee pension system and personal savings for retirement.

Strengthening Employee Pensions and Savings

The Commission believes that the financial problems of social security cannot bé solved by looking only at reforms to the social security financing and benefit structure. The Commission has developed a comprehensive package of tax reduction proposals that are specifically linked to increasing the role of funded employee pension plans and personal retirement savings. Tax incentives, even those proposed by our report, will not significantly increase the pension plan participation of low-and moderate-income workers and workers employed by small businesses.

Therefore, the Commission recommends federal legislation to establish a national minimum funded pension system which would be required of all employers. Such a system, which the Commission called a Minimum Universal Pension System or (MUPS), would be financed by employer contributions to either an employer sponsored plan or a central portability clearinghouse. The benefits would be vested after short service and would be carried from job to job.

MUPS would increase the number of participants in the private pension system by 50 percent --female participants would be increased by 70 percent and male participants by about 40 percent. Without MUPS, 250,000 private sector workers may enter retirement in 2000 without pensions. This number increases to about 460,000 workers who may retire pensionless in 2025 if no such plan is established.

Thus, nearly 96 percent of those who would have retired without a pension retire with one under the Commission's proposals; only 2 percent of all private sector retirees would enter retirement without a pension benefit.

Employers who currently provide employee pension plans would be only minimally affected by this proposal. These employers generally provide benefits that are much more generous than the minimum standard called for in the Commission's report. The benefit provisions in their plans would only be modified to take into account the portability features of a MUPS.

The Commission is sensitive to the situation of employees and owners of small businesses. The minimum standards plan proposed by the Commission would significantly alleviate the administrative complexities often associated with pension plans. To help mitigate the cost, the program would be phased in over a three-year period. And, employers would be able to take a tax credit of 46 percent of their required contribution to the plan.

Table 2 shows the estimated costs to private sector employers for this plan. A substantial part of the programs costs are offset by the special tax credit proposed by the Commission. After the first three years, employers are expected to shift some costs to employees in the form of smaller wage and fringe benefit increases. Employees should be able to absorb this cost without reducing their disposable income because of the tax savings to individuals that will be provided by the Commission's proposal to exclude social security contributions from taxable income.

Chart 3

ESTIMATED COSTS FOR PRIVATE SECTOR EMPLOYERS OF COMMISSION'S MINIMUM UNIVERSAL PENSION SYSTEM (MUPS) PROPOSAL (IN NOMINAL $ BILLIONS)[1]

Year MUPS Contribution Requirements by Size of Establishment	Current Policy Costs	Added Costs	Business Tax Savings[2]	Net Cost Increase
(Expressed In 1982 Dollars)				
Less than 100 employees	$21.1	$3.2	$2.5	$0.7
100-500 employees	13.4	1.1	0.7	0.4
500 or more employees	22.3	1.0	0.5	0.5
Self-employed workers	2.1	1.0	0.7	0.3
Total	$58.9	$6.3	$4.4	$1.9
(Expressed In 1983 Dollars)				
Less than 100 employees	$23.0	$6.3	$4.1	$2.2
100-500 employees	14.6	2.0	1.2	0.8
500 or more employees	24.3	1.7	0.8	0.9
Self-employed workers	2.3	2.2	1.3	0.9
Total	$64.1	$12.2	$7.4	$4.8
(Expressed In 1984 Dollars)				
Less than 100 emloyees	$24.7	$9.5	$5.7	$3.8
100-500 employees	15.7	2.9	1.7	1.2
500 or more employees	26.2	2.6	1.2	1.4
Self-employed workers	2.5	3.6	1.9	1.7
Total	$69.1	$18.6	$10.5	$8.1

[1] All private and public employers must offer a retirement plan with participation standards no stricter than age 25, one year of service, and 1,000 hours of work annually and full and immediate vesting. These estimates assume a phase-in of MUPS requiring a one percent of earnings contribution by employers in 1982, a two percent contribution in 1983 and a three percent contribution in 1984. The Commission's Special MUPS Business Tax Credit is assumed to apply to the first 3% of payroll contributions to qualified pension plans.

[2] These tax savings estimates have two components. Employees earning below $100,000 who currently contribute to a qualified pension plan are assumed to receive the special MUPS Business Tax Credit for the first 3 percent of payroll contribution. All new contributions by employers due to MUPS are subject to the higher of the tax credit or normal tax deduction.

Sources: ICF, Inc., estimates for President's Commission Pension Policy; Estimates by President's Commission on Pension Policy.

In addition, availability of a portability clearinghouse for benefit records and a portability fund for plan assets would require minimal recordkeeping responsibility while allowing employers the investment advantages of large pooled funds.

The establishment of a minimum universal pension system or MUPS will cause a significant shift in the relative roles of social security, employee pensions, and savings as sources of retirement income. By funding a substantial portion of an individual's retirement resources, the nation will be better prepared to provide the resources required to support the retired population.

While some have argued that MUPS will reduce the amount of individual retirement savings, recently completed Commission research shows that each dollar increase in social security or private pension wealth results in a negligible decrease in private savings before retirement.

Furthermore, MUPS would result in significant improvement in the incomes of the elderly, particularly those at the lower end of the income distribution.

This plan would also increase the proportion of total retirement income financed by funded pension programs. Under the program, benefit payments from employee pension plans would increase by 75 percent. Social security benefit payments would remain about the same, though social security's share of benefit payments would drop 13 percent.

The Commission has called for favorable tax treatment of voluntary employee contributions to employee pension plans. Combined with the MUPS proposal, tax incentives for voluntary employee contributions could provide a new mechanism for increasing personal savings for retirement.

By 2010, as the baby boom generation approaches retirement age, average benefits may be increased over 7 percent by the combination of the Commissions proposals. During the peak baby boom retirement period average benefits are predicted to be increased by about 25 percent.

Moreover, the Commission believes tax policy should treat all retirement saving in a more consistent manner. A uniform tax policy toward retirement saving would distribute more equitably the tax benefits of social security and would be a more rational approach to providing incentives for individual effort. Of course, some limitation would be needed on the total amount of income an individual could defer. This limitation should take into account vested benefits in pension plans, IRAs, Keoghs, stock bonus plans, and other forms of retirement saving.

The Commission's tax incentives for retirement saving come at a time when both the Administration and Congress are seeking ways to provide tax relief as well as increase savings and capital formation.

Using a 75 year forecasting model, the Commission has estimated the effects of its proposals. Estimates indicate that MUPS will increase savings by nearly $20 billion in 1985 and by $26 billion in 1990. Investment capital will increase by 2 to 3 percent in the early years of the program

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when all Commission proposals are in effect. Investment capital continues to increase by over 10 percent by the end of the forecast period.

Pension fund balances are predicted to increase an additional 13 to 15 percent for the duration of the forecase period. By 2040 Commission programs will add an additional $1 trillion (1981 dollars) to private pension fund accounts.

MUPS and Commission tax proposals combine to provide an initial boost to saving that is about $20 billion by 1981. The increase in investment in the initial years is about $3 billion or 40 percent greater than under the tax cut alone.

The Commission's tax cut of $30 billion alone would increase savings by only $.2 billion in the year 2000 and $3.2 billion by the year 2020. The Commission's full set of proposals would increase savings by $47 billion and $100 billion during those same years.

Table 3 shows the first year tax savings to businesses and individuals of all of the Commission's tax recommendations. In 1982, we estimate that our proposals would lead to a total tax reduction of approximately $30 billion. The tax reductions for individuals and businesses proposed by the Commission are specifically tied to programs to increase personal savings. By reducing business and personal taxes and increasing savings, the Commission's program offers the possibility of relieving some of the inflationary pressures that exist in the economy.

The Commission believes the tax system provides an appropriate means of encouraging individual retirement saving. However, current policies do not sufficiently encourage retirement savings for those in most need: low and moderate income wage-earners. And, workers who are participants in pension plans have no incentive under current tax laws to lessen the impact of inflation on their retirement income by supplementing employer contributions with their own.

New government policies are needed to provide greater incentives to all individuals to participate directly in providing for their own retirement income needs. Individual savings must be strengthened as a source of retirement income for all workers, regardless of income or form of savings. The Commission believes this direction for public policy is consistent with other national goals encouraging and supporting individual effort and strengthening the economy.

The Commission recognizes that a universal employee pension plan and savings incentives are, solutions primarily to long-term retirement income problems. Therefore, to alleviate interim problems until the balanced program is fully phased in, the Commission has recommended that the social security special minimum benefit be increased for long-service workers to enable them to meet the Commission's retirement income goals.

The special minimum benefit is the most efficient means in the social security system of ensuring a minimum income for those with long service, because it does not affect the regular benefit formula. The Commission feels that in this way additional benefits would be targeted to low-income,

Chart 4

ILLUSTRATIVE TAX SAVINGS TO INDIVIDUALS AND BUSINESSES IN 1982 (In Billions of 1982 Dollars)[1]

Commission Proposal	Tax Savings
1. Social Security Tax Deduction of	
Contributions[2]	$20.5
a) OASDI	5.1
b) HI	$25.6
2. Tax Incentives[3]	
(a) Tax Deductible Employee Contributions	$ 6
(b) Raise IRA and Keogh limits to Corporate Plan level	$ 4
3. Minimum Universal Pension System	
(a) Tax Deductible Employer Contributions	$ 1.7
(b) Extra Tax Credits to Business	$ 2.7
4. Move 1985 Social Security Payroll Tax Increase	-9.9
Net Tax Savings to Individuals and Businesses	$30.1

[1] These figures are intended to illustrate the probable impact of Commission recommendations. The exact values of these estimates are highly dependent on the details and the implementation of the specific proposals adopted.

[2] These figures include the effect of moving the 1985 scheduled OASDI tax increases to 1982. Without this move, the figures would be $19.4 billion for OASDI and $5.0 billion for HI. Inclusions of the Railroad Retirement System in these estimates would increase the figures by $0.7 billion in 1982.

[3] Assumes current utilization rates for first year of program.

Sources: Special Tabulations for the Commission by U.S. Department of the Treasury, 1980; Special Tabulations for the Commission by Office of the Actuary, Social Security Administration, 1981; Estimates by President's Commission on Pension Policy.

long-service workers without affecting benefits to short-career workers or to other beneficiaries with moderate-to-high earnings. Under the Commission's proposal, the special minimum would be integrated with the MUPS so that eventually, this program would be phased out.

The Commission further recommends federal SSI benefits be increased to the poverty level to ensure a minimally adequate level of income for those without significant work histories. The Commission recognizes that such individuals are unlikely to accrue significant work-related retirement income benefits. These individuals must rely on welfare and in-kind benefits.

Further, the Commission believes that in the vast majority of cases, need can be assessed through income tests alone and the current SSI assets test is undesirable. We recommend its elimination, thereby reducing administrative burdens as well as intrusions on individual recipients.

Public Employee Pensions

The Commission's recommendations are cross-cutting and equitable. Both public and private sector systems have been examined for their weaknesses and strengths. Yet, the Commission was repeatedly impressed that public sector retirees often receive more favorable treatment under their retirement income programs than do their private sector counterparts.

In addition to improving the availability of pension benefits to all workers, the Commission makes several recommendations to eliminate excessive benefits provided by public pension systems. The Commission believes that its recommendations for universal social security coverage, once-a-year cost of living adjustments for federal workers, and increases in the normal retirement age for public workers will ensure more equitable treatment of all workers by our retirement programs.

Administration

The Commission has taken a comprehensive approach in its analysis of the problems of retirement income security programs and its evaluation of options for addressing those problems. Continuation of this comprehensive approach is the key to the effective implementation of policy recommendations and to effective national policymaking in the area of retirement income security.

Therefore, the Commission has recommended consolidation of administration of all federal retirement systems; consolidation of ERISA administrative functions in one entity; an interdepartmental task force to coordinate executive branch programs dealing with retirement income, including federal plans; and new committees on retirement income security, one in the House and one in the Senate, which would consolidate jurisdiction over all types of retirement income programs, including federal programs.

Responsibility for retirement income policy and the administration of retirement income programs is scattered among dozens of federal agencies and congressional committees. The Congress and the Executive Branch are mirror images of fragmented jurisdictions as they initiate and implement retirement income policies and programs. Coordination is essential in both branches of government. Unless this fragmentation is addressed soon we will continue the piecemeal policymaking that has plagued retirement income policy in the past.

Conclusion

The Commission feels strongly that the problems it has identified must be addressed without delay. Major changes are necessary and it is still possible to make these changes on an incremental basis.

The Commission is extremely pleased with the large number of proposals already introduced in this Congress that address most of the areas of concern identified by the Commission.

While not all of the legislation is consistent with the Commission's recommendations, they seem to reflect an emerging consensus in Congress that a balanced retirement income system is necessary in this country. Taken as a whole, these bills would place greater public policy emphasis on the roles of employee pensions, individual savings and earnings as sources of income for older Americans.

The burden is now on this Subcommittee and all the others with jurisdiction over retirement income programs to begin the process coordinating the consideration of all of these bills. You can begin that process today by linking your consideration of retirement income policy with the review of tax reduction legislation that will soon be before the full Finance Committee in the Senate.

PENSION COVERAGE IN THE UNITED STATES

President's Commission On Pension Policy

Introduction

The President's Commission on Pension Policy has been charged with reviewing our nation's various retirement income systems in an effort to identify problems and to recommend solutions to the national policymakers.

During its two year life the Commission has undertaken a number of major research projects in an effort to document difficulties in the present system.

The Commission's final report indicated that expansion of pension plan participation was among its highest priorities. Commission research shows that eligibility for an employee pension, in addition to social security benefits, if often the difference between a marginal retirement income and an adequate standard of retirement living.

In addition, the Commission's final report expressed a desire to insure the actual delivery of pension benefits for workers who were pension plan participants through additional policy initiatives.

Anticipating a need to have the most current and comprehensive data available on pension plan coverage, the Commission initiated a major survey project in the Fall of 1979.[1/]

The Commission survey also found that even among full-time private sector workers aged 25 and over, pension benefit eligibility (vesting) was less than one-third of the total private work force.

1/ The President's Commission on Pension Policy, the Department of Labor, the Pension Benefit Guaranty Corporation, the Administration on Aging and the Social Security Administration sponsored a $1.2 million nationwide random survey and analysis of 6,100 households on retirement income issues. The first wave of the survey was conducted in October, 1979 by Market Facts, Inc. A follow-up survey on some questions with the same respondents was completed in October, 1980. Final survey analyses on the primary questions relating to the impact of social security, employer pensions and other forms of retirement income on personal savings behavior and capital formation was done by SRI International.

In 1979 the Department of Labor and the Social Security Administration sponsored a pension coverage supplement to the current population Survey conducted by the Bureau of the Census.[2/] The survey questions were comparable to those asked in the Commission survey.

In almost all respects the composition of the samples used by DOL/SSA and the Commission's household survey were the same with respect to age, sex, and work force characteristics. In almost all categories, the surveys' findings were comparable.

Therefore, the data from the DOL/SSA and the Commission's survey, concerning pension plan coverage and eligibility are considered to be extremely reliable as measures of pension coverage in the United States.

Tabulations of the Commission survey and the DOL/SSA survey are included in this report.

Pension Plan Coverage

It is important to carefully define terms used when determining pension plan coverage. The most frequently used definition of pension coverage means current participation in a pension or profit-sharing plan.

Using this definition, the Commission study found that 48 percent of all public and private sector workers are presently covered by some type of pension, profit-sharing or other retirement plan at their current job, as shows in table 1.

2/ "Survey of Pension Plan Coverage, 1979," DOL/SSA. This survey was based on a sampling of 27,253 workers, including 19,999 private sector employees aged 16 and over. A similar survey was sponsored by the two agencies in 1972.

Table 1

Pension Coverage Among Total Work Force

Age, Years on Job; Average Weekly Hours	Percent of All Workers[1]	Percentage Covered by Pensions		
		All Employees	Men	Women
Total	100%	48%	56%	39%
Under Age 25	24.2	29	34	23
Age 25 and Older	75.8	53	61	43
Less than one year on job	12.5	25	33	17
One or more years on job	63.3	61	68	51
-less than 1,000 hours/year	4.5	36	52	26
-1,000 hours/year or more	58.8	62	68	55

[1]These figures are based on an ICF analysis of May 1979 Current Population Survey data. Data in this table include private wage and salary workers and state and local government workers age 16 and over. This table does not include federal employees, the self-employed, unpaid family workers, or workers under the Railroad Retirement Board.

Source: Special Tabulations of Household Survey, President's Commission on Pension Policy, October 1980.

Fifty-six percent of all employed men and 39 percent of all employed women are covered by a pension plan, as shown in table 1. Among workers under age 25, 29 percent of the total work force is covered. Table 1 shows that among workers age 25 and older, 53 percent of the work force is covered. Among workers approaching retirement, age 55-64, coverage increases to 57 percent.

Chart I shows that across all age groups females are less likely to be participants than male workers.

Some suggest that it is more appropriate to describe pension coverage among those employees who currently meet plan participation standards set by the Employee Retirement Income Security Act (ERISA).[3/]

For the group of public and private sector workers meeting these ERISA criteria, 62 percent are already covered by a plan, as shown in table 1. It should be noted, however, that less than 60 percent of the public and private work force meets the ERISA criteria of age, service and hours-of-work with their employer.

The incidence of pension plan coverage among private sector workers is less than that of the total work force, according to the Commission survey. Total private pension plan coverage is 42 percent, as shown in table 2. For males, the figure is 51 percent. For female private sector workers, pension coverage is 32 percent, as shown in table 2. For the portion of the private sector work force meeting ERISA minimum age, service and hours-of-work standards, coverage increases to 58 percent, as shown in table 2.

The Commission's tabulations of the DOL/SSA survey in regard to pension plan coverage shows that income plays an important role.

Table 3 shows that pension coverage increases as income climbs.

Characteristics of Noncovered Workers

In 1979, over thirty-four and one-half million private sector workers were not covered by pension plans on their current jobs. It is generally recognized that younger, part-time, low-wage earners and workers employed by small businesses generally are not covered by pension plans. However, the data summarized in table 4 show that many of the noncovered are "mainstream," full-time workers, earning moderate incomes that place them in or near the middle of the earned income distribution.

[3/] ERISA does not require private sector employers to provide pension protection to workers who are under age 25, who work less than 1000 hours a year and who have less than one year of service with their companies. For purposes of the Commission's data, meeting ERISA participation standards was defined as over age 25, with one or more years of service and more than 1,000 hours of work annually with the employer.

TABLE II

PRIVATE PENSION PLAN COVERAGE

(active workers, both full-time, and part-time, excluding self-employed)

AGE, YEARS ON JOB, AVERAGE WEEKLY HOURS	PRESIDENT'S COMMISSION ON PENSION POLICY HOUSEHOLD SURVEY 1979			DOL/SSA CURRENT POPULATION SURVEY		
	PERCENTAGE					
	ALL EMPLOYEES	MALE	FEMALE	ALL EMPLOYEES	MALE	FEMALE
TOTAL	42	51	32	43	50	31
UNDER AGE 25	27	33	20	19	22	15
AGE 25 AND OVER	47	56	36	52	60	38
ERISA STANDARDS (more than 1 year of service + 1000 hours)	58	64	48	61	67	50

Source: President's Commission on Pension Policy

Table 3

The Percentage of Workers Covered By Pension Plans, 1979 by Income

Annual Earnings	Covered
Less than $5,000	12%
$5,000-7,500	31%
$7,500-10,000	45%
$10,000-12,500	55%
$12,500-15,000	63%
$15,000-20,000	69%
$20,000-25,000	73%
Greater than $25,000	73%
Total	48%

Source: Special Tabulations of DOL/SSA data.

TABLE IV

WHICH WORKERS ARE NOT COVERED BY PENSION PLANS?

In 1979, 49.4 million workers were not covered by a pension plan:

- o 54% of these were men, 46% were women
- o 71% of them worked full time, 29% part-time
- o 68% were over age 25 and 51% of noncovered were over 25 and have one or more years of service with their employer
- o 8.2 million are employed in the public sector
- o 38.1 million are wage and salary workers in the private sector

Of private sector noncovered wage and salary workers:

- o 77.9% worked in three main industries;
  - o 31.9% from trade
  - o 27.7% from service
  - o 18.3% from manufacturing
- o 29.9% earned less than $5,000 in 1978
- o 36.4% earned between $5,000 and $10,000 in 1978
- o 19.2% earned between $10,000 and $15,000 in 1978
- o 14.6% earned over $15,000 in 1978
- o 79.0% were in firms with fewer than 100 employees
- o 7.5% were in firms with 500 or more employees
- o Approximately 90% were not members of union

Source: ICF, Inc., Analysis of May, 1979 Current Population Survey Data; President's Commission on Pension Policy staff estimates. These numbers included imputed values.

Over half, 54 percent, of these noncovered workers are men, and 71 percent of the noncovered worked full-time. Whilemost part-time workers are not covered by pension plans, part-time employment comprises a small part of the total job market. While pension coverage among young workers is very low, approximately 68 percent of the non covered population is over the age of 25.

Nearly all, 90 percent, of the noncovered are not union members.

Many noncovered workers are employed by small firms. Nearly 79 percent of the noncovered work in establishments employing fewer than 100 workers.

Statistics show a large portion of the noncovered workers earn incomes that place them in or near the middle of the earned income distribution. Nearly thirty percent of the noncovered earned below $5,000 in 1978. Approximately 36 of the noncovered earned between $5,000 and $10,000, and 19 percent earned bewteen $10,000 and $20,000 in that year. Median earned income in 1978 was approximately $10,500 in the private sector work force.

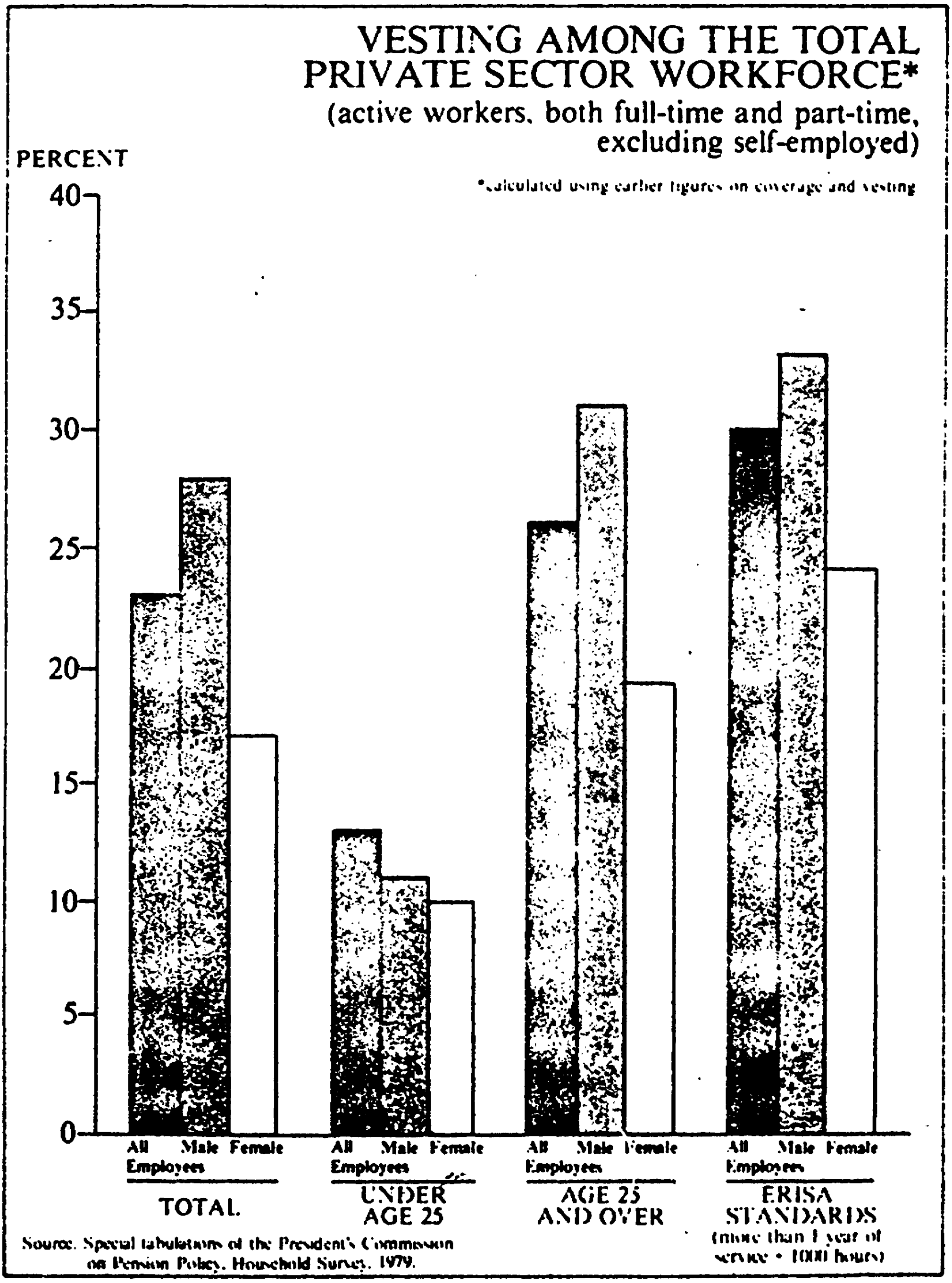
Pension Plan Vesting

Even though a person may be a participant in a pension plan, he or she may not be actually entitled to receive a benefit upon retirement. Pensin plans often require participants to be covered by the Plan for a number of years before they are considered "vested", i.e. entitled to receive benefits.

The Commission survey found that of the total public and private working population over the age of 18, only 25 percent are vested in a pension plan provided by their current employment. This figure increases with each age cohort, equaling 32 percent for those 35 and older and 37 percent for those 55 and older.

Again, among the total work force, men are more likely to be vested than women. And, younger workers are less likely to be vested than older workers. (see chart 1)

CHART I


VESTING AMONG THE TOTAL
PRIVATE SECTOR WORKFORCE*
(active workers, both full-time and part-time,
excluding self-employed)
*calculated using earlier figures on coverage and vesting
PERCENT
40
35
30
25
20
15
10
5
0
All Employees
Male
Female
TOTAL
UNDER AGE 25
AGE 25 AND OVER
ERISA STANDARDS
(more than 1 year of service • 1000 hours)
Source: Special tabulations of the President's Commission on Pension Policy, Household Survey, 1979.

Twenty-three percent of all private sector workers are currently eligible for a pension with their current employer. Twenty-eight percent of all male workers in private industry and 17 percent of all femal workers in the private sector are vested. Thirteen percent of all private sector workers under age 25 are vested. Among workers over 25 vesting increases to 26 percent. Among workers over 25 meeting ERISA standards, vesting is further increased to 30 percent. (see chart 1)

Redefining Pension Coverage Data

One of the problems with surveys such as those discussed in this report is that some people either do not know their pension participation status or they refuse to answer the questions when asked.

These "refusals" or "don't knows" are either included or excluded from the coverage statistics reported from the surveys. The Commission staff sought to rectify this problem by contracting with ICF Inc. to develop an imputation methodology for these missing values in the DOL/SSA 1979 Current Population Survey.

ICF employed standard regression techniques to assign survey nonrespondents to either the "participant" or "non-participant" categories. In general, this methodology increased the estimated figures only slightly. Thorough documentation of this procedure will be included in the Commission technical appendix to its final report.

The results of this effort are reported in Tables 5-~~28~~24 of this report. In addition to including imputed values these tables show, for the first time in such surveys, pension plan participation by families as well as by individual worker.

Tables 5-12 show participation, and vesting figures for all workers, by age, sex, industry, income hours worked and years of service.

With the imputations pension coverage for all workers over the age of 16 is 45 percent for the private sector and 48 percent for all workers. Pension plan participation increases to 54 percent for private sector workers ages 25-64.

Tables 7-9 show that pension participation is highly correlated with the income and sex of the worker.

Table 12 shows how pension coverage is also correlated to the size of the workplace. While pension coverage is very low for private sector workers employed by small establishments (24 percent are participants), about 78 percent of those employed at establishments with 50 or more workers are participants in plans.

Tables 13 and 14 show participation rates for so-called "full-time, full-year" workers. In this table, these workers are defined as those who usually work 35 or more hours per week and 48 or more weeks per year. These figures show that 54 percent of all private sector full-time, full-year workers are participants in pension plans and 59 percent of these public and private workers are participants in plans. Table 14 shows that 31 percent of private sector full-time full-year workers are vested in their plan.

Tables 15-20 show estimates of pension coverage and vesting by marital status. As Table 15 illustrates, married couples tend to have higher pension coverage than non-married individuals. However, among only 29 percent of married two-worker couples do both workers have pension coverage; 23 percent of the two-workers couples have one worker as a participant. In all, 52 percent of all (privately and publicly employed) couples have some form of pension coverage. Only 36 percent of non-married individuals are participants in a plan.

Vesting also varies by marital status. Only 14 percent of two-worker married couples have both workers vested in a plan, while 19 percent have one worker vested. Overall, 26 percent of married couples have some (one or two workers) vested entitlement, while only 19 percent of all non-married individuals are vested.

Tables 21-26 illustrate in detail the characteristics of noncovered workers that were summarized in Table 1.

Myths About Pension Coverage

In the past two years several industry lobbying groupos have asserted, in testimony before the President's Commission on Pension Policy and elsewhere that the "correct" pension coverage figure to use is 70 percent of the workforce rather than the 45 percent to 60 percent figures contained in most of the Commission's written material. The fact is that there is no "correct number to use when discussing pension coverage. The appropriateness of the figures used depends on the issue being discussed.

The authors of the 70 percent coverage figures have chosen to select only a portion of the working population for their analysis. Generally, these authors use phrases such as "full-time workers over the age of 25 who could reasonably expect to receive a pension" or "full-time public and private sector workers who meet ERISA standards" to describe the populations.

The figures from the DOL/SSA survey (modified to include imputed values) indicate the following coverage figures for private sector workers between 25 and 64 years of age.

	Participation Rate
Private wage age salary workers age 25-64, excluding self-employed.	54%
Private self-employed workers age 25-64	15%
Total private wage and salary workers age 25-64	50%

If the group of private sector workers is limited to "full-time, full-year workers" (defined as those who usually work 35 or more hours per week and 48 or more weeks per year) the figures are as follows:

"Full-time Full-year Workers"	Participation Rate
Private wage and salary age 25-64, excluding self-employed	60%
Private self-employed workers age 25-64	22%
TOTAL	56%

The above figures are still significantly different than the sometimes quoted 70 percent number. Some trade groups, such as the Employee Benefits Research Institute (EBRI) and the ERISA Industry Committee (ERIC) sometimes exclude agricultural workers (even those who are full-time, full-year workers) from their analysis. While this exclusion of millions of agricultural wage and salary workers may be appropriate for an industry group concerned about how public policy affects non-agricultural businesses, it is inappropriate for policy discussions concerned with the welfare of the entire noncovered work population.

Forecasting Future Coverage

Snapshot surveys, while limited by themselves, can be used along with labor force and pension forecasting models to predict the likelihood of pension coverage and benefit receipt in the future.

The Commission/DOL forecasting models indicate that the proportion of the labor force covered and vested in employee pension plans is not expected to increase significantly under current policies. Preliminary forecasting results predict an increase of less than three percentage points in the proportion of the labor force covered by employee pension plans and a growth of only two percentage points in the proportion of the labor force vested in employee pension plans by the year 1990.

This near stagnation of coverage and vesting growth--less than .3 percentage points and .2 percentage points annual growth respectively--is due to several factors. Pension plan growth is predicted in those industries, such as manufacturing and transportation, where coverage is already high, as shown in table 5. Most economic forecasts, however, predict that these industries will have a declining share of the labor force in the future. Instead, low pension coverage industries, such as trade and services, are predicted to grow in the future.

Conclusion

A comparison of the coverage and vesting figures for the overall work force vs. the private sector finds that private industry workers are less likely to be pension plan participants than are public sector workers. This is due to increased pension plan participation among government workers at the federal and the state/local levels.

The Commission's findings also illustrate that other "coverage" criteria, using alternative definitions, do not significantly increase private sector coverage figures.

The data illustrates the importance that the Commission has placed on extending pension coverage to more workers. With less than half of the private sector workforce covered by a pension plan through their current employer and less than a quarter of all private industry workers vested, the Commission has proposed the establishment of a mandatory pension plan for all workers.

TABLE 5

THE PERCENTAGE OF ALL WORKERS PARTICIPATING
IN PENSION PLANS, BY AGE GROUP AND INDUSTRY, 1979

	Age Group				
Group of Workers	20-64	25-64	35-64	45-64	16 and Over
Mining	72%	76%	84%	82%	71%
Construction	39%	45%	48%	49%	37%
Manufacturing	69%	73%	75%	77%	66%
Transportation	67%	70%	72%	72%	66%
Trade	36%	41%	42%	41%	30%
Finance	52%	57%	58%	56%	50%
Services	33%	36%	38%	38%	30%
Agriculture	17%	20%	23%	22%	14%
Subtotal Private, Wage and Salary	50%	54%	57%	58%	45%
State and Local Government	80%	83%	84%	83%	77%
Federal Government	89%	91%	94%	95%	87%
Subtotal Public, Wage and Salary	82%	85%	86%	86%	79%
Self Employed Workers	14%	15%	17%	20%	13%
Total	52%	56%	500	58%	48%

Source: ICF analysis of May 1979 CPS data.

TABLE 6

THE PERCENTAGE OF ALL WORKERS VESTED IN PENSION PLANS, BY AGE GROUP AND INDUSTRY, 1979 1/

Group of Workers	Age Group 20-64	25-64	35-64	45-64	16 and Over
Mining	42%	49%	63%	68%	40%
Construction	27%	33%	41%	44%	25%
Manufacturing	37%	42%	51%	58%	36%
Transportation	46%	50%	61%	67%	44%
Trade	21%	25%	31%	33%	17%
Finance	29%	34%	42%	46%	28%
Services	20%	24%	29%	31%	19%
Agriculture	13%	16%	19%	18%	10%
Subtotal Private, Wage and Salary	29%	34%	42%	46%	26%
State and Local Government	59%	62%	69%	72%	56%
Federal Government	75%	78%	85%	89%	73%
Subtotal Public, Wage and Salary	62%	65%	73%	76%	60%
Self Employed Workers	14%	15%	17%	20%	13%
Total	33%	38%	45%	48%	30%

Source: ICF analysis of May 1979 CPS data.

TABLE 7

THE PERCENTAGE OF ALL WORKERS PARTICIPATING IN PENSION PLANS, BY HOURLY WAGE CATEGORY AND INDUSTRY, 1979

Group of Workers	Hourly Wage Category: Less Than $4.00	$4.00-7.00	$7.01 or More	Total
Mining	34%	59%	82%	71%
Construction	13%	17%	62%	37%
Manufacturing	35%	65%	85%	66%
Transportation	30%	60%	78%	66%
Trade	13%	37%	61%	30%
Finance	32%	51%	64%	50%
Services	16%	34%	50%	30%
Agriculture	8%	18%	43%	14%
Subtotal Private, Wage and Salary	19%	47%	71%	45%
State and Local Government	52%	82%	93%	77%
Federal Government	49%	82%	96%	87%
Subtotal Public, Wage and Salary	52%	82%	93%	79%
Self Employed Workers	9%	13%	20%	13%
Total	22%	49%	72%	48%

Source: ICF analysis of May 1979 CPS data.

TABLE 8

THE PERCENTAGE OF ALL WORKERS PARTICIPATING IN PENSION PLANS, BY ANNUAL EARNINGS AND INDUSTRY, 1979

Group of Workers	Annual Earnings in 1978: Less Than $5,000	$5,000-$10,000	$10,001-$15,000	$15,001-$25,000	$25,000 Or More	Total
Mining	11%	58%	67%	79%	81%	71%
Construction	13%	17%	27%	57%	73%	37%
Manufacturing	20%	46%	70%	84%	87%	66%
Transportation	24%	45%	65%	78%	79%	66%
Trade	8%	24%	44%	58%	68%	30%
Finance	13%	44%	57%	61%	77%	50%
Services	8%	29%	41%	51%	60%	30%
Agriculture	5%	12%	28%	46%	23%	14%
Subtotal Private, Wage and Salary	10%	33%	55%	71%	76%	45%
State and Local Government	36%	76%	91%	93%	96%	77%
Federal Government	32%	66%	89%	97%	98%	87%
Subtotal Public, Wage and Salary	35%	75%	90%	94%	97%	79%
Self Employed Workers	4%	12%	16%	21%	18%	13%
Total	13%	38%	59%	70%	73%	48%

Source: ICP analysis of May 1979 CPS data.

TABLE 9

THE PERCENTAGE OF ALL WORKERS PARTICIPATING IN PENSION PLANS BY SEX, AGE GROUP, AND ANNUAL EARNINGS, 1979

	Annual Earnings in 1978					
Sex and Age Group	Less Than $5,000	$5,000- $10,000	$10,001- $15,000	$15,001- $25,000	$25,000 Or More	Total
Male						
Less than 20	4%	13%	19%	37%	47%	8%
20-24	11%	25%	41%	58%	41%	34%
25-34	15%	39%	56%	69%	68%	57%
35-44	20%	37%	59%	73%	74%	63%
45-54	27%	41%	60%	72%	74%	63%
55-64	23%	42%	66%	74%	80%	63%
65 or More	12%	27%	39%	36%	53%	22%
Subtotal	11%	33%	55%	70%	72%	53%
Female						
Less than 20	2%	17%	31%	19%	NA	7%
20-24	9%	31%	49%	58%	49%	29%
25-34	13%	43%	66%	69%	76%	46%
35-44	19%	45%	71%	74%	84%	48%
45-54	21%	50%	72%	80%	93%	51%
55-64	21%	49%	70%	82%	67%	48%
65 or More	15%	31%	63%	45%	100%	23%
Subtotal	13%	41%	66%	73%	79%	41%
Total	13%	38%	59%	71%	73%	48%

Source: ICF analysis of May 1979 CPS data.

TABLE 10

THE PERCENTAGE OF ALL WORKERS PARTICIPATING IN PENSION PLANS, BY HOURS WORKED ANNUALLY AND INDUSTRY, 1979

	Hours Worked Annually				
Group of Workers	Less Than 500	500-999	1,000-1,499	1,500 or More	Total
Mining	26%	15%	52%	76%	72%
Construction	12%	17%	35%	39%	37%
Manufacturing	20%	20%	34%	68%	66%
Transportation	23%	38%	51%	68%	66%
Trade	7%	9%	12%	37%	30%
Finance	8%	12%	15%	54%	50%
Services	6%	7%	18%	38%	30%
Agriculture	0%	3%	2%	20%	14%
Subtotal Private, Wage and Salary	8%	10%	20%	52%	45%
State and Local	18%	36%	65%	87%	77%
Federal	18%	35%	54%	91%	87%
Subtotal Public, Wage and Salary	18%	36%	65%	88%	79%
Self Employed	1%	5%	9%	17%	14%
Total	8%	14%	27%	55%	48%

Source: ICF analysis of May 1979 CPS data.

TABLE 11

THE PERCENTAGE OF ALL WORKERS PARTICIPATING IN PENSION PLANS, BY YEARS OF SERVICE ON CURRENT JOB AND INDUSTRY, 1979

	Years of Service on Current Job						
Group of Workers	Less Than 1	1-2	3-5	6-10	11-15	16 or More	Total
Mining	43%	67%	76%	88%	89%	92%	72%
Construction	22%	36%	37%	47%	62%	66%	37%
Manufacturing	36%	51%	63%	78%	87%	90%	66%
Transportation	33%	50%	60%	79%	85%	84%	66%
Trade	12%	22%	37%	52%	56%	61%	30%
Finance	25%	37%	54%	69%	73%	76%	50%
Services	13%	23%	36%	46%	58%	54%	30%
Agriculture	6%	9%	11%	23%	30%	32%	14%
Subtotal Private, Wage and Salary	20%	33%	46%	63%	74%	77%	45%
State and Local	47%	65%	78%	90%	91%	95%	77%
Federal	48%	81%	83%	94%	98%	97%	87%
Subtotal Public, Wage and Salary	47%	68%	79%	91%	92%	96%	79%
Self Employed	4%	6%	12%	17%	21%	20%	14%
Total	22%	36%	49%	65%	73%	71%	48%

Source: ICF analysis of May 1979 CPS data.

TABLE 12

THE PERCENTAGE OF ALL WORKERS PARTICIPATING IN PENSION PLANS, BY SIZE OF ESTABLISEMENT AND INDUSTRY, 1979

	Size of Establishment					
Group of Workers	Less Than 25	25-99	100-499	500 or More	Not Asked	Total
Mining	48%	62%	81%	92%	NA	72%
Construction	29%	47%	62%	69%	NA	37%
Manufacturing	33%	48%	67%	85%	NA	66%
Transportation	46%	71%	72%	80%	NA	66%
Trade	20%	36%	49%	66%	NA	30%
Finance	34%	59%	64%	71%	NA	50%
Services	17%	32%	46%	57%	NA	30%
Agriculture	9%	28%	44%	45%	NA	14%
Subtotal Private, Wage and Salary	24%	44%	61%	78%	NA	45%
State and Local	69%	81%	81%	77%	NA	77%
Federal	69%	87%	93%	94%	NA	87%
Subtotal Public, Wage and Salary	69%	82%	83%	84%	NA	79%
Self Employed	NA	NA	NA	NA	14%	14%
Total	29%	53%	65%	79%	14%	48%

NA: Data not available.

Source: ICF analysis of May 1979 CPS data.

TABLE 13

THE PERCENTAGE OF ALL FULL TIME, FULL YEAR WORKERS PARTICIPATING IN PENSION PLANS, BY AGE GROUP AND INDUSTRY, 1979[1/]

Group of Workers	Age Group 20-64	25-64	35-64	45-64	16 and Over
Mining	75%	77%	87%	88%	75%
Construction	40%	47%	50%	50%	39%
Manufacturing	71%	75%	78%	80%	69%
Transportation	71%	74%	77%	79%	70%
Trade	41%	46%	47%	48%	39%
Finance	57%	62%	64%	62%	56%
Services	40%	44%	48%	50%	39%
Agriculture	23%	27%	29%	30%	20%
Subtotal Private, Wage and Salary	56%	60%	64%	65%	54%
State and Local Government	87%	88%	90%	89%	86%
Federal Government	93%	95%	97%	98%	93%
Subtotal Public, Wage and Salary	88%	90%	92%	91%	88%
Self Employed Workers	21%	22%	24%	22%	22%
Total	61%	66%	69%	70%	59%

1/ Full time, full year workers are those who usually work 35 or more hours per week and 48 or more weeks per year.

Source: ICF analysis of May 1979 CPS data.

TABLE 14

THE PERCENTAGE OF ALL FULL TIME, FULL YEAR WORKERS VESTED IN PENSION PLANS, BY AGE GROUP AND INDUSTRY, 1979[1/]

Group of Workers	Age Group 20-64	25-64	35-64	45-64	16 and Over
Mining	44%	51%	66%	72%	43%
Construction	29%	35%	44%	47%	28%
Manufacturing	39%	44%	54%	60%	38%
Transportation	49%	54%	66%	73%	49%
Trade	24%	28%	36%	38%	22%
Finance	32%	37%	47%	51%	31%
Services	25%	29%	37%	40%	24%
Agriculture	18%	23%	27%	27%	16%
Subtotal Private, Wage and Salary	33%	38%	47%	52%	31%
State and Local Government	63%	66%	74%	77%	62%
Federal Government	78%	81%	88%	92%	78%
Subtotal Public, Wage and Salary	67%	70%	78%	81%	66%
Self Employed Workers	21%	22%	24%	22%	22%
Total	38%	44%	53%	58%	37%

1/ Full time, full year workers are those who usually work 35 or more hours per week and 48 or more weeks per year.

Source: ICF analysis of May 1979 CPS data.

TABLE 15

THE PERCENTAGE OF INDIVIDUALS PARTICIPATING IN PENSION PLANS BY MARITAL STATUS, 1979

Marital Status	Percentage Participating in: No Plan	1 Plan	2 Plans	Total
Non-Married Individuals				
Male	65%	35%	NA	100%
Female	64%	36%	NA	100%
Subtotal	64%	36%	NA	100%
Married Couples				
2 Workers	49%	23%	29%	100%
1 Worker	47%	53%	NA	100%
Subtotal	48%	34%	18%	100%
All Individuals	54%	35%	12%	100%

Source: ICF analysis of May 1979 CPS data.

TABLE 16

THE PERCENTAGE OF INDIVIDUALS VESTED IN PENSION PLANS, BY MARITAL STATUS, 1979

Marital Status	Percentage Vested in: No Plan	1 Plan	2 Plans	Total
Non-Married Individuals				
Male	82%	18%	NA	100%
Female	79%	21%	NA	100%
Subtotal	81%	19%	NA	100%
Married Couples				
2 Workers	67%	19%	14%	100%
1 Worker	63%	37%	NA	100%
Subtotal	66%	26%	9%	100%
All Individuals	71%	23%	6%	100%

Source: ICP analysis of May 1979 CPS data.

TABLE 17

THE PERCENTAGE OF INDIVIDUALS PARTICIPATING IN PENSION PLANS, BY MARITAL STATUS AND AGE, 1979

Marital Status by Age of Primary Earner	Percentage Participating in: No Plan	1 Plan	2 Plans	Total
Non-Married Individuals				
Male				
Less than 25	81%	19%	NA	100%
25-34	51%	49%	NA	100%
35-44	42%	58%	NA	100%
45-54 More	39%	61%	NA	100%
55-64	41%	59%	NA	100%
65 or More	85%	15%	NA	100%
Subtotal	65%	35%	NA	100%
Female				
Less than 25	83%	17%	NA	100%
25-34	51%	49%	NA	100%
35-44	48%	52%	NA	100%
45-54	42%	58%	NA	100%
55-64	47%	53%	NA	100%
65 or More	75%	25%	NA	100%
Subtotal	64%	36%	NA	100%
Subtotal				
Less than 25	82%	18%	NA	100%
25-34	51%	49%	NA	100%
35-44	45%	55%	NA	100%
45-54	41%	59%	NA	100%
55-64	45%	55%	NA	100%
65 or More	78%	22%	NA	100%
Subtotal	64%	36%	NA	100%
Married Couples with One or More Earners				
Less than 25	64%	26%	10%	100%
25-34	46%	35%	19%	100%
35-44	44%	34%	22%	100%
45-54	45%	34%	21%	100%
55-64	46%	39%	15%	100%
65 or More	78%	16%	6%	100%
Subtotal	48%	34%	18%	100%

Source: ICF analysis of May 1979 CPS data.

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TABLE 18

THE PERCENTAGE OF INDIVIDUALS VESTED IN PENSION PLANS, BY MARITAL STATUS AND AGE, 1979

Marital Status by Age of Primary Earner	Percentage Vested in: No Plan	1 Plan	2 Plans	Total
Non-Married Individuals				
Male				
Less than 25	95%	5%	NA	100%
25-34	78%	22%	NA	100%
35-44	59%	41%	NA	100%
45-54	50%	50%	NA	100%
55-64	50%	50%	NA	100%
65 or More	90%	10%	NA	100%
Subtotal	82%	18%	NA	100%
Female				
Less than 25	95%	5%	NA	100%
25-34	76%	24%	NA	100%
35-44	67%	33%	NA	100%
45-54	60%	40%	NA	100%
55-64	56%	44%	NA	100%
65 or More	78%	22%	NA	100%
Subtotal	79%	21%	NA	100%
Subtotal				
Less than 25	95%	5%	NA	100%
25-34	77%	23%	NA	100%
35-44	64%	37%	NA	100%
45-54	56%	44%	NA	100%
55-64	55%	46%	NA	100%
65 or More	81%	19%	NA	100%
Subtotal	81%	19%	NA	100%
Married with One or More Earners				
Less than 25	88%	9%	2%	100%
25-34	74%	20%	5%	100%
35-44	62%	28%	10%	100%
45-54	56%	31%	13%	100%
55-64	54%	35%	11%	100%
65 or More	80%	16%	4%	100%
Subtotal	66%	26%	9%	100%

Source: ICF analysis of May 1979 CPS data.

TABLE 19

THE PERCENTAGE OF INDIVIDUALS PARTICIPATING IN PENSION PLANS, BY MARITAL STATUS AND FAMILY INCOME, 1979

Family Income	Percentage Participating in: No Plan	1 Plan	2 Plans	Total
Non-Married Individuals				
Less than $5,000	82%	18%	NA	100%
$5,000-9,999	66%	34%	NA	100%
$10,000-14,999	54%	46%	NA	100%
$15,000-19,999	57%	43%	NA	100%
$20,000-24,999	61%	39%	NA	100%
$25,000 or More	69%	31%	NA	100%
Total	64%	36%	NA	100%
Married Couples with One or More Employed				
Less than $5,000	84%	14%	1%	100%
$5,000-9,999	73%	23%	2%	100%
$10,000-14,999	60%	33%	6%	100%
$15,000-19,999	46%	40%	10%	100%
$20,000-24,999	39%	38%	18%	100%
$25,000 or More	36%	33%	24%	100%
Total	48%	34%	14%	100%

Source: ICP analysis of May 1979 CPS data.

TABLE 20

THE PERCENTAGE OF INDIVIDUALS VESTED IN PENSION PLANS, BY MARITAL STATUS AND FAMILY INCOME, 1979

Family Income	Percentage Vested in: No Plan	1 Plan	2 Plans	Total
Non-Married Individuals				
Less than $5,000	92%	8%	NA	100%
$5,000-9,999	83%	17%	NA	100%
$10,000-14,999	74%	26%	NA	100%
$15,000-19,999	75%	25%	NA	100%
$20,000-24,999	78%	22%	NA	100%
$25,000 or More	84%	16%	NA	100%
Subtotal	81%	19%	NA	100%
Married Couples with One or More Employed				
Less than $5,000	93%	7%	0%	100%
$5,000-9,999	87%	12%	1%	100%
$10,000-14,999	78%	20%	3%	100%
$15,000-19,999	67%	28%	5%	100%
$20,000-24,999	60%	30%	10%	100%
$25,000 or More	53%	30%	17%	100%
Total	66%	26%	9%	100%

1/ Vested wage and salary workers are those who would receive some benefits from their pension or retirement plan if they left their employer. For the self employed, all workers currently contributing to a Keogh plan are considered to be vested.

Source: ICF analysis of May 1979 CPS data.

TABLE 21

CHARACTERISTICS OF NON-PARTICIPATING WORKERS
BY INDUSTRY, AGE, AND WORKFORCE STATUS, 1979
(As Percent of All Non-Participating Workers)

	Age and Workforce Status					
	Less Than Age 25		Age 25 or Older and:			
Group of Workers	Full-Time	Part-Time	Full-Time	Part-Time	Subtotal	Total
Mining	*	*	*	*	*	0.5%
Construction	1.8%	*	3.1%	*	3.5%	5.7%
Manufacturing	4.2%	0.6%	8.5%	0.8%	9.2%	14.1%
Transportation	0.7%	*	2.3%	*	2.5%	3.4%
Trade	5.7%	5.8%	9.4%	3.5%	13.1%	24.5%
Finance	1.3%	*	2.6%	0.7%	3.3%	4.8%
Services	3.5%	2.9%	9.6%	5.4%	15.1%	21.4%
Agriculture	0.8%	*	1.3%	*	1.6%	2.7%
Subtotal Private, Wage and Salary	18.1%	10.4%	37.1%	11.4%	48.6%	77.2%
State and Local Government	0.8%	1.1%	2.1%	1.7%	3.7%	5.6%
Federal Government	*	*	*	*	0.5%	0.8%
Subtotal Public, Wage and Salary	1.0%	1.2%	2.4%	1.8%	4.2%	6.4%
Self Employed Workers	0.7%	*	11.3%	4.1%	15.4%	16.5%
Total	19.8%	12.0%	50.9%	17.3%	68.2%	100.0%

* Indicates less than 0.5 percent.

Source: ICF analysis of May 1979 CPS data.

TABLE 22

CHARACTERISTICS OF NON-PARTICIPATING WORKERS
BY INDUSTRY, AGE, AND YEARS OF SERVICE ON CURRENT JOB, 1979
(As Percent of All Non-Participating Workers)

	Age and Years on Current Job					
	Less Than Age 25		Age 25 Or Older and:			
Group of Workers	Less Than One Year	One Or More Years	Less Than One Year	One Or More Years	Subtotal	Total
Mining	*	*	*	*	*	0.5%
Construction	1.3%	0.9%	1.1%	2.5%	3.5%	5.7%
Manufacturing	2.6%	2.2%	2.4%	6.9%	9.2%	14.1%
Transportation	*	*	0.6%	1.9%	2.5%	3.4%
Trade	6.8%	4.8%	3.5%	9.4%	13.1%	24.5%
Finance	0.7%	0.8%	1.0%	2.3%	3.3%	4.8%
Services	3.6%	2.8%	4.4%	10.6%	15.1%	21.4%
Agriculture	*	0.7%	*	1.2%	1.6%	2.7%
Subtotal Private, Wage and Salary	16.0%	12.6%	13.5%	35.1%	48.6%	77.2%
State and Local Government	1.1%	0.8%	1.1%	2.7%	3.7%	5.6%
Federal Government	*	*	*	*	0.5%	0.8%
Subtotal Public, Wage and Salary	1.2%	0.9%	1.2%	3.0%	4.2%	6.4%
Self Employed Workers	*	0.7%	2.0%	13.4%	15.4%	16.5%
Total	17.6%	14.2%	16.8%	51.5%	68.2%	100.0%

* Indicates less than 0.5 percent.

Source: ICP analysis of May 1979 CPS data.

TABLE 23

CHARACTERISTICS OF NON-PARTICIPATING WORKERS
BY INDUSTRY AND ESTABLISHMENT SIZE, 1979
(As Percent of Non-Participating Workers)

Group of Workers	Establishment Size (No. of Employees) Less Than 25	25-99	100-499	500 Or More	Total
Mining	*	*	*	*	0.5%
Construction	4.4%	0.9%	*	*	5.7%
Manufacturing	3.4%	4.0%	4.3%	2.4%	14.1%
Transportation	1.5%	0.8%	0.8%	*	3.4%
Trade	15.7%	6.3%	2.2%	*	24.5%
Finance	3.0%	0.9%	0.5%	*	4.8%
Services	13.5%	3.5%	2.4%	2.0%	21.4%
Agriculture	2.2%	*	*	*	2.7%
Subtotal Private, Wage and Salary	43.9%	16.9%	10.6%	5.6%	77.2%
State and Local Government	2.1%	1.7%	1.0%	0.8%	5.6%
Federal Government	*	*	*	*	0.8%
Subtotal Public, Wage and Salary	2.6%	1.8%	1.1%	0.9%	6.4%
Self Employed Workers	NA	NA	NA	NA	16.5%
Total	46.5%	18.7%	11.7%	6.6%	100.0%

* Indicates less than 0.5 percent.

Source: ICP analysis of May 1979 CPS data.

TABLE 24

THE DISTRIBUTION OF NON-PARTICIPATING WORKERS
BY INDUSTRY AND HOURLY WAGE LEVEL, 1979

Group of Workers	Hourly Wage Level: $3.50 Or Less	$3.51-7.00	$7.01 Or More	Total
Mining	*	*	*	0.5%
Construction	0.7%	3.4%	1.6%	5.7%
Manufacturing	4.2%	7.5%	2.4%	14.1%
Transportation	0.7%	1.6%	1.2%	3.4%
Trade	13.3%	8.6%	2.6%	24.5%
Finance	1.3%	2.6%	1.0%	4.8%
Services	9.0%	9.1%	3.3%	21.4%
Agriculture	1.4%	1.1%	*	2.7%
Subtotal Private, Wage and Salary	30.7%	34.1%	12.3%	77.2%
State and Local Government	2.5%	2.4%	0.6%	5.6%
Federal Government	*	*	*	0.8%
Subtotal Public, Wage and Salary	2.8%	2.9%	0.8%	6.4%
Self Employed Workers	4.0%	8.7%	3.7%	16.5%
Total	37.5%	45.7%	16.8%	100.0%

* Indicates less than 0.5 percent.

Source: ICF analysis of May 1979 CPS data.

TABLE 25

THE DISTRIBUTION OF NON-PARTICIPATING
WORKERS BY INDUSTRY AND ANNUAL EARNINGS, 1979

Group of Workers	Annual Earnings in 1978: Less Than $5,000	$5,000-$10,000	$10,001-$15,000	$15,001-$25,000	$25,000 Or More	Total
Mining	*	*	*	*	*	0.5
Construction	0.8%	1.8%	1.7%	1.2%	*	5.7%
Manufacturing	1.7%	6.4%	3.7%	1.9%	*	14.1%
Transportation	0.5%	1.0%	0.9%	0.9%	*	3.4%
Trade	9.9%	8.6%	3.4%	2.1%	0.5%	24.5%
Finance	0.9%	2.0%	1.1%	0.7%	*	4.8%
Services	8.1%	7.3%	3.4%	1.9%	0.7%	21.4%
Agriculture	1.1%	1.0%	*	*	*	2.7%
Subtotal Private, Wage and Salary	23.1%	28.1%	14.7%	9.0%	2.3%	77.2%
State and Local Government	2.8%	1.7%	0.7%	*	*	5.6%
Federal Government	*	*	*	*	*	0.8%
Subtotal Public, Wage and Salary	3.1%	2.0%	0.8%	*	*	6.4%
Self Employed Workers	4.2%	4.1%	3.2%	3.6%	1.4%	16.5%
Total	30.3%	34.2%	18.7%	13.0%	3.8%	100.0%

* Indicates less than 0.5 percent.

Source: ICP analysis of May 1979 CPS data.

TABLE 26

THE DISTRIBUTION OF NON-PARTICIPATING WORKERS
BY AGE GROUP, SEX, AND ANNUAL EARNINGS, 1979

Sex and Age Group	Annual Earnings in 1978: Less Than $5,000	$5,000-$10,000	$10,001-$15,000	$15,001-$25,000	$25,000 Or More	Total
Men						
16-19	4.5%	2.0%	0.5%	*	*	7.1%
20-24	1.8	4.0	2.8	1.0	*	9.7
25-34	1.2	3.2	4.0	3.7	0.9	13.0
35-44	0.5	1.7	2.4	2.7	1.1	8.4
45-54	0.5	1.8	2.0	2.4	1.0	7.7
55-64	0.9	1.6	1.4	1.3	0.4	5.7
65 Or More	1.5	0.6	*	*	*	2.7
Subtotal	10.9%	14.9%	13.4%	11.4%	3.6%	54.3%
Women						
16-19	4.5%	1.6%	*	*	*	6.2%
20-24	2.9%	4.7	1.0	*	*	8.7
25-34	3.6	4.9	1.8	0.6	*	10.9
35-44	2.9	3.5	1.0	*	*	7.8
45-54	2.4	2.6	0.8	*	*	6.0
55-64	2.0	1.7	0.6	*	*	4.5
65 Or More	1.3	*	*	*	*	1.6
Subtotal	19.6%	19.2%	5.4%	1.5%	*	45.7%
Men and Women						
16-19	9.0%	3.6%	0.6%	*	*	13.3%
20-24	4.7	8.7	3.8	1.2	*	18.4
25-34	4.8	8.1	5.8	4.3	0.9	23.9
35-44	3.4	5.2	3.4	3.0	1.1	16.2
45-54	2.9	4.4	2.8	2.6	1.0	13.7
55-64	2.9	3.3	2.0	1.4	0.5	10.2
65 or More	2.8	0.8	*	*	*	4.3
Total	30.5%	34.1%	18.8%	12.9%	3.7%	100.0%

* Indicates less than 0.5 percent.

Source: ICP analysis of May 1979 CPS data.

WORKING PAPERS

MACROECONOMIC EFFECTS OF

RERIREMENT INCOME POLICY

PRESIDENT'S COMMISSION
ON PENSION POLICY

MACROECONOMIC EFFECTS OF RETIREMENT INCOME POLICY

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May, 1981

FOREWORD

This working paper reports on the major findings of the efforts by the President's Commission on Pension Policy to measure the effects of recommended national retirement income and tax policies on the economy. This paper specifically analyzes the findings of the Commission's macroeconomic growth model project. In this project, a model of the U.S. retirement income system was developed and integrated with the Hudson-Jorgenson-Anderson (H-J-A) Macroeconomic Growth Model.

The major issue addressed by this paper is whether it is possible to develop sound retirement income policy which is consistent with the needs of the national economy. This paper's findings are that not only is it possible but that sound retirement income policy can have a significant, positive influence on such factors as national savings, investment, and economic growth.

Using the integrated Commission/H-J-A model, the major recommendations of the President's Commission on Pension Policy were simulated. These recommendations were to establish a Minimum Universal Pension System (MUPS); to change the tax treatment of Social Security contributions and benefits and implement other tax changes to encourage retirement savings; and to raise the social security retirement age by three years and implement other policies to delay retirement. The major findings of the simulations were:

- Savings and Economic Growth
  - A minimum universal pension system (MUPS) reduces consumption and directs that reduction into retirement savings.
  - MUPS will increase savings by nearly $20 billion dollars in 1985 and by $26 billion in 1990.
  - Investment capital increases by 2-3 percent in the early years of the program when all Commission proposals are in effect. Investment continues to increase --by over 10 percent by the end of the forecasting period.

    GNP will be increased by 2 percent by the year 2000, 5 percent by 2015 and 8 percent by 2050.
- Labor Market Impact
  - Average annual compensation will increase by approximately 2 percent by 2000 due to the Commission proposals. By 2020, this increase rises to 4 percent and remains at that level for the remainder of the forecast period.
  - Raising the retirement age will increase the supply of older workers. This may put downward pressure on the wages of older workers. However, if older workers become more highly substitutable for younger workers, as is likely, this may not occur. An increased supply of older workers would help mitigate the effects of the increasing scarcity of

younger workers that will result from the expected slow down in population growth.

o Pension Benefit Effects

- MUPS increases the number of participants in the private pension system by 50 percent --female participants are increased by 70 percent and male participants by about 40 percent.

- Without MUPS, 250,000 private sector workers may enter retirement in 2000 without pensions. This number increases to about 460,000 workers who may retire pensionless in 2025.

- Nearly 96 percent of those who would have retired without a pension retire with one under the Commission's proposals; only 2 percent of all private sector retirees would enter retirement without a pension benefit.

- By 2010, as the baby boom generation approaches retirement age, average benefits may be increased over 7 percent by the combination of the Commission's proposals. During the peak baby boom retirement period (2020-2035) average benefits are predicted to be increased by about 25 percent.

- Private pension fund contributions will increase by over 30 percent initially and are over 60 percent greater by the end of the forecast period.

- By 2000, private pension funds would increase by $300 billion (1981 dollars) --an additional growth of 11 percent.

- Fund balances are predicted to increase an additional 13-15 percent for the duration of the forecast period. By 2040, Commission programs will add an additional $1 trillion (1981 dollars) to private pension fund accounts.

The study also shows that the Commission's proposals may be more effective in increasing personal savings and investment funds than measures under consideration in Congress which simply provide tax reductions. For example, the estimates show:

- MUPS and Commission tax proposals combined to provide an initial boost to saving that is about $20 billion by 1981. The increase in investment in the initial years is about $3 billion or 40 percent greater than under the tax cut alone.

- The Commission's tax cut alone would increase savings by only 0.2 billion in the year 2000 and 3.2 billion by the year 2020. The Commission's full set of proposals would increase savings by $47 billion and $100 billion during those same years, the latter being 30 times as great as under the tax cut alone.

The Commission attempted to gather sufficient data and information on these subjects to aid its own decision-making process and to further develop the empirical and theoretical findings in these very complex areas. We hope that researchers and policy makers will make full use of our findings and the extensive data files and models that we have created.

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Part I: DEVELOPMENT OF A DEMOGRAPHIC MACROECONOMIC MODEL OF THE U.S. ECONOMY

The President's Commission on Pension Policy has developed an economic growth model that integrates the retirement income system in the United States with the macroeconomy. The model was developed by ICF Incorporated under contract to the Commission. Begun in March 1980, the model and studies for the Commission will be completed in May 1981.* A federal interagency group was created through a memorandum of understanding and cooperation in which the participating agencies agreed to undertake cooperative efforts to assist in the development of the macroeconomic and demographic growth model and to share pertinent data and analyses regarding the model. The following agencies signed the memorandum: the Department of Health and Human Services, (National Institute on Aging, and the Office of Planning and Evaluation), the Office of Management and Budget, the Department of Housing and Urban Development (Office of Policy Development and Research), and the Department of Labor (Pension and Welfare Benefit Programs).

The goals of this undertaking are consistent with the Commission's mandate under Executive Orders 12100 and 12071. First, studies were conducted concerning the present financial ability of private, federal, state and local government retirement, survivor, and disability systems to meet their future obligations. Second, research was done on the relationships among the retirement income system, private capital formation, and economic growth. Third, some of the impli-

* The National Institute on Aging (N.I.A.) joined with the Commission to fund the model development and will receive all contract deliverables and maintain the model after the Commission completes its work.

cations for the economy of policies recommended by the Commission were examined. This paper reports on the findings of the third area of inquiry: the effects of the Commission's retirement income policies on the economy.

The Need for a Comprehensive Model

No comprehensive model that depicts interactions between retirement programs and the economy or population existed. Naturally, the economy and population affect retirement income programs. For example, the larger proportion of aged individuals in our population projected for the future will create pressures to allocate proportionately more of our total income to this group through social security or private pensions. However, retirement income programs may alter individual behavior and cause effects on the economy or population. For example, the social security retirement test affects labor supply and the level of national income. The lack of feedback from the retirement income system into the economy represents a major gap in model development for policy analysis purposes.

The New Model's Theoretical Foundations

The theoretical framework of the model is the neoclassical theory of economic growth. This theory provides an analysis of determinants of long-run productivity and economic growth. It explains the determination of investment, consumption, and output; aggregate relative factor shares (labor and capital); substitution between factors; and productivity change. A central role is given to the theory of production and capital. Under the theory of production, outputs are related to inputs in the mathematical expression of a "production function." Capital is viewed as a homogeneous, aggregate factor that depreciates and is replaced and accumulated through investment. Prices and quantities of outputs and factor inputs are determined through the interaction of supply and demand in

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competitive markets. This theory predicts that the lower the rate of interest, others things equal, the greater the capital intensity of production and the greater the net national product per worker. Thus, policies which change savings and the interest rate have direct effects on the net national product per worker. Also, policies which affect supplies of labor and capital have direct effects on economic growth.

Use of a long-term model is entirely appropriate for analysis of the interaction of the retirement income system and the economy. Social security and other pension systems represent long-term commitments, and the level of benefits depends fundamentally on the productive performance of the nation's economy. Short-run, Keynesian type models are less appropriate because of their focus on the determinants of aggregate demand given a fixed capital stock, rather than the long-run determinants of the nation's income and wealth.

The Components of the Comprehensive Model

The comprehensive model of the retirement income system and the economy developed by ICF Incorporated integrates the Hudson-Jorgenson Macroeconomic Growth Model and the Anderson Labor Market Model and models of each of the major components of the retirement income system. The following is a list of all models included in the comprehensive model:

1. Hudson-Jorgenson Macroeconomic Growth Model
2. Anderson Labor Market Model
3. ICF Population Model
4. Private Employee Pension Model
5. Public Employee Pension Model
6. Social Security Model
7. Supplemental Security Income Model
8. Medicare Model

The integration of these models into one comprehensive model represents a significant and new achievement in the development of macroeconomic models of the U.S. economy. The administrative coordination of the participating agencies ensures wide dissemination of this model throughout the federal government and to the public.

Hudson-Jorgenson Macroeconomic Growth Model

This model is a neoclassical model of the U.S. economy. It depicts household behavior in formulating spending and work plans and producer behavior in formulating production, investment, and employment plans. The model assumes that the forces of demand and supply determine prices, quantities, wages, and interest rates. The model permits the investigation of the determinants of long-term growth, savings and investment, labor and capital supplies, and productivity.

The Hudson-Jorgenson Macroeconomic Growth Model has four sectors. Producer and household sector behavior is modeled endogenously, and government and foreign sector behavior is given outside the model. The interaction of producer and household behavior determines the quantities and prices of the inputs and outputs. There are two output goods, consumption and investment, and two productive factors, capital and labor.

The model assumes that producers maximize profits or minimize costs subject to the available technology that is described by an aggregate cost function. Linking inputs to outputs, the aggregate cost function permits the demands for labor and capital and the supply of consumption and investment goods to be determined, given the prevailing prices that the producer faces. Furthermore, substitution between capital and labor and the level and change of economic productivity may be determined.

The household maximizes its welfare over time subject to its available resources. The household chooses how to distribute its expected wealth over all years, and, for each year, chooses how much leisure and consumption goods and services it desires to consume. Thus, the household determines how much labor it will supply and how much consumption goods it will demand, given prevailing prices. Savings is the residual between current income and consumption and represents the net change in wealth.

The government sector demands goods and labor services, and government enterprises supply some goods and services. All of these are determined outside the model. The level of taxes and transfer payments are determined in the model, with tax rates given and tax bases modeled. In the foreign sector, net exports of consumption goods and services and of investments goods, purchases of labor services by the foreign sector, and net private claims on the rest of the world are given outside the model.

Over time, conditions of each market change in response to changing technology and availability of factor inputs. As market conditions change, the household sector alters its labor-leisure choice and its consumption and savings, while producers alter the mix of inputs and outputs. Investment and capital accumulation lead to change in the available supply of capital services; population growth and tastes alter labor supply; and production efficiency changes over time. These forces determine the nation's productive capacity. In order to represent the growth path of the economy, the market system is solved each year within the constraints of productive capacity and the behavioral characteristics of the producer, household, government, and foreign sectors. Economists call such a system a "dynamic, general equilibrium model" —dynamic because of the saving-investment mechanism, general because it deals with the whole economy, and equilibrium because all markets clear in each year.

Hudson and Jorgenson used statistical techniques to estimate the parameters of this model. They developed a simulation computer program to solve the simultaneous system of non-linear equations which result from such a dynamic, general equilibrium model.

Anderson Demographic Labor Market Model

In addition to the neoclassical determinants of economic growth, the model focuses on changes in population and labor market behavior and the implications for social security, the pension system, government transfer payments, and Medicare expenditures of these changes. In order to model this aspect of the economy, a population model and a demographically disaggregated labor market model are integrated with the macroeconomic model.

The demographically disaggregated labor market model depicts the demand for labor, the supply of labor, the simultaneous determination of labor and capital service factor inputs, compensation and unemployment by age and sex. The producer sectors' demand for labor is modeled by disaggregating inputs into four factors--capital services, age 14-24 labor services, age 25-54 labor services, and age 55 and over labor services. The household sector's supply of labor is modeled for twenty age-sex groups. Labor supply in total manhours for each group is determined by population size, labor force participation, employment and average annual hours-worked per person employed. The demand and the supply of labor are integrated and solved with the macroeconomic model.

Population Model

The composition and size of the U.S. population has important implications for the economy. A population model similar to that of the Census Bureau is incorporated into the macroeconomic model to project the population.

The population model projects the size and composition of population with a probability (Markov) structure. Assuming a fixed set of fertility rates, mortality rates, and number of immigrants, population is dynamically projected for each year by race, age, and sex. This population feeds into the macroeconomic model and labor market model, but there is no feedback from economic activity to the population model.

The user is able to vary the demographic parameters--cohort fertility rate, survival rates, and immigration. Starting with a base case population, e.g. a recent Census Bureau estimate, the implications of changing the demographic assumptions can be determined. Such flexibility is an important analytical tool in assessing how the retirement system will be affected by demographic factors.

Private Employee Pension Model

The model of the private pension system permits the study of interactions between economic and demographic changes and the pension system. Three categories of private pensions are modeled--defined benefit programs, defined contribution programs, and individual arrangements. The private pension model estimates the number of workers covered by private pension plans, the number of retired and separated vested participants, the average benefit per retiree, total benefits and contributions, and the level of assets, for each category of pension program. The impact of the pension and social security system on the process of asset accumulation and savings, on labor force behavior, and on output is depicted.

Public Employee Pension Model

The retirement income programs for public employees include the federal civil service and military retirement programs, plus state and local government programs. The models of military and federal civilian programs take into account the demographic composition of the armed services and the federal civilian work force. The state and local government retirement systems are modeled for general administrative workers, hazardous duty workers, state and local educators, taking into account the demographic characteristics of the different work forces. The public employee pension model predicts the number of participants and beneficiaries, average contribution rates, average benefit per retiree, and total benefits, contributions, and assets. This model permits investigation of changes in the level and demographic composition of public employment on the overall retirement income system.

Social Security Model

The model of the Social Security retirement and disability systems explores the relationship between changes in the U.S. age structure and economy and the financial flows of the system. The model incorporates not only direct age structure effects, but also changes in age group incomes and factor shares, savings, rates of return, and labor force participation and employment behavior that are affected by age structure and will influence the financial condition of the social security system. Given the forecast of future wages and incomes, the model determines the contribution and benefit bases and the total contributions and benefit payments corresponding to alternative statutory provisions. The model's capability to show the way these respond to alternative demographic scenarios is useful for analysis of the actuarial status of OASDI. The Social Security Model also permits investigation of the impact of social security on the economy, especially the implications for savings and the interaction between social security and employee pensions.

Supplemental Security Income Model

The retirement income system must take into account the Supplemental Security Income (SSI) program designed to assist the low-income elderly population.

This model projects the size of the low-income population at retirement ages and estimates the number of SSI beneficiaries. Determined by current statutes and forecast average wage and income levels, the model estimates average SSI benefit payments and total SSI benefit payments by age and sex. The SSI Model is integrated with the macroeconomic model and labor market model.

Medicare Model

The level of Medicare benefits is closely related to retirement income needs and is modeled to reflect demographic and economic factors. The medicare model includes information on average Medicare benefit payment by age-sex group for each of six services, total Medicare expenditures, and total health insurance tax collections. Thus, outlays and revenues can be compared over time in the context of the performance of the economy and demographic trends. There is no attempt to model the complete demand and supply of the health care industry.

Studies

The complete model has been used to study three areas of concern to the President's Commission on Pension Policy. First, pensions, savings, and investment has been studied. Second, the relationship of retirement income programs and labor force participation has been examined. Third, the impact of alternative pension policy proposals on the pension system and the economy has been simulated. The complete model will be a valuable tool for other agencies of the federal government to use in current and future research on the retirement income system.

The first study examines pensions, savings, and investment. The complete model depicts the feedback of the retirement income system on the aggregate economy, as well as the impact of the population and economy on the retirement system. Of particular importance to policy analysis is the question of how private pensions and social security affect savings and the growth of the economy. Given estimates of the effects of private pensions and social security on savings, the overall performance of the economy may be evaluated. The investment in the economy is disaggregated into three components: 1) additions to the productive capital stock; 2) purchases of housing; and 3) purchases of consumer durables. Finally, the effect of the changing age structure on savings is examined.

The second study examines the relationship of retirement income programs and the labor market. In this study, the labor market model plays an important role because the effect of national wealth is incorporated in the labor supply equations. In addition, social security and pension system variables in the labor force participation equations of younger and retired workers permit an assessment of their impact on labor force participation Employee compensation and unemployment is also studied.

The third study examines alternative pension policies and economic-demographic scenarios. As the age-sex structure of the population changes, it has an impact on the pension system. Also, policies to change vesting rules or expand coverage of private pensions and implement new retirement age and tax policies is examined.

Caution Concerning the Use of Economic Models

Any mathematical model of the economy by necessity attempts to simplify economic behavior into quantifiable relationships. This model is no exception. The building of such mathematical models is a process of blending economic theory with empirical research. The success of such efforts is often limited by the appropriateness of both.

Commission and ICF staff have attempted to incorporate the findings of Commission-sponsored research as well as other recent empirical studies into the model. As more empirical studies are completed, the model will hopefully be further improved under the guidance of staff at the National Institute on Aging.

This model should prove useful to policymakers in suggesting retirement policy that is consistent with other objectives of national economic policy. The specific numerical forecasts of the model, however, should be used with caution. The primary usefulness of a model such as this one is to predict the order of magnitude and direction of economic effects, not specific values. Too many uncertainties exist in the real world that render specific long-term forecasts unreliable.

In its use to date, however, this model has proved to be extremely useful. Some of the policy simulations have yielded findings that show that retirement income policy can have a much larger effect on the macroeconomy than many of us expected at the outset of the model-building effort. This suggests that further development of the model by the Federal government might be money well spent during the next several years as retirement income policy is debated.

Part 2: POLICY SIMULATIONS

With the model constructed, Commission and ICF staff performed a series of policy simulations to estimate the effect of the Commission's proposals on a number of economic variables. These variables were divided into three groups: macroeconomic variables, labor market variables, and pension and social security variables. The macroeconomic variables studied include savings, investment, consumption, and Gross National Product (GNP). Labor market variables included labor input (measured in total hours worked), total compensation, and unemployment. Pension and Social Security variables included participation, level of benefits, and pension contributions. A number of additional variables were estimated but are not discussed in the paper.

The Commission's final report, issued on February 26, 1981, contained over fifty proposals that would lead to a coordinated national retirement income policy. The Commission made proposals for national policy with regard to employee pensions, social security, savings for retirement, and employment of older workers.

The proposals that would have the most significant effect on the economy if enacted are retirement age policy, the establishment of a minimum universal pension system, and changes in the tax treatment of contributions to and benefits from retirement income programs. These three areas for policy simulations can be summarized as follows:

Retirement Ages and Employment. The Commission suggested that the age of eligiblity for benefits be raised for all retirement programs and that employment policy be changed to encourage and enable older workers to remain in the labor force. Specifically, the Commission's major recommendations were:

- The normal retirement age of 65 for social security should not be raised for working people who are now approaching retirement. However, an increase in the normal retirement age to 68 should be phased in over a 12-year period beginning in the year 1990. The social security early retirement age, now 62, should be raised to 65, in tandem with the changes in the normal retirement age. Disability benefits should be available through the normal retirement age.
- ERISA should be amended to permit private pension plans, on a voluntary basis, to increase their normal retirement age in tandem with social security.
- As in the private sector, public employee pension plans should increase their normal retirement age in tandem with social security. A retirement age policy that parallels that of social security is recommended for all federal retirement programs. Under this recommendation, the current social security normal retirement age of 65 would be phased in for new retirees. This age would increase in tandem with increases in the social security normal retirement age. Early retirement benefits would be actuarially reduced for new retirees.
- The social security earnings test should be removed. The earnings test limits should be phased out as the Commission's proposal concerning the exclusion of social security contributions and inclusion of benefits in taxable income is phased-in.
- Information on alternative work patterns should be encouraged and developed through research and demonstration programs in existing federal employment programs. Job retraining and job

redesign for older workers in private industry also should be encouraged.

For purposes of the model, the net effect of all of these policies was assumed to lead to a delay of retirement of three months a year for twelve years beginning in 1990 (when the increase in the age of eligibility for Social Security benefits begins). By the year 2002, all individuals in the labor force would retire three years later than they would have without the introduction of the retirement age and employment policies.

Minimum Universal Pension System. The Commission recommended that a Minimum Universal Pension System (MUPS) be established for all workers. The system should be funded by employer contributions. The Commission further recommended that a 3 pecent of payroll contribution be established as a minimum benefit standard. All employees over the age of 25, with one year of service and 1,000 hours of employment with their employers would be participants in the system. Vesting of benefits would be immediate.

To the macroeconomy, the MUPS proposal acts like a compulsory savings program. Contributions made by employers to funded employee pension plans serve to reduce consumption.

Taxation of Retirement Contributions and Benefits. The Commission made a number of a proposals to provide greater tax incentives to encourage retirement savings and to make the tax treatment of retirement contributions and benefits more consistent. The major proposals were:

- Contributions to and benefits from social security should receive the same tax treatment as do those of other retirement programs. At the time of filing, the employee would choose the higher of a tax deduction or a tax credit for the social security employee contribution. Social security benefits would be included in taxable income. As this tax treatment is phased in, the social security earnings test should be phased out.

- Favorable tax treatment should be extended to employee contributions to pension plans. A refundable tax credit for low and moderate income people to encourage voluntary individual retirement savings and employee contributions to plans is recommended. At the time of tax filing, the employee would choose the higher of a tax deduction or a tax credit.
- Contributions and benefit limitations for all individuals should be treated more consistently for all types of retirement savings.
- The tax treatment of savings specifically for retirement should be the same as the tax treatment of pension plans.
- Employers would be eligible for a tax credit equal to 46 percent of their contribution to a qualified employee pension plan, up to a limit of 3 percent of payroll.

All of the above tax proposals would lead to a very large tax cut for individuals and businesses. In addition, the Commission recommended one tax increase: to move the scheduled January 1, 1985 social security payroll tax to January 1, 1982. The net effect of all of these proposals, if enacted, would be to reduce federal taxes to individuals and businesses by approximately $30 billion in 1982.

For purposes of the model, effective tax rates were changed such that federal tax collections were reduced by $30 billion in 1982 and corresponding amounts for years beyond 1982. Separate reductions and taxes on labor earnings and capital income were calculated based on estimates provided by the Department of the Treasury and the Commission, and implemented in the model. For all of the simulations, government spending was reduced by an amount equal to the tax reductions, so that the government deficit was not changed directly.

Part 3: THE FINDINGS

Computer simulations using the model were conducted testing each of the above sets of proposals separately and all of them together. In its final report, the Commission indicated that the proposals should be considered as a package rather than separately, due to the interrelationships among them. In addition, many proposals were specifically tied to each other by the Commission. For example, introduction of the Minimum Universal Pension System (MUPS) was specifically linked to a number of the proposals.

The tables in this paper show the combined effects of all of the proposals. References will be made, however, to the individual simulations when they help explain the economic effects of the policy simulations more clearly.

Savings and Growth Effects

Table 1-7 show the impact of the Commission's policies on savings, consumption, investment, Gross National Product, capital input, labor input and compensation.

Introducing a minimum universal pension system has the direct effect of reducing consumption and directing the reduction into retirement savings. The Commission's tax reductions, however, more than offset the decreased consumption. Therefore, the net effect is that total consumption increases slightly even with the compulsory savings program. The phase-in of the retirement age policy further increases total consumption. By the year 2000, consumption is up approximately 4%, by 2030 over 7%, and by 2055 over 10%.

In the early years (before 1990) savings increases largely due to the minimum universal pension system. Savings increases by nearly 20 billion dollars in 1985 and

26 billion dollars in 1990 (all values are in 1981 dollars). While this represents a large increase in individual and family savings, it represents a relatively small increase in total savings in the economy.

Increased savings also makes more capital available for investment purposes. In the early years investment increases 2-3% due to the proposals. The effect of the total program is cumulative, however, so that investment continues to increase--by over 10% by the end of the forecasting period.

The Hudson-Jorgenson-Anderson (H-J-A) model is a neoclassical general equilibrium model. Therefore, when savings and investment capital are increased, interest rates (a measure of the cost of capital) tend to decline. While this effect is modest, it is also long-term.

Both capital and labor inputs to the economy are increased by the proposals. This leads to a modest increase in GNP in the early years and cumulative increases in the later years. In the early years, the MUPS and tax proposals promote mild (less than 1%) increase in GNP. As the retirement age policies take effect after 1990, GNP increases considerably, due in large part to increased labor input in the economy.

By the year 2000, GNP is estimated to grow by an additional 2% due to Commission recommendations. In 2015 GNP is 5% greater, and in 2050 it is 8% greater in the simulation of the Commission's recommendations.

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TABLE 1

GROSS PRIVATE SAVINGS*

	BASE CASE	POLICY SIMULATION	DIFFERENCE	PERCENT DIFFERENCE
1970	502.0	502.0	0.0	0.0
1975	699.4	699.4	0.0	0.0
1980	605.1	605.1	0.0	0.0
1985	880.4	900.0	19.6	2.2
1990	1220.0	1246.2	26.2	2.1
1995	1549.5	1586.0	36.5	2.6
2000	1919.2	1965.7	46.6	2.4
2010	2420.4	2489.0	68.6	2.8
2020	2555.4	2654.9	99.5	3.9
2030	3074.0	3209.2	135.2	4.4
2040	4401.5	4577.4	175.9	4.0
2050	5951.6	6174.1	222.5	3.7

*Expressed in billions of 1981 dollars.

TABLE 2

CONSUMPTION *

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	1216.776	1216.776	0.0	0.0
1975	1462.235	1462.204	-0.031	-0.0
1980	1811.562	1811.509	-0.052	-0.0
1985	2134.549	2143.620	9.070	0.4
1990	2454.158	2473.219	19.061	0.8
1995	2692.306	2747.028	54.721	2.0
2000	2942.914	3044.546	101.633	3.5
2005	3244.484	3386.778	142.295	4.4
2010	3564.266	3752.958	188.692	5.3
2015	3927.199	4165.973	238.773	6.1
2020	4285.215	4576.004	290.789	6.8
2025	4632.848	4968.895	336.047	7.3
2030	4983.840	5345.293	361.453	7.3
2035	5338.250	5733.645	395.395	7.4
2040	5679.473	6142.727	463.254	8.2
2045	5976.848	6530.645	553.797	9.3
2050	6299.887	6936.176	636.289	10.1
2055	6648.184	7324.273	676.090	10.2

*Expressed in billions of 1981 dollars.

TABLE 3

INVESTMENT*

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	293.633	293.633	0.0	0.0
1975	361.391	361.380	-0.011	-0.0
1980	284.412	284.391	-0.021	-0.0
1985	456.630	467.414	10.784	2.4
1990	663.086	676.808	13.722	2.1
1995	842.212	868.466	26.255	3.1
2000	1026.437	1068.957	42.520	4.1
2005	1144.998	1201.413	56.416	4.9
2010	1190.867	1263.023	72.156	6.1
2015	1184.002	1273.342	89.340	7.5
2020	1202.344	1309.752	107.408	8.9
2025	1275.045	1398.668	123.622	9.7
2030	1409.760	1543.077	133.317	9.5
2035	1605.181	1752.562	147.381	9.2
2040	1777.497	1950.345	172.848	9.7
2045	1940.312	2147.014	206.702	10.7
2050	2093.799	2332.890	239.091	11.4
2055	2266.862	2525.832	258.969	11.4

*Expressed in billions of 1981 dollars.

TABLE 4

GNP *

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	1985.428	1985.430	0.002	0.0
1975	2362.084	2362.042	-0.042	-0.0
1980	2660.486	2660.414	-0.072	-0.0
1985	3186.919	3194.014	7.095	0.2
1990	3787.295	3807.137	19.843	0.5
1995	4286.848	4354.691	67.844	1.6
2000	4817.250	4947.242	129.992	2.7
2005	5334.004	5517.609	183.605	3.4
2010	5810.426	6055.371	244.945	4.2
2015	6261.949	6573.422	311.473	5.0
2020	6742.418	7123.203	380.785	5.6
2025	7274.949	7716.410	441.461	6.1
2030	7882.891	8358.652	475.762	6.0
2035	8593.980	9116.934	522.953	6.1
2040	9286.266	9901.746	615.480	6.6
2045	9931.707	10670.809	739.102	7.4
2050	10612.273	11465.457	853.184	8.0
2055	11358.359	12270.418	912.059	8.0

*Expressed in billions of 1981 dollars.

TABLE 5

CAPITAL INPUT *

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	800.895	800.895	0.0	0.0
1975	975.505	975.505	0.0	0.0
1980	1149.354	1149.354	0.0	0.0
1985	1290.423	1299.140	8.717	0.7
1990	1580.263	1596.823	16.560	1.0
1995	1959.813	1989.823	30.009	1.5
2000	2421.964	2477.100	55.137	2.3
2005	2948.470	3040.585	92.116	3.1
2010	3497.300	3634.671	137.371	3.9
2015	4057.840	4252.379	194.539	4.8
2020	4604.793	4867.660	262.867	5.7
2025	5190.383	5533.602	343.219	6.6
2030	5841.500	6266.344	424.844	7.3
2035	6646.602	7159.668	513.066	7.7
2040	7609.242	8220.340	611.098	8.0
2045	8723.707	9467.180	743.473	8.5
2050	9969.965	10882.281	912.316	9.2
2055	11320.363	12417.918	1097.555	9.7

*Expressed in billions of 1981 dollars.

TABLE 6

LABOR INPUT: TOTAL*

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	192.094	192.094	0.0	0.0
1975	211.599	211.599	0.0	0.0
1980	234.986	234.986	0.0	0.0
1985	252.588	252.680	0.093	0.0
1990	268.681	269.733	1.052	0.4
1995	275.370	280.128	4.758	1.7
2000	277.579	285.581	8.001	2.9
2005	275.095	284.297	9.202	3.3
2010	269.846	280.573	10.728	4.0
2015	264.599	276.677	12.078	4.6
2020	259.943	273.082	13.139	5.1
2025	256.105	269.903	13.797	5.4
2030	253.415	266.582	13.167	5.2
2035	251.183	264.091	12.908	5.1
2040	246.593	260.621	14.028	5.7
2045	239.442	255.067	15.625	6.5
2050	231.773	248.298	16.526	7.1
2055	225.078	240.905	15.827	7.0

*Expressed as millions of hours.

TABLE 7

AVERAGE ANNUAL COMPENSATION: TOTAL *

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	14233.625	14233.625	0.0	0.0
1975	14133.562	14133.562	0.0	0.0
1980	14144.891	14144.891	0.0	0.0
1985	14907.641	14934.074	26.434	0.2
1990	15534.457	15577.883	43.426	0.3
1995	16368.953	16565.305	196.352	1.2
2000	17252.539	17618.809	366.270	2.1
2005	18187.098	18685.531	498.434	2.7
2010	19329.336	19959.930	630.594	3.3
2015	20564.090	21317.402	753.312	3.7
2020	21864.922	22752.281	887.359	4.1
2025	23167.641	24094.648	927.008	4.0
2030	24525.113	25465.336	940.223	3.8
2035	26007.191	26945.527	938.336	3.6
2040	27572.344	28605.078	1032.734	3.7
2045	29175.254	30370.359	1195.105	4.1
2050	30797.047	32109.207	1312.160	4.3
2055	32458.484	33829.172	1370.687	4.2

*Expressed in billions of 1981 dollars.

Labor Market Effects

Total hours of labor input into the economy are predicted to increase due to the Commission's proposals, particularly the three year increase in the retirement age.

Average compensation to workers also is predicted to increase significantly. By the year 2000, average annual compensation has increased about 2% due to the proposals. By 2020, this increase equals 4% and continues at approximately that level for the remainder of the forecast period.

In earlier Commission research, concern was expressed about potential increases in unemployment due to Commission recommendations. One set of concerns centered around the costs of the MUPS program to employers and employees. The economic literature indicates that, in general, increased labor costs are either directly passed on by the employer to workers in the form of smaller wage increases or to consumers in the form of higher prices or are absorbed by the employer, resulting in some degree of unemployment. This prediction would apply to increases in social security payroll taxes as well as increased payroll costs due to a MUPS or any other program.

The Commission, therefore, adopted a series of offsetting payroll-related tax reductions to individuals and businesses. In each year of the forecast period (1982-2055) these tax reductions exceed the increased payroll-related costs of a MUPS program. Therefore, employers and employees should be able to share the costs of the MUPS program without experiencing either an increase in after tax payroll costs or a reduction in take-home pay.

While the combined MUPS and tax proposals should not have a significant effect on total employment, the Commission's retirement age policy might. Raising retirement ages has the effect of increasing the labor supply of older workers. Unless the demand for the labor of older workers increases by a similar amount, either unemployment will result or the average wage of these workers will not increase as much as they would otherwise.

In its final report, the Commission expressed concern about the employment problem of older workers due to its retirement age recommendations. In its final report the Commission stated:

> "In conjunction with its recommendation to raise the retirement age, the Commission recognizes the problem of long-term unemployment among older workers and the use of early retirement under social security to solve this problem. Rather than utilize the social security system, consideration should be given to improving unemployment benefits to provide both short-term income maintenance for these workers and to keep them in the labor force."

The Commission's concerns about employment conditions among older workers is born out by the model. While wages and unemployment of most age groups are generally unaffected, the model does show the effects of the increased supply of older workers. In the simulations for the report, age groups 55-64 and 65+ do experience a significant drop in average hourly wages relative to the base case. This drop increases significantly (from 8% to 13%) as the post-World War II Baby Boom enters the older age groups and delays its retirement beginning in the year 2000.

In the policy simulations for this paper, fertility rates were assumed to slowly increase to 2.1 children per female of child-bearing age by the year 2000. Currently, the fertility rate equals approximately 1.8. The potential older-worker labor supply problems cited above might be reduced or eliminated if fertility rates remain at current levels and the total labor force shrinks after the year 2000. Additional model simulations will test this sensitivity.

For all age groups, excess supply of labor does not appear to be a significant problem. Even with an increase in the fertility rate to 2.1 children/female by the year 2000, the labor force after year 2000 is not expected to grow. As the capital stock grows, therefore, labor will become relatively scarce. If the demand for the labor of older workers could be adjusted--through public and private policies--to look more like the demand for workers in general, then the labor supply problems raised by raising the retirement age would be alleviated. If not, then other measures, such as those suggested by the Commission regarding special unemployment benefits for older workers, may be necessary.

TABLE 8

AGGREGATE HOURLY WAGES (1981 $), AGES 55-64

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	9.317	9.317	0.0	0.0
1975	9.984	9.984	0.0	0.0
1980	10.588	10.588	0.0	0.0
1985	11.315	11.311	-0.004	-0.0
1990	12.251	12.179	-0.072	-0.6
1995	13.609	13.180	-0.429	-3.1
2000	14.672	13.854	-0.818	-5.6
2005	15.466	14.455	-1.012	-6.5
2010	16.401	15.202	-1.199	-7.3
2015	17.496	16.120	-1.376	-7.9
2020	18.925	17.309	-1.616	-8.5
2025	21.208	19.014	-2.194	-10.3
2030	23.651	21.102	-2.549	-10.8
2035	25.947	23.166	-2.781	-10.7
2040	27.680	24.727	-2.953	-10.7
2045	30.168	26.517	-3.651	-12.1
2050	33.620	29.153	-4.467	-13.3
2055	37.303	32.519	-4.784	-12.8

TABLE 9

AGGREGATE HOURLY WAGES (1981 $), AGES 65+

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	5.977	5.977	0.0	0.0
1975	6.387	6.387	0.0	0.0
1980	6.863	6.863	0.0	0.0
1985	7.274	7.265	-0.009	-0.1
1990	8.050	7.933	-0.117	-1.5
1995	9.072	8.347	-0.725	-8.0
2000	9.910	8.606	-1.305	-13.2
2005	10.290	8.879	-1.410	-13.7
2010	10.680	9.261	-1.420	-13.3
2015	11.268	9.789	-1.478	-13.1
2020	12.263	10.563	-1.699	-13.9
2025	13.809	11.724	-2.084	-15.1
2030	15.474	13.084	-2.390	-15.4
2035	17.005	14.413	-2.592	-15.2
2040	18.170	15.417	-2.753	-15.1
2045	19.794	16.603	-3.191	-16.1
2050	21.991	18.289	-3.702	-16.8
2055	24.404	20.387	-4.018	-16.5

TABLE 10

AGGREGATE HOURLY WAGES (1981 $), AGES TOTAL

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	8.942	8.942	0.0	0.0
1975	9.179	9.179	0.0	0.0
1980	9.429	9.429	0.0	0.0
1985	9.914	9.920	0.006	0.1
1990	10.460	10.450	-0.009	-0.1
1995	11.201	11.139	-0.062	-0.6
2000	12.044	11.943	-0.100	-0.8
2005	12.984	12.876	-0.108	-0.8
2010	14.052	13.915	-0.138	-1.0
2015	15.172	15.004	-0.168	-1.1
2020	16.354	16.163	-0.191	-1.2
2025	17.602	17.394	-0.208	-1.2
2030	18.933	18.736	-0.196	-1.0
2035	20.396	20.192	-0.204	-1.0
2040	22.065	21.799	-0.266	-1.2
2045	23.951	23.606	-0.346	-1.4
2050	26.007	25.592	-0.415	-1.6
2055	28.218	27.782	-0.436	-1.5

Pension and Social Security Effects

Introduction of a minimum universal pension system immediately increases the number of participants in the private pension system by about 50%. Female participants are increased by nearly 70% and male participants by approximately 40%. These increases remain throughout the forecasting period.

Even more significant than the increase in participants is the increase in new retirees who receive private pension benefits. Under current policy, approximately 60% of new private sector retirees may retire with a pension by the year 2000, and approximately 40% may not. If there is no change in the existing private pension system, in the year 2000 about 250,000 private sector workers may enter retirement without pensions. This number may increase to about 460,000 private sector retirees without pensions retiring in 2025. After the year 2000, the number of private sector retirees without pensions may increase from about 3.5 million people in the year 2000, to a peak of nearly 6 million pensionless retirees (out of a total of about 15 million private sector retirees) by the year 2030.

The introduction of a MUPS nearly eliminates the problem of private pension entitlement. Nearly 96% of those who would have retired without a pension retire with one under the Commission's proposals. The proportion of those entering retirement with a pension increases by nearly 50% by the year 2000. During this period, only about 2% of all private retirees enter retirement without a pension benefit under the Commission's program.

The reason for the sharp reduction in those without pensions is twofold. First, pensions are made available to all workers over the of age of 25, with more than a year of service with the employer and with more than 1,000 hours of work. Even with these eligibility standards, most workers eventually qualify for benefits. Second, forefeitures of benefits by workers in existing plans are reduced. Under current policy, a private sector worker may have to be employed for 10 years prior to vesting in a pension benefit. The MUPS proposal would make at least the minimum benefit vested immediately upon participation.

Initially, the level of benefits under a MUPS program would be relatively small unless past service credits were granted by the system. For a number of years, therefore, the average benefit paid by private pension plans would actually decline. As the system matures, however, average pension benefits would begin to increase significantly. As the baby boom approaches retirement age in the year 2010, average benefits would have increased over 7%. During the peak baby boom retirement period (2020-2035) average benefits are predicted to be about 25% greater than they would be without the Commission's recommendations.

Total benefits paid by funded private pension plans increase dramatically. Private pension fund contributions increase by over 30% initially and steadily grow to an increase of over 60% by the end of the forecast period. The size of the increase is due to the MUPS as well as the extension of the working years and the growth of the economy as a whole.

As more contributions are made to private employee pension plans, fund balances continue to grow. By 1985 they would have increased by nearly 60 billion dollars, an increase of over 3%. By the year 2000 private pension funds would have increased by an additional $300 billion, additional growth of about 11%. After that time, fund balances are predicted to increase an additional 13-15% for the duration of the forecast period. By the year 2040, Commission policies are predicted to add an additional $1 trillion to private pension fund accounts.

Total benefits paid by funded private pension plans increase modestly at first, but by the year 2000 have increased by 40%. The private pension payments increase as the baby boom retires, peaking at an increase of 83% in the year 2035.

TABLE 11

PRIVATE PENSION SYSTEM, PARTICIPANTS MALE TOTAL (MILLIONS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	20.200	20.200	0.0	0.0
1975	21.800	21.800	0.0	0.0
1980	24.000	24.000	0.0	0.0
1985	25.900	36.600	10.700	41.3
1990	27.100	38.300	11.200	41.3
1995	27.800	39.000	11.200	40.3
2000	28.200	39.300	11.100	39.4
2005	28.200	39.100	10.900	38.7
2010	28.100	38.900	10.800	38.4
2015	27.700	38.400	10.700	38.6
2020	27.300	37.800	10.500	38.5
2025	27.000	37.500	10.500	38.9
2030	27.000	37.500	10.500	38.9
2035	27.300	37.900	10.600	38.8
2040	27.300	38.000	10.700	39.2
2045	27.100	37.700	10.600	39.1
2050	26.800	37.500	10.700	39.9
2055	26.800	37.400	10.600	39.6

TABLE 12

PRIVATE PENSION SYSTEM, PARTICIPANTS FEMALE TOTAL (MILLIONS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	7.800	7.800	0.0	0.0
1975	9.500	9.500	0.0	0.0
1980	11.200	11.200	0.0	0.0
1985	12.400	20.600	8.200	66.1
1990	14.400	24.200	9.800	68.1
1995	15.700	26.200	10.500	66.9
2000	16.300	27.100	10.800	66.3
2005	16.500	27.300	10.800	65.5
2010	16.500	27.200	10.700	64.8
2015	16.700	27.500	10.800	64.7
2020	16.900	27.900	11.000	65.1
2025	16.900	28.100	11.200	66.3
2030	16.800	28.000	11.200	66.7
2035	16.900	28.100	11.200	66.3
2040	16.900	28.300	11.400	67.5
2045	16.900	28.300	11.400	67.5
2050	16.800	28.200	11.400	67.9
2055	16.600	27.900	11.300	68.1

TABLE 13

PRIVATE PENSION SYSTEM, PARTICIPANTS TOTAL (MILLIONS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	28.000	28.000	0.0	0.0
1975	31.300	31.300	0.0	0.0
1980	35.200	35.200	0.0	0.0
1985	38.300	57.200	18.900	49.3
1990	41.600	62.400	20.800	50.0
1995	43.500	65.200	21.700	49.9
2000	44.600	66.500	21.900	49.1
2005	44.800	66.300	21.500	48.0
2010	44.600	66.100	21.500	48.2
2015	44.400	65.900	21.500	48.4
2020	44.100	65.700	21.600	49.0
2025	43.900	65.600	21.700	49.4
2030	43.900	65.500	21.600	49.2
2035	44.100	66.000	21.900	49.7
2040	44.200	66.300	22.100	50.0
2045	44.000	66.100	22.100	50.2
2050	43.600	65.600	22.000	50.5
2055	43.400	65.200	21.800	50.2

TABLE 14

PRIVATE PENSION SYSTEM, NEW RETIREES WITH PENSIONS (MILLIONS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	0.289	0.289	0.0	0.0
1975	0.323	0.323	0.0	0.0
1980	0.378	0.378	0.0	0.0
1985	0.418	0.672	0.254	60.8
1990	0.417	0.670	0.253	60.7
1995	0.400	0.633	0.233	58.3
2000	0.396	0.593	0.197	49.7
2005	0.461	0.628	0.167	36.2
2010	0.555	0.752	0.197	35.5
2015	0.639	0.960	0.321	50.2
2020	0.709	1.033	0.324	45.7
2025	0.719	1.117	0.398	55.4
2030	0.650	1.083	0.433	66.6
2035	0.610	0.969	0.359	58.9
2040	0.582	0.905	0.323	55.5
2045	0.658	0.934	0.276	41.9
2050	0.704	1.067	0.363	51.6
2055	0.696	1.093	0.397	57.0

TABLE 15

PRIVATE PENSION SYSTEM, NEW RETIREES WITHOUT PENSIONS (MILLIONS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	0.185	0.185	0.0	0.0
1975	0.206	0.206	0.0	0.0
1980	0.242	0.242	0.0	0.0
1985	0.267	0.013	-0.254	-95.1
1990	0.267	0.013	-0.254	-95.1
1995	0.256	0.013	-0.243	-94.9
2000	0.253	0.012	-0.241	-95.3
2005	0.295	0.012	-0.283	-95.9
2010	0.355	0.015	-0.340	-95.8
2015	0.408	0.019	-0.389	-95.3
2020	0.453	0.021	-0.432	-95.4
2025	0.460	0.022	-0.438	-95.2
2030	0.416	0.022	-0.394	-94.7
2035	0.390	0.019	-0.371	-95.1
2040	0.372	0.018	-0.354	-95.2
2045	0.421	0.019	-0.402	-95.5
2050	0.450	0.021	-0.429	-95.3
2055	0.445	0.022	-0.423	-95.1

TABLE 16

PRIVATE PENSION SYSTEM, ALL RETIREES WITH PENSIONS (MILLIONS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	4.918	4.918	0.0	0.0
1975	4.867	4.867	0.0	0.0
1980	4.983	4.983	0.0	0.0
1985	5.009	5.964	0.955	19.1
1990	5.305	7.366	2.061	38.9
1995	5.483	8.338	2.855	52.1
2000	5.452	8.568	3.116	57.2
2005	5.534	8.113	2.579	46.6
2010	6.058	8.200	2.142	35.4
2015	7.028	9.197	2.169	30.9
2020	8.128	10.703	2.575	31.7
2025	9.038	12.216	3.178	35.2
2030	9.345	13.200	3.855	41.3
2035	9.085	13.155	4.070	44.8
2040	8.540	12.579	4.039	47.3
2045	8.301	11.867	3.566	43.0
2050	8.629	11.993	3.364	39.0
2055	9.049	12.634	3.585	39.6

TABLE 17

PRIVATE PENSION SYSTEM, ALL RETIREES WITHOUT PENSIONS (MILLIONS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	4.635	4.635	0.0	0.0
1975	4.114	4.114	0.0	0.0
1980	3.729	3.729	0.0	0.0
1985	3.332	2.164	-1.168	-35.1
1990	3.393	1.155	-2.238	-66.0
1995	3.507	0.495	-3.012	-85.9
2000	3.488	0.167	-3.321	-95.2
2005	3.540	0.158	-3.382	-95.5
2010	3.875	0.164	-3.711	-95.8
2015	4.495	0.187	-4.308	-95.8
2020	5.199	0.217	-4.982	-95.8
2025	5.780	0.247	-5.533	-95.7
2030	5.976	0.263	-5.713	-95.6
2035	5.810	0.259	-5.551	-95.5
2040	5.462	0.246	-5.216	-95.5
2045	5.309	0.233	-5.076	-95.6
2050	5.518	0.239	-5.279	-95.7
2055	5.787	0.253	-5.534	-95.6

TABLE 18

PRIVATE PENSION BENEFIT, AVERAGE BENEFIT (1981 DOLLARS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	1728.482	1728.482	0.0	0.0
1975	2159.947	2159.947	0.0	0.0
1980	2649.770	2649.770	0.0	0.0
1985	3173.652	2826.958	-346.693	-10.9
1990	3537.450	2948.338	-589.112	-16.7
1995	3794.709	3159.718	-634.990	-16.7
2000	4068.035	3613.650	-454.385	-11.2
2005	4364.750	4269.012	-95.738	-2.2
2010	4669.605	5012.109	342.504	7.3
2015	4948.859	5770.047	821.187	16.6
2020	5204.324	6410.645	1206.320	23.2
2025	5479.898	6884.230	1404.332	25.6
2030	5795.742	7353.285	1557.543	26.9
2035	6169.734	7795.852	1626.117	26.4
2040	6605.465	8186.156	1580.691	23.9
2045	7145.906	8614.371	1468.465	20.5
2050	7733.266	9180.508	1447.242	18.7
2055	8312.242	9789.746	1477.504	17.8

TABLE 19

PRIVATE PENSION BENEFIT, TOTAL BENEFITS (BILLIONS 1981 DOLLARS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	8.496	8.496	0.0	0.0
1975	10.516	10.516	0.0	0.0
1980	13.197	13.197	0.0	0.0
1985	15.897	16.860	0.963	6.1
1990	18.767	21.712	2.945	15.7
1995	20.806	26.356	5.551	26.7
2000	22.184	30.963	8.779	39.6
2005	24.148	34.645	10.497	43.5
2010	28.301	41.102	12.801	45.2
2015	34.777	53.072	18.295	52.6
2020	42.310	68.610	26.300	62.2
2025	49.522	84.891	34.569	69.8
2030	54.167	97.062	42.895	79.2
2035	56.055	102.556	46.501	83.0
2040	56.413	102.971	46.558	82.5
2045	59.321	102.235	42.914	72.3
2050	66.722	110.108	43.386	65.0
2055	75.218	123.683	48.465	64.4

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TABLE 20

PRIVATE PENSION SYSTEM, TOTAL CONTRIBUTIONS (BILLIONS 1981 DOLLARS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	37.817	37.817	0.0	0.0
1975	39.969	39.969	0.0	0.0
1980	42.310	42.310	0.0	0.0
1985	45.539	60.303	14.764	32.4
1990	48.880	65.627	16.747	34.3
1995	52.316	71.536	19.220	36.7
2000	39.818	61.587	21.769	54.7
2005	42.990	66.816	23.827	55.4
2010	45.803	71.706	25.903	56.6
2015	48.050	75.992	27.942	58.2
2020	50.202	80.221	30.019	59.8
2025	52.449	84.431	31.983	61.0
2030	55.602	89.340	33.739	60.7
2035	59.472	95.306	35.834	60.3
2040	63.172	101.499	38.326	60.7
2045	66.250	107.371	41.121	62.1
2050	69.195	112.714	43.518	62.9
2055	72.782	118.227	45.444	62.4

TOTAL 21

PRIVATE PENSION SYSTEM, TOTAL FUND BALANCE (BILLIONS 1981 DOLLARS)

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	925.969	925.969	0.0	0.0
1975	1182.605	1182.605	0.0	0.0
1980	1465.729	1465.729	0.0	0.0
1985	1781.403	1838.610	57.207	3.2
1990	2133.722	2269.791	136.068	6.4
1995	2529.844	2753.383	223.539	8.8
2000	2912.900	3230.745	317.844	10.9
2005	3329.374	3751.436	422.062	12.7
2010	3790.518	4329.031	538.514	14.2
2015	4285.437	4943.215	657.777	15.3
2020	4808.316	5570.426	762.109	15.8
2025	5360.160	6206.023	845.863	15.8
2030	5955.844	6859.383	903.539	15.2
2035	6621.023	7567.836	946.812	14.3
2040	7374.355	8374.410	1000.055	13.6
2045	8220.371	9306.492	1086.121	13.2
2050	9144.109	10349.539	1205.430	13.2
2055	10142.559	11471.312	1328.754	13.1

TABLE 22

TOTAL OASDI BENEFICIARIES*

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	25.898	25.898	0.0	0.0
1975	31.547	31.547	0.0	0.0
1980	36.250	36.250	0.0	0.0
1985	39.911	39.911	0.0	0.0
1990	43.254	43.254	0.0	0.0
1995	45.620	45.660	0.040	0.1
2000	47.175	47.197	0.022	0.0
2005	48.955	48.349	-0.606	-1.2
2010	52.206	50.425	-1.781	-3.4
2015	56.995	53.957	-3.038	-5.3
2020	62.251	58.342	-3.909	-6.3
2025	66.836	62.668	-4.168	-6.2
2030	69.102	65.546	-3.556	-5.1
2035	69.008	65.967	-3.041	-4.4
2040	67.503	64.888	-2.615	-3.9
2045	66.797	63.602	-3.195	-4.8
2050	67.654	63.880	-3.774	-5.6
2055	69.051	65.336	-3.715	-5.4

*Expressed in millions of people.

TABLE 23

AVERAGE OASI BENEFIT*

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	2567.600	2567.600	0.0	0.0
1975	3077.563	3077.563	0.0	0.0
1980	3660.017	3660.017	0.0	0.0
1985	3778.750	3790.935	12.185	0.3
1990	3691.571	3733.561	41.989	1.1
1995	3578.767	3676.941	98.174	2.7
2000	3499.320	3517.473	18.153	0.5
2005	3521.396	3417.109	-104.288	-3.0
2010	3670.881	3626.545	-44.336	-1.2
2015	3822.734	3953.094	130.359	3.4
2020	3857.264	4114.156	256.892	6.7
2025	3829.342	4172.695	343.353	9.0
2030	3742.227	4148.402	406.176	10.9
2035	3624.506	4021.282	396.776	10.9
2040	3583.255	3982.892	399.637	11.2
2045	3652.983	4034.474	381.491	10.4
2050	3845.636	4353.602	507.966	13.2
2055	3921.711	4539.141	617.430	15.7

*Expressed in 1981 dollars.

TABLE 24

AVERAGE DI BENEFIT *

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	3782.954	3782.954	0.0	0.0
1975	4942.352	4942.352	0.0	0.0
1980	5011.687	5011.687	0.0	0.0
1985	4821.656	4822.168	0.512	0.0
1990	4834.930	4839.512	4.582	0.1
1995	4902.539	4872.570	-29.969	-0.6
2000	5032.867	5039.871	7.004	0.1
2005	5172.242	5204.090	31.848	0.6
2010	5319.797	5366.195	46.398	0.9
2015	5494.145	5555.316	61.172	1.1
2020	5683.121	5744.281	61.160	1.1
2025	5878.402	5942.957	64.555	1.1
2030	6074.797	6141.656	66.859	1.1
2035	6269.937	6336.668	66.730	1.1
2040	6476.957	6542.711	65.754	1.0
2045	6682.121	6749.988	67.867	1.0
2050	6869.828	6951.871	82.043	1.2
2055	7049.371	7145.023	95.652	1.4

*Expressed in 1981 dollars.

TABLE 25

TOTAL OASI PAYMENTS*

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	49.528	49.528	0.0	0.0
1975	69.331	69.331	0.0	0.0
1980	95.952	95.952	0.0	0.0
1985	112.255	112.617	0.363	0.3
1990	120.838	122.212	1.374	1.1
1995	123.747	125.939	2.192	1.8
2000	123.360	119.718	-3.642	-3.0
2005	127.147	116.223	-10.924	-8.6
2010	141.623	126.843	-14.779	-10.4
2015	163.958	149.514	-14.443	-8.8
2020	185.396	172.431	-12.965	-7.0
2025	202.741	194.107	-8.634	-4.3
2030	207.599	207.295	-0.304	-0.1
2035	200.947	203.156	2.209	1.1
2040	192.072	195.976	3.904	2.0
2045	192.366	191.117	-1.250	-0.6
2050	205.788	207.004	1.216	0.6
2055	215.411	222.741	7.329	3.4

*Expressed in billions of 1981 dollars.

TABLE 26

TOTAL DI PAYMENTS*

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	7.624	7.624	0.0	0.0
1975	18.414	18.414	0.0	0.0
1980	22.633	22.633	0.0	0.0
1985	23.041	23.043	0.002	0.0
1990	24.553	24.576	0.023	0.1
1995	27.102	28.724	1.622	6.0
2000	31.762	38.049	6.287	19.8
2005	36.865	44.842	7.977	21.6
2010	41.034	51.170	10.137	24.7
2015	43.832	55.596	11.764	26.8
2020	44.742	58.113	13.371	29.9
2025	44.060	57.962	13.901	31.6
2030	44.393	56.851	12.459	28.1
2035	46.099	58.503	12.404	26.9
2040	50.476	62.657	12.181	24.1
2045	53.510	68.191	14.681	27.4
2050	54.724	70.602	15.878	29.0
2055	55.715	71.770	16.056	28.8

*Expressed in billions of 1981 dollars.

TABLE 27

TOTAL OASDI PAYMENTS *

	BASE CASE	ALTERED CASE	DIFFERENCE	PERCENT DIFFERENCE
1970	57.152	57.152	0.0	0.0
1975	87.745	87.745	0.0	0.0
1980	118.585	118.585	0.0	0.0
1985	135.296	135.660	0.364	0.3
1990	145.391	146.788	1.397	1.0
1995	150.847	154.663	3.816	2.5
2000	155.122	157.767	2.645	1.7
2005	164.012	161.065	-2.947	-1.8
2010	182.658	178.014	-4.644	-2.5
2015	207.788	205.110	-2.677	-1.3
2020	230.138	230.544	0.406	0.2
2025	246.801	252.069	5.268	2.1
2030	251.991	264.146	12.155	4.8
2035	247.047	261.660	14.613	5.9
2040	242.548	258.633	16.086	6.6
2045	245.876	259.307	13.431	5.5
2050	260.512	277.606	17.094	6.6
2055	271.126	294.511	23.385	8.6

*Expressed in billions of 1981 dollars.

Pension Benefit Effects

While private pension participants increase under the Commission's proposals, beneficiaries of the Social Security (OASDI) system actually are decreased due to the retirement age policy. This decrease becomes significant by the year 2005 and peaks at about a 6 percent decline in beneficiaries by the year 2020.

As a result of the decline in beneficiaries, total OASI (Old Age and Survivors) payments decline significantly, the largest decline coming by the year 2010. After that time, however, increased economic growth and labor force input into the economy lessen the decrease; and by 2035, the total payments actually begin to be higher than the base case.

The simulations also show that increases in disability benefits (DI) tend to offset some of the decreased OASI payments. Disability rates among older workers are relatively high, and increased disability payments should be expected to result from a policy to increase the age of eligibility for OASI benefits.

Total OASDI payments, however, decline for approximately a twenty year period starting shortly after the turn of the century until about 2020. After that time, total payments increase due to the increase in average OASI benefits resulting from increased labor input, wages, and economic growth.

Part 4: TAX REDUCTIONS AND THE COMMISSION'S PROPOSALS

Currently, Congress and the Administration are proposing various measures to reduce individual and business taxes. Stated objectives of these proposals include the increase in personal savings and investment funds.

The Commission has proposed tax cuts that are comparable to those of the administration. As the following tables show, combining a tax reduction with a MUPS and the Commission's retirement age policies is a much more effective way of increasing savings and investment than implementing the Commission's tax reduction by itself.

Initially, the MUPS and tax programs combine to provide an initial boost to private savings that is about $20 billion in 1985 (in 1981 dollars). The tax program alone is estimated to increase savings about 1.6 billion dollars in 1985. The increase in investment in 1985 is about $3 billion (or about 40 percent) greater under the Commission's proposals than under the Commission's tax cut alone.

In the later years the differences in both savings and investment continue to increase. Under the Commission's tax cut alone, savings increases by only $0.2 billion in the year 2000 and $3.2 billion in the year 2020. Under the full set of the Commission's proposals, savings increases by over $47 billion in the year 2000 and $100 billion in the year 2020, the latter being thirty times as great as under the tax cut alone.

Investment also is much greater under the Commission's combined approach than under the tax cut alone. More than four times as much ($43 billion) is invested in the year 2000 and more than six times as much ($108 billion) in the year 2020.

In addition to these positive macroeconomic effects, of course, the Commission's proposals also provide for a greater availability of savings for retirement purposes. Under the Commission's program, a large portion of the additional savings would be set aside to alleviate the retirement income crisis that will exist as the post World War II Baby Boom enters retirement.

TABLE 28

Increased Gross Private Savings Due to Tax Reductions and Other Commission Policies

	Tax Reduction Alone	Tax Reduction with MUPS and Retirement Age Policy
Year	Increased Saving*	Increased Saving*
1985	1.6	19.6
1990	1.2	26.2
2000	0.2	46.6
2010	1.6	68.6
2020	3.2	99.5
2030	5.1	135.2
2040	8.6	175.9
2050	10.8	222.5

*Billions of 1981 dollars. This includes business and personal savings.

TABLE 29

Increased Investment Due to Tax Reductions and Other Commission Policies

	Tax Reduction Alone	Tax Reduction with MUPS and Retirement Policy
Year	Increased Investment*	Increased Investment*
1985	7.5	10.8
1990	8.1	13.9
2000	10.3	42.9
2010	13.9	72.2
2020	17.2	107.3
2030	20.8	133.4
2040	26.7	173.1
2050	33.1	239.2

*Billions of 1981 dollars.

APPENDIX

Assumptions Used in the Simulations

1. **MUPS Simulations**

   a. Persons not covered by a pension plan may be covered by a MUPS, according to proportions obtained from the PCPP MUPS microsimulation model.

   b. The MUPS is a 3 percent defined contribution plan covering all persons 25 years of age and over, with 1 year's tenure and 1,000 hours of service. Vesting is full and immediate upon participation. Benefits/contributions are fully portable.

   c. The presence of a MUPS causes an increase in expected pension benefits for other pension recipients of 19 percent. This estimate is based on PCPP MUPS microsimulation model.

   d. The average number of year's tenure for some one solely in a MUPS at retirement is 35 years.

   e. MUPS participants earn the average wage in their age/sex groups.

   f. 89 percent of all new pension contiributions represent new private savings. This estimate is based on Professor Mordecai Kurz's work for the Commission using the Pension and Savings Household Survey. His final report is entitled "The Effects of Social Security and Private Pensions on Family Savings".

2. **Delayed Retirement Simulation**

In order to implement the delayed retirement simulation, indices of probability-of-new-retirement arrays were moved up by an amount IDEC:

$$IDEC = \begin{cases} 0 \text{ if before 1990} & \\ \dfrac{YEAR - 1989}{4}, & \text{if 1990-2012 rounded to the nearest integar} \\ 3 \quad \text{otherwise} & \end{cases}$$

Additionally, the Social Security section of the model keeps track of the maximum age for disability eligibility. In the base case, it is 61; in the delayed retirement case, it increases with the minimum age to qualify for retirement benefits.

Labor force participation rates' indices are moved to correspond to the change to retirement behavior.

3. **Tax Simulations**

a. Corporate Tax Collections

Corporate tax revenues decrease due to the deductibility of MUPS contributions. The tax revenue changes cited in Table 23 of the PCPP Final Report were adjusted as follows:

Year	Nominal	CPI	Real (1972=1.0)	Capital Price Index	Estimates
1982	$ 4.4	2.385	1.84	1.75	3.22
1983	7.4	2.595	2.85	1.92	5.47
1984	10.5	2.798	3.75	2.05	7.69
1985-2055	1984 changes are applied proportionately to all future corporate tax rates.				

b. Deductibility of Social Security Contributions

The effective tax rate on personal income is decreased in 1982 sufficiently to decrease income tax revenues $25.6 billion as shown in table 21 of the PCPP Final Report. In the simulation we adjust tax rates to decrease revenues $22.6 billion ($25.6 billion deflated to 1972 real dollars then inflated by the exogenous price of labor). The adjusted tax rate remains in effect in all future years.

c. Favorable Treatment of Retirement Savings

The effective tax rate is decreased (in addition to the change from Social Security Deductibility) as follows:

Year	Nominal	CPI	Real (1972=1.0)	Labor Price Index	Estimates
1982	$ 10.0	2.385	4.2	2.11	8.86
1983	12.1	2.595	4.7	2.26	10.62
1984	14.1	2.798	5.0	2.41	12.14
1985-2055	1984 changes are applied proportionately to all future labor income tax bases.				

Figures for nominal tax losses were obtained from Treasury estimates done for the Commission.

d. Taxation of Social Security Benefits

All Social Security benefits of the previous year are taxed beginning in 1982. The tax is phased in — initially it is 1/15 of the marginal tax rate (set at 10 percent) and it increases in equal increments until it equals the marginal tax rate in 1996.

e. Changes in the Social Security Tax Rate

The 1985 payroll tax increase is implemented in 1982.

f. Phase Out of the Retirement Earnings Test

The effect of the earnings test is phased out in equal increments. In 1982 we eliminate 1/15 of all earnings test effects. In each succeeding year we eliminate an additional 1/15 of earnings test effects until all effects disappear in 1996. Hours worked for all 65-71 year olds increases 9.2 percent when the test is fully phased out. This estimate is consistent with the analysis of Gordon and Schoeplein in their Social Security Bulletin article of 1979. Social Security benefits are increased by 2.65 percent upon full phase out. We obtain this estimate of a 2.65 percent increase when the earnings test is eliminated by dividing $2.1 billion (the OASI Actuary's estimate of the cost of the earnings test) by $79.2 billion, an estimate of OASDI benefits paid in 1978.

g. Federal Government Expenditures

Federal government expenditures were reduced by an amount equal to the Commission's tax reductions. The government deficit, therefore, would not be changed directly by the tax policies.

h. Savings

In the basic H-J-A model, savings is "endogenous", that is, it is a function of other variables in the model. (Savings is a function of income, income transfers and consumption.) When corporate and individual taxes are changed, total savings changes in response.

WASHINGTON UPDATE

PRESIDENT'S COMMISSION ON PENSION POLICY

736 Jackson Place, Northwest, Washington, DC 20006

C. Peter McColough
Chairman

Thomas C. Woodruff
Executive Director

Final Edition

Washington--Release of the President's Commission on Pension Policy final report on February 26, 1981 touched off a series of discussions on pension policy in Congress.

On the morning of February 26, C. Peter McColough, Chairman of the Commission, testified before the House Select Committee on Aging. After a lengthy statement on the Commission recommendations, Mr. McColough was questioned in detail for over two hours by members of the Select Committee.

On February 27 Mr. McColough testified before the House Ways and Means Subcommittee on Social Security. This presentation was followed by a briefing for the senior staff of the Senate Special Committee on Aging.

Thomas Woodruff, Executive Director of the Commission, testified before the Senate Finance Committee's Subcommittee on Savings Pensions, and Investment Policy on May 15th. His testimony included further explanation of the Commission recommendations and presented additional Commission findings contained in two recently released Commission research papers.

There have been a large number of legislative proposals introduced in this session that pertain to the Commission recommendations.

Most important among the proposals is a comprehensive package introduced on May 1st by Congressman Claude Pepper, Chairman of the House Select Committee on Aging. The package of five bills, known as the "Pepper Retirement Enrichment Pension Annuity Reform Act", H.R. 3393 through H.R. 3397, includes proposals to establish a minimum universal pension system with portable benefits for all workers and to encourage individuals to save for retirement.

Congressman Pepper's bills are the first attempt in Congress to package a set of proposals that address most of the areas of concern identified in the Commission's final report: employee pensions, social security, new tax incentives to encourage individual retirement savings, employment policy for older workers, etc.

A number of additional bills have also been introduced this session that pertain to the goals outlined in the Commission's final report. All of the proposals appear to reflect an emerging concensus in Congress that a balanced retirement income system is necessary in this country. Taken as a whole, these bills call for greater public policy emphasis on the roles of employee pensions, individual savings, and earnings as sources of income for the elderly.

Other proposals include:

Establishment of a Universal Employer Based Pension Plan

H.R. 3396 (Pepper): requires all employers to provide a minimum, portable pension for employees with full vesting at five years.

Encouraging Individual Savings for Retirement

H.R. 191 (Downey), (Similar bill: Downey - H.R. 1901, Conable - H.R. 2815): allows a deduction for contributions to individual retirement savings even though the taxpayer is an active participant in a pension plan.

H.R. 646 (Whitehurst): encourages individual supplemental retirement savings.

H.R. 886 (Jacobs): excludes from the gross income of individuals over age 65 amounts received on the redemption of certain United States savings bonds which have been held for at least 10 years.

H.R. 1087 (Hinson): allows individuals to compute the amount of the deduction for payments into retirement savings on the basis of the compensation of their spouses, and for other purposes.

H.R. 1250 (Moore): increases the allowable contributions to individual retirement plans and allows employees a deduction for savings contributions to employees a deduction for savings contributions to employer retirement plans or to individual retirement accounts.

H.R. 1316 (Gibbons): allows individuals a 50 percent tax credit for retirement savings and encourages, expands, and simplifies independent savings for retirement.

H.R. 1380 (Frenzel): encourages savings for retirement by making permanent the funding provisions of employee stock ownership plans through the investment tax credit, and providing a credit against tax for contributions to an employee stock ownership plan based upon wages.

H.R. 1415 (Minish): reform of tax treatment of qualified dividend reinvestment plans.

H.R. 1641 (Ferraro): allows a married individual with no earned income to use the working spouses income to compute the dedication for payments to retirement savings.

H.R. 2207 (Frenzel): allows employees a deduction for savings contributions to employer retirement plans or to individual retirement plans.

H.R. 2346 (Cotter): extends and liberalizes the deduction for individual retirement savings.

H.R. 2445 (Coughlin): provides a basic $7,500 exemption from income tax, in the case of an individual or a married couple, for amounts received as annuities, pensions, or other retirement benefits.

H.R. 364 (Kildee): provides for the exclusion from gross income of a certain portion of amounts received as annuities, pensions, or other retirement benefits by individuals who have attained age 65.

H.R. 469 (Roe), (Similar bill: Rousselot - H.R. 820): excludes from the gross income of individuals who have attained the age of 62 $3,000 of interest received during any taxable year.

H.R. 38 (Annunzio), (Similar bills: Ashbrook - H.R. 91, Lent - H.R. 372, Long - H.R. 376): provides a basic $5,000 exemption from income tax, in the case of an individual or a married couple, for amounts received as annuities, pensions, or other retirement benefits.

H.R. 3395 (Pepper): provides tax incentives for retirement savings, (specifically targets low and moderate income workers).

S. 638 (Bentsen): allows individuals to compute the amount of the deduction for payments into retirement savings on the basis of the compensation of their spouses.

S. 486 (Bentsen): permits an individual covered by a private retirement plan to establish a separate individual retirement account or deduct a separate contribution to the plan.

S. 243 (Chafee): increases the allowable contributions to individual retirement plans and to allow employees a deduction for savings contributions to employer retirement plans or to individual retirement accounts.

S. 12 (Dole): allows a retirement savings deduction for persons covered by certain pension plans.

Earnings Sharing, Inheritance of Credits, Election of Survivor Benefits

H.R. 541 (Roe): provides that a husband and wife may elect to split their earnings for social security purposes upon the retirement of either or both of them, or upon their divorce.

H.R. 543 (Roe): provides that the combined earnings of a husband and wife during the period of their marriage shall be divided equally and shared between them for benefit purposes under social security.

H.R. 539 (Roe): provides that upon the death of one member of a married couple the surviving spouse or divorced spouse shall automatically inherit the credits of the deceased spouse.

H.R. 2445 (Coughlin): provides a basic $7,500 exemption from income tax, in the deceased spouse's earnings credits to the extent that such credits were earned during the period of their marriage.

H.R. 1398 (Lehman): provides that any Federal employee who, at the time of retirement, does not elect a reduced annuity in order to provide a survivor annuity to a spouse or other person may make such an election within one year after retiring.

H.R. 1513 (Oakar): provides that the combined earnings of a husband and wife during the period of their marriage shall be divided equally and shared between them for benefit purposes.

H.R. 1514 (Oakar): provides that upon the death of one member of a maried couple the surviving spouse or surviving divorced spouse shall atuomatically inherit the deceased spouse's earnings credits.

H.R. 1515 (Oakar): provides the combined earnings of a husband and wife during the period of their marriage shall be divided equally and shared between them for benefit purposes if they become divorced and either of them so elects.

H.R. 1641 (Ferraro): automatic joint and survivor protection unless waived by both parties, such waiver must be witnessed.

H.R. 3393 (Pepper): provides for earnings sharing and inheritance credits.

Retirement Ages

S. 484 (Chiles): provides for an increase in the social security retirement age among other provisions.

H.R. 2795 (Green): would improve the long range financing of the social security system by increasing the normal retirement age from 65 to 68.

H.R. 3207 (Pickle): would raise the normal retirement age beginning in 1990 from 65 to 68.

Universal Social Security Coverage

H.R. 889 (Levitas), (Similar bill: Levitas - H.R. 903, Conable - H.R. 1018): provides social security coverage for federal workers.

H.R. 401 (Pickle): provides mandatory social security coverage for Members of Congress and the Vice President.

H.R. 1018 (Conable): provides mandatory social security for government workers.

H.R. 2638 (Gingrich): provides mandating social security coverage for members of Congress.

CPI Index for Elderly

H.R. 578 (Roybal): provides for the monthly publication of a Consumer Price Index for the Elderly and for studies to be made with regard to utilizing such index in determining cost-of-living adjustments for individuals who are at least sixty-two years of age.

Tax Credit/Deduction for Employee Social Security Contributions

H.R. 2350 (Luian): allows a deduction from gross income for certain social security taxes.

S. 44 (Bradley): provides income tax credit for social security taxes paid in 1981 and 1982.

Earnings Test and Employment Incentive

H.R. 589 (Roybal): increases the social security earnings limitation to $10,000 for an individual under age 65 and earnings test to $15,000 for those over age 65.

H.R. 706 (Brown): provides for a phasing out of the social security earnings limitation for individuals age 65 or over.

H.R. 309 (Hansen), (Similar bill: Courter - H.R. 2104): increases the earnings limitation under social security to $24,000.

H.R. 46 (Archer), (Similar bills: Clausen - H.R. 166, Fuqua - H.R. 239, Hansen - H.R. 308, Quillen - H.R. 416, Roe - H.R. 470, Rousselot - H.R. 614, Shumway -H.R. 623, Chappell - H.R. 801, Lehman - H.R. 901, McDonald - H.R. 995, Lagomarsino - H.R. 1125, Emery - H.R. 1310, Collins - H.R. 1804, Derwinski - H.R. 2531): removes the earnings limitation.

H.R. 3393 (Pepper): eliminates mandatory retirement and provides financial incentives to employers to hire older workers.

S. 259 (Goldwater): would repeal the earnings ceiling of the Social Security Act for all beneficiaries age 65 and older.

Research Papers Released

On May 1st, the Commission released a series of economic papers dealing with various aspects of savings behavior in the U.S. and further assessing the economic impact of its recommendations for a minimum universal pension system (MUPS).

The five papers are entitled, "the Effects of Social Security and Private Pensions on Family Savings," "Macroeconomic Effects of Retirement Income Policy," "Household Savings and Demographic Change 1950-2050," "Review: Social Security, Pensions and Savings," and "The Relationship Between Pension Wealth and Riskiness of Family Portfolios."

The first paper, by Professor Mordecai Kurz at Stanford University presents empirical effects of social security and pensions on personal savings patterns. It shows that each dollar increase in social security or private pension wealth results in a negligible decrease in private savings before retirement. The study was based on data from a Commission household survey begun in 1979.

A second paper by Thomas C. Woodruff titled, "Macroeconomic Effects of Retirement Income Policy" shows the economic impact of the Commission proposals over a 75 year forecast period. Estimates have been done on the recommendations as a package because of the interrelationships among many of the proposals.

Major findings of this paper show that a minimum universal pensions system reduces consumption and directs that reduction into retirement savings. MUPS and the Commission tax proposals combined to provide an initial boost to saving that is about $20 billion by 1985. By 2010, as the baby boom generation approaches retirement age, average employee pension benefits may be increased over 7 percent by the combination of the Commission's proposals.

Another paper, "Household Savings and Demographic Change 1950-2050" by Paul Wachtel focuses on the importance of age and family composition as a factor in savings behavior. The study concludes that demographic change over the last 20 years has had a depressing effect on savings patterns. However, the study notes that this trend should reverse itself in the 1980's as the baby boom reaches middle age. Savings will decline some what after that as the baby boom enters the retirement years.

The fourth paper entitled "Review: Social Security, Pensions and Savings," by William Cartwright reviews the range of theories on the effect of pensions on personal savings. The importance and difficultities in determining the impact of pension wealth on savings are detailed. This paper was completed prior to the results presented in "The Effects of Social Security and Private Pensions on Family Savings."

The last paper "The Relationship Between Pension Wealth and Riskiness of Family Portfolios" looks at the relationship between a family's pension assets and the riskiness of its other investments. Results of the study show that an increase in pension assets does not encourage a family to hold more risky investments. The author concludes that the accural of pension wealth and the attending tendancy for safe investments may reflect an aversion to risk taking.

All five papers will be included in the Commission's technical appendix.

Public Affairs Film

Encouraged by the successful distribution of its first public affairs television film entitled, "Pensions: Solution or Crisis," the President's Commission on Pension Policy produced and released a second 28 minute program on March 15.

The second program, titled "Coming of Age," features a candid roundtable discussion of the Commission's final recommendations. Syndicated T.V. columnist Martin Agronsky moderates the discussion group which includes C. Peter McColough, Chairman of the Commission; Harrison Givens, Vice Presidént, Equitable Life Insurance Co.; Howard Samuel, President, Industrial Union Department, AFL-CIO; and Jack Ossofsky, Executive Director, National Council in Aging.

The program is being offered free of charge to television stations throughout the country.

Pension Library Transfer

Commission documents and records will be transferred to the National Archieves when the Commission officially terminates operation on May 24th.

The Commission library, consisting of approximately 1,500 volumes and 100 subscriptions to periodicals and business services relating to pension issues, will be transferred to the Office of Administration Executive Office of the President on May 24th. These volumes were collected with the assistance of the Pension and Welfare Benefit Programs, U.S. Department of Labor.

In addition to the items mentioned above, all materials issued by the Commission are contained in the collection, including: testimony, transcripts of public meetings, working papers, background and options papers, video tapes and reports.

During its existence, the library functioned as a depository and a clearinghouse for published and ongoing pension research. It has been actively used by policy makers and researchers in other government agencies, trade associations, labor unions, universities, law firms and private businesses.

The collection will be housed in the EOP Information Center, Room G102 of the New Executive Office Building, 726 Jackson Place, N.W., Washington, D.C. The Center is open to the public.

Final Report Technical Appendix

The Commission has issued a technical appendix to its final report. The appendix is a compilation of working and research papers prepared by the Commission.

This comprehensive document will be extremely useful as a handbook for future research in the pension area. The appendix will be available for reading at the Information Center.

Research Data Tapes Available

The Commission intends to make the data tape from its 6100 household survey available to the public through the National Technical Information Service. NTIS should be contacted for details.

A Closing Note From the Executive Director

The volumes and scope of legislation entered in Congress this session offers some hope that many of the Commission's recommendations may be enacted in the next several years.

The enactment process however, remains cumbersome. Each proposal will be considered separately and, possibly in isolation by the subcommittee(s) having jurisdiction. Linkages among proposals that the Commssion made in its report may be lost. A proposal that is good policy when enacted along with two others, might be bad policy by itself.

It is my hope that those of you who followed the Commission's work will not permit policymakers to continue the myopic decisionmaking of the past. Those of you who are involved in writing, research, or public speaking can also increase public awareness of the dimensions of the retirement income crisis forcing this nation over the next several decades.

The Commission officially "retires" May 24. Please do not write us after that date. If you would like to write or share research with me, I can be reached at Cornell University (School of Industrial of Labor Relations, P.O. Box 1000, Ithaca, N.Y., 14850) where I have accepted a faculty appointment.

Thomas C. Woodruff
Executive Director

Senator CHAFEE. Our next witnesses are Mr. Salisbury, executive director of the Employee Benefit Research Institute and Mr. Greenough who is a member of the Commission.

Mr. Salisbury, please proceed.

PANEL OF DALLAS L. SALISBURY, EXECUTIVE DIRECTOR, EMPLOYEE BENEFIT RESEARCH INSTITUTE AND WILLIAM C. GREENOUGH, CHAIRMAN, SUBCOMMITTEE ON RETIREMENT POLICY, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. SALISBURY. Mr. Chairman, it's a pleasure to be here today on behalf of the Employee Benefit Research Institute.

Members of the President's Commission on Pension Policy gave substantial time and attention to their 2-year study effort.

We are concerned, however, that much of the benefit of this effort may be lost. Very little of the Commission's detailed data and research has yet been made public. As part of the prepared full statement of the institute, you will find attachment 1 which details the information that we hope sincerely will be made available prior to May 24 or definitely thereafter, including the basic data that underlay the additions to Mr. Woodruff's statement that he proposed to the record today. Pension coverage of private sector workers was the central issue in the President's Commission Report. We have found shortcomings in the Commission's analysis which raise in our minds serious questions about many other areas of the report.

As EBRI completes these additional reviews they will be made available to you.

To analyze the coverage question, EBRI examines what the Commission's document on coverage given to you today, refers to as our relevant population. Mr. Woodruff, in that document states that this is an unfair narrowing of the population, because we must be concerned with providing for all retired individuals.

I would stress that, as you did in your opening comments and as he did, solutions must be targeted. And that applies to the use of private pensions and judging their success or failure, as well as the use of IRA's Keogh social security benefits and other programs.

If one looks at the more limited workforce of fulltime workers, age 25-64, out of the agricultural workforce and not self-employed, one finds that 74 percent are currently covered by private plans, 68.3 percent actively participate in those plans, 56 percent of those participants are currently vested to receive a benefit and of those in those plans for 10 years or more, in excess of 80 percent of those individuals are vested.

These are statistics taken from the same data sources used by the Commission.

Senator CHAFEE. Mr. Salisbury, we've really got a divergency in statistics. I'm not sure which page you're on.

Mr. SALISBURY. I'm at the front of my summary statement, which I was asked to present to you, sir, which is a two-page—three-page statement that I present provided with my testimony.

Senator CHAFEE. Is the divergence due to self-employed?

Mr. SALISBURY. It is principally the difference between looking, as Mr. Woodruff's 40 percent figure in his statement today did, at the entire work force age 18 to 65, and beginning to narrow that population to those individuals that it is reasonable to expect should and can be included in a private pension program—(a) and (b) were they included—could be expected to earn a reasonable benefit based on earnings and years of service.

Since private pensions unlike the redistributional aspects of social security, provide a benefit only for the time you worked and only relative to the work that you did at the earnings levels. If you narrow that total workforce of 18 to 65, which I point out is 95.4 million people, to this narrower group, those 25 to 64, working in excess of 1,000 hours a year, having been with an employer for at least 1 year, you take out agricultural workers who tend to build their retirements security through their farm and their farm work, and self-employed who generally make use of IRA and Keogh and other mechanisms and businesses they own. You then get down to a work force that is closer to 49 million people. A very substantial reduction.

But, when looking at this particular mechanism, among all of the mechanisms earnings and others, that Mr. Woodruff noted, we feel that this is the relevant group to look at because it is the group that you can actually get at and benefit most directly through the private pension mechanism given the direct earnings and work relationship.

In that, and in our estimates as well as the Commission's estimates, I would note that of those workers now 25 to 29 participating in a plan by their simulation models, an excess of 70 percent of those people are likely—definitely likely to receive a benefit before they retire—at the time they retire.

Seventy percent of those participants—which puts it in a dynamic light that is very, very different than a static picture which the 40 percent figure is.

From 1950 to 1979 when the total work force increased by 90 percent, participation in employer sponsored plans grew by 263 percent. Yet, the Commission study concluded that based upon its forecasting models, the portion of the work force covered and vested in employee benefit plans was not expected to increase significantly in the future.

We have carefully looked at those models which were received by us under the Freedom of Information Act in the assumption.

The Commission paid for use and development of two models.

First the Commission placed maximums—absolute maximums on the level that coverage could grow in the future in their macroeconomic model. The difference here by 1995 is the difference in pension growth of 72 percent versus 83 percent on constrain.

Second a microsimulation model was developed by the Commission. The Commission staff had run this model with a specification that the real wage rate in the future would grow. They changed that specification, and based on a zero real wage increase projected this very limited growth in the private pension system.

They then however, used the same model to analyze their mandatory, universal pension proposal. In analyzing that proposal, they assumed a 1 percent real wage growth. In other words, using very different economic assumptions in the two scenarios.

Running the Commission's own model based on a 1 percent growth, one finds that it projects very significant future growth in the private pension mechanism.

We question the appropriateness, therefore, of using contrary economic assumptions.

Fourth, the Commission's MUP assessment is likely wrong, due to a number of other built in assumptions in the analysis, which we hope to explore in the future, since we just received this information in the last week.

First, there will be no growth in employer sponsored plans after 1984 as an assumption.

Second, there will be no changes in present plans after 1984 as an assumption.

Third, that the administrative costs to initiate, operate, and maintain the MUPS program will be zero.

And, fourth, that the assessment assumes no effects occur by reason of adoption of its tax treatment changes or other recommendations in the retirement income system.

In short, their assessment of the future analysis of proposals and what it would do for retirement income principally limits itself to MUPS plus the change in the social security programs.

We feel that this is an exceptionally partial analysis and not a sufficient analysis for one to reach the conclusions that they were presenting to you today.

Because we have found inconsistencies and problems in the Commission's research available to date, we feel it especially important that all of the items specified in attachment 1, with full documentation and full data tapes be made available to the public and interested researchers, so it can be evaluated.

Only with full information, can all parties, including this committee, move toward a national retirement income policy based upon solid facts in a comprehensive understanding of the consequences for other national needs and priorities.

In closing, I would stress Senator, that as you noted in the beginning, the provision of retirement income is something that must come through many vehicles, through individual savings, through structured retirement programs, through social security, through individual savings in the form of assets and other accumulation, and through earnings after what would normally be a retirement age.

Therefore, to judge the private pension system or any other component of that complex of retirement income programs, individually and independently against the entire working population, in our view, represents a distortion, and we hope in the future, as you move forward with hearings in this area, that we will be able to make available to you, our continued assessments of the research done to date, as well as our future research in order to aid you in your decisionmaking.

Thank you.

Senator CHAFEE. Well, Mr. Salisbury, as you recognize, this is just the opening round on this matter. There will be an adequate chance for barrage and counterbarrage. [Laughter.] And Mr. Greenough's waiting eagerly to get out of the box. [Laughter.]

Let me ask you this, Mr. Salisbury. Is it true that 60 percent of current retirees are almost entirely dependent on income from social security.

Mr. SALISBURY. It's an accurate statement.

From our statistics, it matches that what you find is a very substantial portion of individuals who are currently on social security, particularly at the minimum benefit levels, had tenuous attachment to the workforce throughout their careers and worked at very low wage levels.

In addition, you'll find that substantial numbers of those currently on social security were in the employment setting prior to the current dramatic growth that has taken place in private pensions. As I note, the development was a 263-percent participation increase between 1950 and 1979. A very substantial portion of those absolute growth numbers in participation were between 1970 and 1979. So to judge the effectiveness of the private pension system or individual retirement accounts, or Keoghs, or any of these other things, against the current retired population is very misleading.

Senator CHAFEE. What has been the effect of ERISA on private pension plans growth? Has it had a chilling effect?

Mr. SALISBURY. It had an initial chilling effect. By 2 years after the act, net new plan formations had dropped to just over 3,400 plans as compared to close to 60,000 plans in the year prior to ERISA.

I think there's an optimistic note, however, that by 1980, according to Internal Revenue Service figures, net new plan creations were again approaching that 60,000 figure.

It is one of the reasons that we were inclined to go back and carefully assess the Commission's conclusion that future pension growth could not be expected. That with 60,000 new plans in an average size of around 70 created in 1980 alone, it was inconceivable to us that that was going to immediately stop, and one could reasonably not expect future expansion of the private pension systems.

Senator CHAFEE. In your judgment, what would the effect be of increasing the attractiveness of IRA through, let's say, a $1000 deduction for everyone—except those in mandatory plans?

Mr. SALISBURY. Well, if you looked at it strictly from the standpoint of the number of individuals that might reasonably be—who might be eligible for that—the numbers are obviously into the neighborhood of 50 million or so people who are in an income status and a work status that might be able to take advantage of it.

Senator CHAFEE. But what would the effect be?

Mr. SALISBURY. There is a potential effect if you use the IRA and it may be used as an employer sponsored IRA, but in a very small plan situation, small employer situation, it is reasonable to assume that many employers might choose to sponsor IRA's for their employees, rather than to create a full-blown retirement income program, and that's a tradeoff that one has to look at.

Senator CHAFEE. What do you mean by an employer sponsored IRA?

Mr. SALISBURY. Well, there are cases now, where many employers, small employers, will basically set up a plan that is the equivalent of just IRA accounts for all their employees, and they make the contribution or the employee can make the contribution as well, but if they do that and use that as the vehicle rather than creating what we normally see as defined benefit or defined contribution plans.

Senator CHAFEE. However, if you make the IRA too attractive, isn't it feasible that the employer would opt for the IRA rather than his own plan?

Mr. SALISBURY. I would have to doubt that most employers would view a $2,000 contribution level as so attractive to make the difference in that particular decision.

Senator CHAFEE. Yes; but there must be a cutoff period. If it was $10,000 it might make a difference.

Mr. SALISBURY. I think it could. One of the areas of research we're beginning to explore are those kinds of trade off issues. I know other groups are as well. I think that one of areas in my full statement I noted, we regretted that the Commission had done almost no research, was in the area of assessing what the potential affects of the tax incentives that they have recommended would be. Either positive or negative.

Senator CHAFEE. Thank you Mr. Salisbury.

Mr. Greenough, you may proceed.

OPENING REMARKS OF DR. WILLIAM C. GREENOUGH, CHAIRMAN, SUBCOMMITTEE ON RETIREMENT POLICY, COMMITTEE FOR ECONOMIC DEVELOPMENT AND TRUSTEE, TIAA-CREF AND CHAIRMAN, CREF FINANCE COMMITTEE ON RETIREMENT AND PENSION POLICY

Mr. GREENOUGH. Mr. Chairman, I will, to conserve time, speak from notes, if we may put the full testimony of CED in the record.

Senator CHAFEE. Without objection, it is so ordered.

Mr. GREENOUGH. I was a member of the President's Commission on Pensions. Tom Woodruff was speaking officially for it today. I'm speaking for the Committee for Economic Development today.

It's a private nonprofit business and academic organization with 200 trustees, top business people and top heads of commissions, who themselves consider our policy statements and vote on them as a whole. So we come to you with a very powerful background.

We will be bringing this statement to them this coming week after many months of committee meetings on them. You're getting a preview of them a little earlier.

Now, in recent years the effort of the CED has been to develop strategies to rebuild competitiveness, bolster capital formation, productivity, increasing employment, reduce inflation and make policy statements on those.

Everywhere we turn, of course, we run into the central dominant position of pensions. They're huge. They're expensive. The effort to get enough money from the working population to the retired is very, very expensive. In fact I'll try to cover in my allotted time about $1 trillion of expense per minute.

The purpose—I'd like to state a purpose. To make all Americans secure and comfortable with social security, private pensions and private savings, a three-legged stool, universal social security, voluntary extension of private pensions to supply capital to assure the productivity to finance social security and retirement. The whole thing ties together.

One comment on your question on adequacy of benefits. The President's Commission suggests a goal of replacing preretirement income, the highest standard of living that most people have ever had. I personally think that's a very pleasant goal to contemplate, but pretty unrealistic.

You're suggesting—not you. It's a suggestion that that final standard of living at the highest level should be maintained in retirement, while younger families trying at age 30, buying a house, trying to raise a family, all the rest of it, are living at perhaps only half the salary that they could look forward to later.

So, it's a very generous goal.

How do we achieve, however, good adequacy in retirement?

For one, I think we—quit mandating everything. With the level under the social security, which is a very broad, very good mandated program, telling us all how much to set aside for retirement, we now need to encourage good action. Your own programs for encouraging good action by diverse efforts in the private sector to fit the pension needs of individuals and particular companies.

Let me sketchily outline the main CED framework.

It parallels in many respects to the President's Commission. It should because both of them are taking a very long, very comprehensive look at it.

One, let's start young. You know the crisis in confidence in social security that I worry about is not of the old people, it's of the young. They are heavily burdened by it and they've kind of lost confidence in it.

Let's exclude the employee contributions from taxable income. It happened accidentally, but now we're taxing individuals to transfer the money to retired people and taxing them on the tax.

Untax both the social security and the employee retirement plan contributions; extend the limits of IRA's and Keogh's as you had suggested. This is expensive, but overdue and we need to work it into the tax things we are now working on. This would mean deferring until the person gets the set asides either to transfer money under social security or on private pensions to transfer money from himself when young to himself when old.

But then that, of course, means including taxable income on the benefits when received.

That would mean not taxing the poor. They do not get into a tax level at all. Concurrent with this, adjust the retirement ages upward.

The most powerful lever we have is putting the retirement ages upward and working out efforts to to CED and others to increase and improve employment opportunities at the older ages. And then, and then only, get rid of the employment tests.

Employment tests is under pressure again, social security was never set up to transfer money from working younger people to working older people. That wasn't its idea at all, or to give a person a big increase at age 65.

So, until we untax contributions through the benefits in taxes, so that people who are in higher income because of work or whatever do pay taxes on the work that their making, then we should not do away with the work test.

Now, if we do this whole cycle, and, of course——

Senator CHAFEE. By the work test, what do you mean?

Mr. GREENOUGH. The test set up in social security to determine whether a person has withdrawn from the work force, and therefore gets social security. You can earn $4,500——

Senator CHAFEE. Are you talking about the earnings limitations?

Mr. GREENOUGH. Yes.

Senator CHAFEE. Once you retire?

Mr. GREENOUGH. Yes, that's right.

Senator CHAFEE. Are you proposing eliminating the earnings limitations?

Mr. GREENOUGH. I would not get rid of it until those extra earnings in retirement are included in the progressive income tax.

Senator CHAFEE. Contrary to what the administration is recommending?

Mr. GREENOUGH. That's right. They're grabbing out the idea that its unfair after you pay taxes all these years not to get the benefits, but what they're overlooking is putting in competition with the younger people also holding jobs, older people who are getting social security free transfers from the younger people, not taxed, and then working on top of that.

Senator CHAFEE. Of course, the older person when he's working would still be paying social security taxes.

Mr. GREENOUGH. He'd be paying social security taxes, but you know a younger couple with two kids, gets into a taxable income bracket of about $7,400, an older couple, just a couple alone because of double exemptions, doesn't get into a taxable bracket until the same $7,400 even though there's only two people. Yet, to get social security benefits they can be as much as $11,000 so that it's possible for an older person not to have any taxable income up to $19,000 compared to a younger person, $7,400.

And, it's that imbalance that we really need to take a very hard look at.

Senator CHAFEE. What you're suggesting, is quite a dramatic change in the tax policy. What you're suggesting is exactly as the Commission recommended, that employee's contributions to social security would be deductible and social security would be taxable. Is that right?

Mr. GREENOUGH. Would be included in taxable income.

A great many people wouldn't pay taxes under the present statistics because of the double exemption and under $7,400—they don't get into taxes.

Senator CHAFEE. How do you work your way into that program? Where do you start? Would those collecting now be tax free?

Mr. GREENOUGH. You would phase it in. You would have to phase it in.

Senator CHAFEE. It would take a long time to phase in wouldn't it?

Mr. GREENOUGH. Yes it would. And it is expensive at the start. That is why both the President's Commission and the CED suggest doing that when any major tax reduction is made, because you make the tax reduction on people for people who are paying a tax already and they're merely paying tax on the tax, so you reduce that. That puts the money into the consumer stream and provides it for the people who have lost confidence or who are losing it in social security.

Senator CHAFEE. Thank you very much, Mr. Greenough. Is there any other major point you wanted to make?

Mr. GREENOUGH. There's a good many of them. The statement itself., but the main thing is to break the pattern of low savings, low productivity, high inflation and the financial problems with social security in order to be able to finance retirement for our older people through a very productive economy. It all ties in together.

Senator CHAFEE. I must say, the principal point you made here doesn't seem to affect the solvency of the social security fund one way or another, except for the increase in the retirement age you mentioned.

What difference does it make to the solvency of the fund whether the contributions are taxable or nontaxable? That has more to do with the Treasury of the United States as opposed to the social security funds.

Mr. GREENOUGH. And, with the exceptance to younger people who are paying the bill of the whole social security system. It has a great deal to do with that, you see.

Senator CHAFEE. But, you're finding a rebellion out there amongst younger people.

Mr. GREENOUGH. If you talk with younger people, their confidence in social security is distressingly low.

Senator CHAFEE. You are proposing a complicated way to proceed in order to restore this confidence.

Mr. GREENOUGH. It's a very fair way. It's hard to accept at the start. I predict it will be very strongly—it will become the conventional wisdom within two or three years, once people think through this excessive difference in when younger couples get into taxable income and when older people get into taxable income. We're not talking about taxing the older poor or even the older middle class.

Senator CHAFEE. Thank you very much, Mr. Greenough.

[The prepared statements of the preceding panels follow:]

STATEMENT OF

DALLAS L. SALISBURY

EXECUTIVE DIRECTOR

EMPLOYEE BENEFIT RESEARCH INSTITUTE

MAY 15, 1981

THE PRESIDENT'S COMMISSION ON PENSION POLICY REPORT,
"COMING OF AGE: TOWARD A NATIONAL RETIREMENT INCOME POLICY"

A Hearing of

Committee on Finance
Subcommittee on Savings, Pensions, and Investment Policy
United States Senate
Ninety-Seventh Congress
First Session

INTRODUCTION

I am Dallas L. Salisbury, Executive Director of the Employee Benefit Research Institute (EBRI). It is a pleasure to be here this morning and I thank you for giving EBRI the opportunity to appear. EBRI was established in 1978 to meet a need for professional analysis and comprehensive, practical, objective research on employee benefits.

EBRI is not an action-oriented, lobbying organization which takes specific positions on policy proposals. Rather, the Institute provides research and basic information that can be of use to private organizations, the Congress, and others, in reaching policy conclusions. I should note specifically that EBRI does not have a position on the policy recommendations of the President's Commission on Pension Policy. EBRI does believe that one should be allowed, based upon full and open information, to make an assessment of whether or not a recommended policy course is the appropriate one. I will briefly review today the Commission report from the standpoint of research sufficiency. EBRI has used a number of criteria for this analysis, including:

1. Have major research questions regarding benefits, costs and consequences been addressed?

2. Does the report provide sufficient information to allow an understanding of why a particular conclusion was reached?

3. Does the report provide sufficient information to allow one to reach an independent conclusion?

4. Were appropriate and consistent assumptions used for analysis and modeling?

Over the past two years members of the Commission gave substantial time and attention to the study effort. They succeeded in focusing public attention on the importance of retirement income issues and in beginning many potentially far reaching research projects. We are concerned that much of the benefit of this effort may be lost, for the Commission's detailed work has not been made public at this time. We hope that the information will be made public before the Commission's termination on May 24, 1981. I submit for the Record as part of this statement Attachment 1 which outlines the products and items that should be made available in order to serve the public interest.

INCOME ADEQUACY

The Commission stated the following principal recommendation as underlying the entire report:

* The Commission believes that the replacement of pre-retirement disposable income from all sources is a desirable retirement income goal.

While this need may exist, the research criteria are not satisfied. Cost and consequences analyses were limited. The amount of comprehensive and interactive economic analysis needed to effectively assess the major policy implications would be substantial. This is made clear in documentation of the Commission's models. Analysis must include assessing the impact on other government expenditures as well as private business expenditures. What programs will be cut back to enable retirement income expenditures to expand?

At a very early stage, the Commission downplayed the potential success of many alternative approaches to increasing retirement income. The Commission's Executive Director, speaking in Vancouver, B.C. in June, 1979 (only three months after the first meeting of the Commission) noted that tax incentives had not worked in the past and could not be expected to work in the future. The Commission's report presents no research to substantiate this hypothesis, and no working papers were released during the life of the Commission that provided additional insights in this area. The criteria cannot be satisfied. Nonetheless, the Commission concluded:

* Tax incentives, even those proposed by this report, will not significantly increase the pension plan participation of low and moderate income workers and workers employed by small businesses.

This hypothesis deserves to be fully researched and tested before it is used as the basis for justifying major policy changes. Testing would need to be on a dynamic basis making use of recent data. While limited analysis has been completed, data from the Bureau of Labor Statistics indicates that by 1977 current incentives were having an effect among small employers.

THE COVERAGE QUESTION

The President's Commission on Pension Policy concluded that "the most serious problem facing our retirement system today is the lack of pension coverage of private sector workers." The coverage question, the common statement that the failure of the employer pension system is that it covers less than half of the working population, has been a common measure for the private pension system and employer sponsored plans for many years.

Because coverage was the central issue in the PCPP report, it is the principal focus of our testimony this morning. The shortcomings we have found in the Commission's analysis in this area, however, do raise questions in many other areas of the report. As EBRI completes its review in those areas the results will be made available to the Subcommittee.

The Commission based its conclusion that the lack of pension coverage was the most serious retirement income problem on analysis of the total workforce and without regard to employment stabililty. It concluded that of the total workforce, only 45 percent participate in a private employer sponsored pension program.

EBRI Coverage Statistics

Congress established, through the Employee Retirement Income Security Act (ERISA), minimum standards for participation in pension programs. The standard, according to the legislative history, identifies when a worker most readily begins to stay with an employment situation and when it is financially reasonable to require participation. There are worker groups in the population that as a matter choice or the nature of their work role would not normally be expected to be in employer sponsored plans. With these adjustments, one can move from the total workforce to a relevant workforce.

The relevant workforce removes from the total 95.4 million those under age 25 and over age 64 (24.1 million persons). EBRI also removes agricultural workers and the self-employed, groups not likely to be covered by employer plans. or unlikely to generally need this additional source of income (8.1 million workers). Finally, when moving to the ERISA standard (25 years of age, one year of service, 1,000 hours of employment per year), the number of the relevant workforce drops from the 95.4 million total to 49.7 million workers.

Of the relevant workforce, 74 percent are currently covered by employer sponsored programs; 68.3 percent are actively participating in the plan; 56 percent of participants are currently due a vested benefit and 80 percent of those who have been in the plans for more than 10 years are due a vested benefit. In addition, 9 percent of the participants have benefits that are vested in previous employers' plans. Of those who are not currently covered by a retirement program who meet the ERISA minimum standard criteria, 14 percent are vested in a plan from a previous employer. These statistics indicate that approximately two-thirds of the relevant workforce will receive a benefit from employer sponsored plans.

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From 1950 to 1979, when the total workforce increased by 90 percent, participation in employer sponsored plans grew by 263 percent. Of those workers not covered by a plan, 65 percent earn less than $10,000 per year or $5.00 per hour; 46 percent work for employers who have less than 25 employees; 66 percent work for employers with less than 100 employees. Of those individuals working for employers with 1,000 or more employees, 92 percent are covered by an employer sponsored plan; of those working for employers with 500-999 employees, 84 percent are covered. These figures indicate a relatively significant success story since 1950 for private employer sponsored and public employer sponsored plans. Those who are not covered can be clearly identified and policies targeted to provide for them.

Coverage Growth

The President's Commission study concluded that its "forecasting models indicate that the portion of the labor force covered and vested in employee pension plans is not expected to increase significantly under current policies." As a result of this assumption and based on their forecasts of no future growth, the Commission presented as its keystone recommendation the Mandatory Universal Pension System (MUPS). The EBRI study has carefully attempted to access the Commission's models and assumptions. Our assessment raised two questions: First, how can 263 percent participation growth over 29 years be assumed to instantaneously stop? Second, how can recent history be such an inaccurate predictor of the future? Dynamic analysis based on recent data indicates that employer plan coverage is growing and can be expected to do so in the future. While regulatory uncertainty caused new net plan formations in the private sector to drop to 3,494 plans in 1976, 1980 witnessed the formation of 56,063 net new plans: 14,552 defined benefit plans, 41,511 defined contribution plans.

The Commission assumed that new small plan development was unlikely. Yet, the average new plan size in 1980 was less than 75. Once a firm views itself as an ongoing business concern and profitable enough to afford the plan, the employer will probably create a plan. This is particularly significant since 66 percent of those individuals not currently covered work for employers with less than 100 employees. Over the last ten years the small employer sector has created new jobs at a much faster rate than larger employers. But the average life of firms with fewer than 20 employers is less than five years. This indicates that it takes time for small employers to reach a point of profitability sufficient for plan creation. Economic questions arise as to when young firms can either voluntarily or mandatorily set aside more money than is already required by law for retirement savings.

PCPP Models

It is important to analyze the means by which the President's Commission reached its conclusion that coverage growth will be limited in the future. The Commission paid for the use and development of two models. Our assessments find that using reasonable assumptions in the same models do not support the Commission's conclusions.

First, the Commission placed absolute maximums on the level that coverage could grow in the future in their macroeconomic model. Their cap resulted in a maximum potential coverage of 72 percent in 1995. EBRI had the same models rerun without those caps. The result: by 1995 there could be a possible increase in coverage to 83 percent, an increase of over 11 points or 1 percent per year. In assessing the reasonableness of the maximums the Commission assumed, EBRI examined the fact that over the last ten years, with the exception of the years immediately following ERISA, annual growth in coverage exceeded 1.2 percent per year.

Second, a microsimulation model was developed for the Commission. Microsimulation models focus on individual workers and their pension protection accruals. The contractor who developed the model submitted an initial report to the Commission which indicated that there would be substantial future growth in employer sponsored plans. The Commission staff changed a critical assumption; instead of assuming future real wage growth, they assumed no growth. Except for the past 2½ years, real wage growth has been common. Further, future real wage growth is assumed by the Administration, the Congressional Budget Office, the Senate Budget Committee, and others in planning for the future.

MUPS ANALYSIS

The Commission used the same microsimulation model to analyze the potential effects of the mandatory universal pension system in the future. However, in running the model to assess "MUPS," the Commission staff assumed a 1 percent per year increase in real wages. It is peculiar that two contradictory assumptions were used to assess these two different futures: the future of voluntary programs:

We submit that this is a highly questionable procedure to use when attempting to allow a distinguished Commission to reach reasoned conclusions based upon full information.

The Commission report concludes that the basis for recommending "MUPS" is the projection of no significant growth in the private pension system. Yet a positive real wage assumption, if uniformly applied, would have shown such growth. The PCPP analysis of "MUPS" was also based on four other assumptions. First, there will be no growth in employer sponsored plans after 1984. Second, as a result of reaction to institution of the Commission's recommendations, there will be no changes in present plans after 1984: no freezes, no terminations, no changes in participation standards. Third, the administrative costs to initiate, operate and maintain MUPS will be $0. Finally, the assessment includes no effects which may occur by reason of its tax treatment changes or other recommendations.

A CONSISTENT PUSH FOR MORE

The Commission recommendations include a consistent emphasis on allocating additional national resources to retirement income provision.

* The Commission believes that other programs to supplement social security's basic floor of protection must be substantially increased.

The report provided no information on the potential cost of accomplishing this particular goal. The criteria were not met, whatever the merits. A staff working paper which was completed in May, 1979, did provide some estimates of cost. According to that paper, achieving this goal with a 75 percent spouse benefit at age 65 retirement would cost:

YEARS OF SERVICE	COST AS PERCENT OF PAYROLL
20	45
25	35
30	29
35	24
40	21

There is a tremendous amount of research that would need to be presented to meet the criteria for evaluation. What would be the social and economic benefits, costs and consequences? What benefits might employees lose in order to gain extra retirement income? What segments of the population would benefit? How would this goal compare to that set for other segments of the population?

Having established an umbrella goal, the report turns to recommendations for increasing retirement program coverage.

We feel that the Commission staff's analysis understates the future of employer plans under current policy, does not adequately assess the potential impact of additional voluntary incentives, and may overstate the relative positive effects of "MUPS." A balanced and consistent analysis would be necessary to allow a full assessment of the Commission recommendations.

PRIORITIES FOR THE '80s

The Commission's work represents a monumental effort. Given the substantive breadth and scope they were asked to study, a great deal was accomplished, but not enough. The Commission's final report and working papers leave much to be explored. This was made clear by researchers at the Commission's January "Research Conference." Substantial behavioral, benefit, and economic research must still be undertaken. Research regarding the effect of tax incentives is only now beginning.

If adopted, the Commission's recommendations could have significant implications for the public and private sectors in many areas, including:

* The cost of doing business
* The level of employment and new job creation
* The pattern of new business creation
* The scope of government regulation
* Future prospects for government mandating of programs
* Levels of overall Federal taxation
* Distribution of tax incentives amongst and between government programs
* The proportion of gross national product dedicated to retirement income programs
* Makeup of the total compensation package

The Commission's recommendations set out a framework that should be analyzed and conceptually tested. All parties must move toward a national retirement income policy based upon solid facts and comprehensive understanding, including an understanding of the consequences for other national needs and priorities.

CONCLUSION

Because we have found inconsistencies and problems in the Commission research made available to date, we feel it especially important that all the items in Attachment 1 be released. If the information is not released, we may never be able to identify those recommendations for which the analysis stands up under careful evaluation.

EBRI's work on coverage is only one of the studies we currently have underway. It is one that we hope will be helpful to this Subcommittee in assessing what you feel policy in the future should be. Our research does lead us to two solid conclusions. First, judging the private pension system on the basis of half of the workforce is unfair, unrealistic and unwise. Second, available research, including reasonable runs of the Commission models, indicates that significant voluntary employer sponsored plan growth can be expected in the future.

Attachment 1

EBRI

March 25, 1981

Robert Roeder
President's Commission on Pension Policy
736 Jackson Place, NW
Washington, DC 20006

Dear Mr. Roeder:

I respectfully request copies of the following documents which we believe should be available under the Freedom of Information Act. The Employee Benefit Research Institute will reimburse the Commission for any expenses incurred in duplicating the documents.

1. The Commission on Pension Policy published a reference list of 52 papers and projects to be undertaken by the Commission. I request copies of the following studies, which are presented exactly as listed in Attachment 1.

2. Copies of the work specifications and compensation and/or contract specifications signed between the Commission and those authors under contract with the Commission, including but not limited to those listed in Attachment 2. • partially received 4/8/81

3. Copies of data tapes and programs specially developed from the CPS master tapes by ICF, Incorporated to create tables included in "Potential Effects of a Minimum Universal Pension System (MUPS)", DRAFT FINAL REPORT, January 23, 1981. Specifically, breakdowns for households versus individuals contained in Tables 19, 20 and 21. If permission were granted, we would be pleased to work directly with ICF, Incorporated.

Please let me know if there are any difficulties or if full response will exceed ten days.

Sincerely,

Dallas L. Salisbury

Dallas L. Salisbury
Executive Director

DLS/das
Attachments

EMPLOYEE BENEFIT RESEARCH INSTITUTE

1920 N Street, NW/Washington, DC 20036/Telephone (202) 659-0670

Attachment 1

Commission Working Papers

Pensions and Personnel/Human Resource Management: Documented and Potential Impacts of Pensions on Human Resource Management Systems and Individual Work Behaviors by Judy D. Olian, Stephen J. Carroll, Jr., and Craig E. Schneier, College of Business and Management, University of Maryland, February 1981.

Early Retirement in Public Safety Organizations by Michael J. O'Connell, February 1981.

President's Commission on Pension Policy

RELEASE DATES

Papers and Projects	Due Date	Authors	PCPP Representative
11. ADEA Impact on Alternative Work Patterns	August 1980	Portland State	Betty Meier
14. Index Bonds	August 1980	Bob Schoeplein	Betty Meier
15. Bargaining Over Retiree Benefits	September 1980	Rick Bank	Tom Woodruff
16. Social Security Benefit Structure	September 1980	Shelley Lapkoff	Shelley Lapkoff
17. Social Security Financing	September 1980	Bill Cartwright	Bill Cartwright
18. Tax Policy-Report on Costs	September 1980	Mary Barth	Emily Andrews
20. Effects of Savings	September 1980	Bill Cartwright	Bill Cartwright
23. Description of Small Plans	September 1980	American Society of Pension Actuaries	Michael O'Connell
24. 1979 Schedule B Data	September 1980	American Academy of Actuaries	Preston Bassett

Papers and Projects	Due Date	Authors	PCPP Representative
Economic Implications of Allocation of Pension Fund Capital	September 1980	Jim Barth	Emily Andrews
26. Unisex Tables	September 1980	Preston Bassett	Shelley Lapkoff
27. Implications of Making the Single Person's Budget 75% of the BLS Intermediate Couple's	October 1980	Tom Borzilleri	Betty Meier
28. Cost of Eliminating Earnings Test	October 1980		Betty Meier
29. Early Retirement, Hazardous Duty Occupations, etc.	October 1980	Betty Meier	Betty Meier
30. Pensions and Personnel Management	October 1980	Craig Schneier Stephen Carroll Judy Olian	Michael O'Connell
31. Wage/Pension Tradeoff	October 1980	Smith	Emily Andrews
32. Disability Studies	October 1980	Monroe Berkowitz	Michael O'Connell
. Coordination of Pension Programs	October 1980	Cynthia Dittmar	Cynthia Dittmar
37. Alternatives to Universal Social Security Coverage	October 1980		Leigh McDermott
38. Household Survey		Market Facts/SRI	Emily Andrews
39. Description of Private Plans	October 1980	Tom Woodruff	Tom Woodruff
40. Actuarial and Accounting Standards	October 1980	Jim Ball	Michael O'Connel
41. Intergenerational Distribution of Income	October 1980	Tom Woodruff Marcy Avrin	Tom Woodruff
42. Description of State and Local Plans	November 1980	SRI/Urban Institute	Michael O'Connel
43. Risk in the System	November 1980		Tom Woodruff
44. Ownership and Control	November 1980	Rick Bank Cynthia Dittmar	Emily Andrews
45. The Impact of Demographic Changes on Savings	November 1980	Paul Wachtel	Emily Andrews
. Appropriate Preretirement Earnings Base	December 1980		Betty Meier

Papers and Projects	Due Date	Authors	PCPP Representative
47. Setting the Retirement Age	December 1980		Betty Meier
48. Alternative Designs for A Universal Minimum System	December 1980	Michael O'Connell Betty Meier ICF	Treasury Michael O'Connell
49. Vesting	December 1980	Michael O'Connell Betty Meier ICF	Treasury Michael O'Connell
50. System Administration, Enforcement and Monitoring	December 1980	Blaydon, et. al.	Tom Woodruff
51. Pensions and the Labor Market	January 1980	Larry Kotlikoff	Emily Andrews
52. Implications of Policy for Capital Formation, Savings and Investments	January 1980	Bill Cartwright	Bill Cartwright

Attachment 2

Papers and Projects	Due Date	Authors	PCPP Representative
. Private Pensions and Capital Formation	September 1979	Mordecai Kurz Marcy Avrin	Emily Andrews
11. ADEA Impact on Alternative Work Patterns	August 1980	Portland State	Betty Meier
13. Role of In-Kind Benefits	August 1980	Tom Borzilleri	Betty Meier
15. Bargaining Over Retiree Benefits	September 1980	Rick Bank	Tom Woodruff
18. Tax Policy-Report on Costs	September 1980	Mary Barth	Emily Andrews
23. Description of Small Plans	September 1980	American Society of Pension Actuaries	Michael O'Connel
24. 1979 Schedule B Data	September 1980	American Academy of Actuaries	Preston Bassett
27. Implications of Making the Single Person's Budget 75% of the BLS Intermediate Couple's	October 1980	Tom Borzilleri	Betty Meier
3. Pensions and Personnel Management	October 1980	Craig Schneier Stephen Carroll Judy Olian	Michael O'Connel
31. Wage/Pension Tradeoff	October 1980	Smith	Emily Andrews
32. Disability Studies	October 1980	Monroe Berkowitz	Michael O'Connel
33. Roles of Income Security Programs	October 1980	Stanford Ross	Barbara Bowers
38. Household Survey		Market Facts/SRI	Emily Andrews
40. Actuarial and Accounting Standards	October 1980	Jim Ball	Michael O'Connel
42. Description of State and Local Plans	November 1980	SRI/Urban Institute	Michael O'Connel
45. The Impact of Demographic Changes on Savings	November 1980	Paul Wachtel	Emily Andrews
50. System Administration, Enforcement and Monitoring	December 1980	Blaydon, et. al.	Tom Woodruff
1. Pensions and the Labor Market	January 1980	Larry Kotlikoff	Emily Andrews

File

President's Commission on Pension Policy
736 Jackson Place, NW, Washington, DC 20006

April 8, 1981

Mr. Dallas L. Salisbury
Executive Director
Employee Benefit Research Institute
1920 N Street, N.W.
Washington, DC 20036

Dear Mr. Salisbury:

This is in reply to your letter of March 25th requesting various materials which we had expected to be available at this time. Unfortunately, many projects remain unfinished.

Of the 52 papers listed in Attachment 1 to your letter, only 18 have been issued by the Commission. These are listed on page 105 of the Commission's final report. The paper by Mike O'Connell was included in this list by mistake as it has not yet been completed. Copies of these 18 papers are available from our office if there are any you don't have. All are being revised, however, and will be included as chapters in the technical appendix to the final report. Most of the other papers listed in Attachment 1 will also be incorporated as chapters in this appendix, which we hope to publish early in May.

Enclosed are copies of work specifications and invoices which you requested in Attachment 2. Except for the household survey all work was done on a noncompetitive basis through purchase orders. In most cases the Executive Director gave work specifications orally to the authors under contract. The following papers were not funded by the Commission so I am unable to furnish any information about work specifications or compensation for them:

18. Tax Policy - Report on Costs
40. Actuarial and Accounting Standards
42. Description of State and Local Plans
50. System Administration, Enforcement and Monitoring.

Rick Bank is on our payroll as an intermittent consultant at $192.72 per day. The contract file on Market Facts has been misplaced but the total contract cost was $1,377,408. The SRI contract was for $487,063.

The "MUPS" project was carried out by ICF under contract to the Department of Labor. Release of public use taped produced from that work is being controlled by Ian Lanoff's office. I understand from Wally Kolodrubetz that these tapes are still under review.

I regret that I could not be more helpful in furnishing the materials you requested. If you have any more questions, please give me a call.

Sincerely,

Robert J. Roeder

Robert J. Roeder
Administrative Officer

Enclosures

EBRI

April 20, 1981

Mr. Robert Roeder
Freedom of Information Officer
PCPP
736 Jackson Place N.W.
Washington, D.C. 20006

Dear Mr. Roeder:

This letter shall serve as an official request for information under the Freedom of Information Act.

1. One copy of all items referred to in your letter of April 8, 1981 as not yet available
2. One copy of the final report from PCPP contractor ICF, Inc. titled "Background Analysis of Potential Effects of a Minimum Universal Pension System (MUPS)" Received 5/1/81
3. One copy of full documentation and data tapes from PCPP contractor SRI International as soon as available.

Let me know should you need additional information. Thank you in advance for your cooperation.

Sincerely,

Dallas L. Salisbury
Executive Director

DLS/bw

EMPLOYEE BENEFIT RESEARCH INSTITUTE
1920 N Street, NW/Washington, DC 20036/Telephone (202) 659-0670

For Release on Delivery
May 15, 1981

TESTIMONY
of

WILLIAM C. GREENOUGH, Ph.D

Chairman, Subcommittee on Retirement Policy
Committee for Economic Development

Trustee, TIAA-CREF
and
Chairman, CREF Finance Committee

on

Retirement and Pension Policy

before

Subcommittee on Savings and Investment Policy

Committee on Finance

United States Senate

May 15, 1981

Remarks by William C. Greenough

before the

Senate Finance Subcommittee on Savings, Pensions, and Investment Policy

May 15, 1981

SYNOPSIS

- While not yet formally approved for publication, the forthcoming report of the Committee for Economic Development on retirement policy will call for a broad, comprehensive approach to the retirement question. Far too many of this nation's retirement financing problems are the result of piecemeal retirement policy decisions.

- The CED report will recommend a three-tiered national retirement system composed of Social Security, employer pensions, and personal saving. The goal of this system is to provide enough saving and productive capital formation to yield both a decent standard of living for retired workers and a permanent strengthening of the economy.

- The CED report calls for an approach which will break the current cycle of low savings, low productivity, and high inflation, and will help raise the real income of the elderly and workers alike.

- We strongly urge Congress and the Administration to use all of the proposals being made for retirement reform as the basis of a comprehensive examination of retirement policies needed to develop an economy that can support the kinds of retirement programs the nation wants and can provide. In this respect, we endorse the direction of current proposals to reform Social Security, as one necessary component of overall retirement reform.

- Social Security should provide a basic retirement benefit upon which an individual can build. The CED report will recommend that:

  -- Any rise in Social Security benefits be linked to the Consumer Price Index or to the rise in average pre-tax wages, whichever is less. Also, the government should try to develop a price index which more accurately reflects the consumption pattern of the elderly.

  -- The average retirement age for Social Security be gradually raised to 68 and the early retirement age to 65.

  -- Federal workers and other noncovered workers be brought into the system.

  -- Employee contributions to Social Security be excluded from current taxable income and the benefits taxed when received.

- A number of important tax and regulatory actions can be taken to broaden the use of employer pensions.
  - -- All employee contributions to private pension plans should be from before tax income.
  - -- Employers should be able to raise voluntarily normal retirement ages in tandem with Social Security.
  - -- The proposal will encourage more workers and employers to contribute to employer pension plans which meet the specific needs of their industrial and occupational structure. We do not believe that a mandatory universal pension system (MUPS) is feasible or necessary.
- Personal savings can be increased through a variety of tax measures. Specifically, the CED report will recommend that eligibility and contribution rules governing individual retirement accounts and related retirement and savings plans be liberalized and brought more into line with the contribution limits of corporate pension plans. Employers are also urged to establish a savings portion to their benefit program.
- These recommendations for strengthening the employer pension and personal savings tiers of our retirement system will contribute to increased investment in plant and equipment. Pension plans and personal savings will therefore make an increasingly important contribution to the economic growth which is essential to the health of our retirement system in the future.

84-763 O—81——11

Mr. Chairman, my name is William C. Greenough. I am a board member of TIAA-CREF and Chairman of the CREF Finance Committee. TIAA-CREF provides retirement plans for employees of some 3,500 colleges, universities, independent schools and related nonprofit research organizations and educational institutions. But today I am speaking as Chairman of the Committee for Economic Development's Subcommittee on Retirement which is completing a comprehensive statement on retirement policy after over two years of extremely hard work. I am pleased to have this opportunity today to introduce you to our thoughts on the important subject of retirement and reform, which I hope you will find useful to your deliberations.

First, let me give you some background on the Committee for Economic Development and how this particular statement on retirement policy came to be. CED is a private, nonprofit business and academic policy group. It enjoys the active support and participation of over 200 trustees most of whom are top officers in the nation's large corporations and universities. Unlike a number of other groups the CED trustees, of which I am one, are directly responsible for CED's published policy recommendations.

For the past several years, CED has been deeply concerned with a number of disturbing trends in the U.S. economy. Accordingly, CED has been turning more and more of its research and policy activities toward developing strategies to rebuild America's competitiveness, bolster capital formation, improve productivity, increase employment, and to reduce inflation.

It is within this context that our trustees believe it is crucial that policy makers examine the future of both public and private retirement systems. Our trustees have concluded that the nation's retirement systems have an enormous impact on the future economic health of the nation. Inflation has made the cost of providing retirement benefits a substantial burden both on workers and on employers. Declining birth rates and increased longevity mean that proportionately fewer young people will be working to pay these higher costs. The report stresses that unless we curtail the growth of Social Security and strengthen employer pension plans and encourage individual saving for retirement, we will place an unbearable burden on future generations. We will also lose the opportunity to improve the capacity of the economy to provide growth in real income for the elderly and workers alike.

Our report is drafted and is scheduled to come before CED's Research and Policy Committee next week for final approval with a view toward distribution as soon as possible. While not yet officially voted upon, I welcome the opportunity to give you a preview of our major recommendations.

A Comprehensive Approach

First, and perhaps foremost, it is our conviction that the nation requires a comprehensive, broad-based retirement policy and that any piecemeal approach will not solve either the long-term problems facing our retirement system or contribute to a healthy economy.

In this regard, let me comment for a moment on the Administration's new proposals to reduce certain of the benefits and the scope of the Social Security system. The CED statement strongly endorses limiting the growth of Social Security. While our recommendations for Social Security differ from those proposed by the Administration, I personally endorse the intent of these proposals. But singling out Social Security as the focus in the retirement form is symtomatic of the same piecemeal approach that has consistently characterized years of decisions on retirement policy. Social Security is the most visible target but it is only one facet of the problems facing the entire U.S. retirement system. Reducing certain kinds of benefits, adjusting cost of living increases, and changing benefit formulas are major improvements, but CED urges the members of this committee to seek and support additional reforms for the entire retirement system.

In essence, the forthcoming CED report recommends that any national system should be made up of three tiers -- each building on the other -- Social Security, employer pensions, and personal savings. The goal of this three-tier system, which we believe must be a balanced one, is to provide enough savings and productive capital formation to yield both a decent standard of living for retired workers and a permanent strengthening of the economy.

CED's Three-Tier Approach

Social Security is the first tier. We believe that the relative role of Social Security should be to provide a basic retirement benefit upon which an individual can build. However, to insure this basic level of support for future generations, we recommend a number of changes: We call for gradually raising the normal retirement age for Social Security to 68 and the early retirement age to 65. Again, as I have already stated, I commend the Administration's proposal to reduce early retirement benefits but do not feel that this goes far enough.

The CED statement will also call for revising the current system of indexing Social Security benefits to the Consumer Price Index. If possible, we should have an index which more accurately reflects consumption patterns of older Americans. We also recommend that any raising of Social Security benefits be linked to this newly developed index or the rise in average pre-tax wages for the working population, whichever is less. In this respect we support the recent indexing proposals of the Senate Budget Committee.

Perhaps the most sweeping change is the recommendation that we share with the President's Commission to exclude employee payments into retirement funds from current taxable income and instead make the ultimate benefit payments a part of taxable income when received. We would apply this principle to Social Security as well as to employer retirement plans. While the cost of this proposal is large -- $25.6 billion in 1982 for Social Security alone, if introduced at once -- this could partially be offset by including such a tax change in the current proposal for personal tax reductions. Even given the necessary transition period, I believe that when combined with additional incentives for individual savings, this type of tax change could have real long-term advantages for the economy.

It should be noted that if this policy were adopted, it is unlikely that those elderly who rely on small pensions or basic Social Security would have to pay a tax. In most of these cases, double exemptions and regular exclusions would exclude such elderly from paying taxes.

We also believe that excluding pension and Social Security contributions from taxable income and including the ultimate benefits in taxable income when received would make it possible to eliminate the controversial earnings test, otherwise it should be continued intact because Social Security was never designed to tax younger workers in order to transfer funds to untaxed older workers.

In addition to these major changes the report makes a number of other important recommendations on Social Security including, for example, gradually bringing in federal and other noncovered workers to make the system truly comprehensive.

Employer pensions make up the second tier. Since the development of employer pension plans in the '50s, an increasing proportion of workers has become involved and is benefiting from such pension plans. But we feel certain changes in pension policies and regulations can improve funding, broaden coverage, help protect pensions from inflation, and increase private pension contributions to capital formation. In this latter regard, CED trustees believe that funded private pension plans, in addition to serving the retirement needs of the American people, can serve as a major source of capital for the economy. Consequently, the CED trustees recommend in the upcoming report a number of ways to encourage businesses to broaden voluntarily pension coverage. These include such means as simplifying certain ERISA rules, especially for small employers, and maintaining reasonable vesting periods.

Most importantly, we believe that employee contributions to private plans should not be included in taxable income, but instead that the ultimate benefits should be taxed when received. This is a similar recommendation to that which we made for Social Security taxes. We believe this would go a long way toward encouraging greater use of private plans and would make such tax policy consistent in both public and private efforts.

We agree with the President's Commission report that ERISA should be amended to permit employer plans to increase their normal retirement ages to 65 and 68 in tandem with Social Security -- on a strictly voluntary basis.

Personal saving forms the third tier. We believe that not enough emphasis has been placed on encouraging personal saving and investment to provide a significant portion of retirement income. As I am sure you are all too well aware, the United States has one of the lowest personal saving rates in the industrialized world. To repeat the disturbing litany, between 1973 and 1980, personal savings as a percent of disposable income declined from 8.6 percent to 5.7 percent. This is lower than the rates for Canada, Japan, and West Germany. While inflation is partly responsible for our low rate of saving, there is also a strong consumption bias built into the U.S. tax structure. In sum there are inadequate incentives for an individual to save for retirement.

We believe policies to encourage greater personal saving and investment through an expansion of private pension programs and individual savings is one of the essential ingredients to the future health of U.S. retirement systems and to the economy as a whole. We believe that specific measures targeted toward saving for retirement could do much to make saving an attractive option for millions of workers. Specifically, we recommend liberalizing the eligibility rules for individual retirement accounts so that even those individuals already covered by a private pension plan can establish a supplemental retirement account on their own. In addition, we recommend liberalizing the upper ceiling on the amount which can be put into such accounts. We also urge employers who already have pension plans to integrate some measure of individual savings into their benefit program through such measures as matching thrift programs, profit sharing and voluntary employee contributions. Since there is a generally low incidence of pre-retirement withdrawal from individual retirement accounts (due to severe tax penalties), we believe these arrangements can generate the long-term saving the nation so sorely needs to finance increases in capital plant and equipment.

This is the third and final tier of our three-tier approach. The key to this strategy is the flexibility it gives individuals to plan for their own secure retirement, at the same time encouraging essential levels of savings and investment in capital formation required for a strong, growing economy. The CED report urges policy-makers to develop a comprehensive and well-coordinated reform of U.S. retirement policies which will lead to a better balance among the major components of our retirement system. In strengthening the role of employer plans and personal savings, we do not mean to downgrade the absolutely essential role that Social Security and other government programs have played in the impressive development of the U.S. retirement system.

How then does this approach differ from that of the President's Commission? Let me say first that I had the privilege of serving as a member of the Commission, and while the CED report may differ from the President's Commission recommendations in several important respects, we also share many similarities and our analysis supports several of their recommendations. For example, we agree with the Commission's findings such as the exclusion of Social Security taxes from taxable income and the raising of the retirement age to 68. But in several important respects we disagree. The most fundamental difference between the CED paper and the President's Commission report is CED's very strong emphasis on encouraging the voluntary growth of private pensions and individual saving and investment for retirement. We believe that these private pension provisions are uniquely designed to create the necessary capital formation to assure a growing productive economy. The CED report stresses that the long-term health of all retirement systems, public and private, and of the economy in general, lies in encouraging such capital formation. And it is this particular point that we will continually stress in our future policy statements.

Specifically, the CED report and the President's Commission differ on setting specific income goals for retirement and on the minimum universal pension system, or MUPS as we know it. As you know, the President's Commission recommended a national goal of providing retirement income equal to a worker's disposable income just before retirement.

In my view, this is a pleasant goal to contemplate, but not a very realistic one. CED believes that American workers and their families are too diverse in their needs and circumstances for individuals to be well served by such a sweeping and costly national goal. While we believe that Social Security and other government programs should provide a floor of protection, we do not believe that it is appropriate for public policy to prescribe a specific standard of retirement living for all Americans. However, public policy should provide an economic environment in which individuals have an incentive to set and meet their own reasonable retirement objectives.

We also disagree with MUPS -- the concept that each employer be required to establish a pension program for all of his or her employees. While the goal is well-intended, I do not believe that those who support MUPS sufficiently appreciate the cost of making private pensions mandatory. Nor do they comprehend the progress already made in extending private pension plans to individuals since their relatively recent broadscale introduction in the 1950s. The CED report makes a number of recommendations which would make it simpler and more attractive for employers to voluntarily establish new pension plans. Mandated private pensions are likely to result in an inflexible pension system which could be inappropriate for many employers and many workers. It could also have serious consequences for new and marginal businesses, causing many either to go out of business or severely restrict wages and employment.

In conclusion, the CED report stresses the following major themes:

- Failure to strengthen our retirement system now will lead to serious consequences for the elderly and for the economy generally.
- While it is absolutely necessary to address the serious problems facing Social Security, broad improvements can be made concurrently in coverage funding and benefits of employer pensions.
- This comprehensive approach should include three tiers which, in addition to Social Security changes now underway, include a balanced retirement system in which private pension plans and personal saving play a more important role than in the past.
- Such an approach should not require a specific retirement goal for all Americans through a mandated system of employer pension plans, but a flexible system that allows individuals to adequately make personal decisions leading to secure retirement.
- Any such system should include additional incentives to encourage individuals to save to meet their own retirement income goals, and provide a needed source of investment and capital so necessary for a growing and strong economy.

The policies CED recommends, I believe, will provide a workable, affordable and humane source of retirement income. At the same time, we believe our policies will help the economy to break away from the current vicious cycle of low saving, low productivity and high inflation and move into an era in which the long-term saving generated in our retirement system can help to bring about the capital formation that will enlarge the country's productive potential. That in turn, is the only sound way in which our nation can raise the standards of living of both its retirees and its workers. Eventually, we feel that if these policies are enacted now we will achieve the common goal of providing a decent retirement income and a prosperous, sound economy for all Americans.

* * * * * * *

COMMITTEE FOR ECONOMIC DEVELOPMENT

CONFIDENTIAL - NOT FOR QUOTATION

FORMULATING NATIONAL RETIREMENT POLICY

Chapter 1
"Introduction and Summary of Recommendations"

A draft of a statement on national policy for consideration by the Research and Policy Committee on May 20, 1981

Chapter 1

Introduction and Summary of Recommendations

In the last forty-five years, the United States has built a huge and complicated assortment of pension and retirement programs in pursuit of the goal of a decent standard of living in retirement for every American. While this goal is commendable, efforts in pursuit of it have too often been uncoordinated, short-sighted, and inconsiderate of other national objectives. Consequently, unless changes are made this nation now faces a future in which the cumulative effects of all these retirement plans can prove disastrous in the long run. Yet with the proper changes, the United States can evolve a coordinated system of retirement and pension programs that can be affordable to society, satisfying to the elderly, and supportive of a healthy and expanding economy.

Progress in extending retirement benefits for the elderly has been substantial. Since 1960 the incidence of poverty among the elderly has declined from about 35 percent to 14 percent (measured by cash income only), which is only a slightly higher incidence than for the entire population.[1]

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1. O'Neill, June A., Sources of Income of the Elderly, With Special Reference to Elderly Women, Urban Institute, 1981, DRAFT REPORT.

Substantial improvement in the income security of the elderly has resulted from rapid economic growth in the sixties, the expansion of private pensions and a substantial shift toward a variety of federal expenditure programs for the elderly, including higher benefit levels for Social Security. Moreover, when the expansion of in-kind benefits for the elderly are included in elderly income, the incidence of poverty among the elderly drops somewhat below the incidence for the rest of the population. Yet, on their present course the public and private components of the U.S. national retirement system will be unable to continue to meet their obligations to the elderly.

Over the next several years the Social Security system will experience a serious financing problem, with insufficient funds to meet mandated retirement benefits. Congress can be expected to take action to solve the imminent financing problem, but, this action may only be a temporary solution. Basic economic and demographic trends indicate that a potential retirement disaster is on the way early in the 21st Century, and action is needed now to avert it.

Social Security is not the only part of our retirement system that is in trouble. The finances of state and local governments have been strained as pension fund payments have come to account for a rapidly increasing share of their expenditures.

Similar problems exist for some private sector pension plans. Year by year, inflation is eroding their purchasing power, and in some industries unfunded liabilities pose potential problems.

In the past decade, policymakers in Congress and successive Administrations and at the federal, state and local government levels have failed to recognize the full implications of their policies toward retirement income for the elderly. The lack of a comprehensive conception of a national retirement system to guide these policy actions has been a major flaw. Developing public policy for retirement ought not to be done in a vacuum, it needs to be done in the context of all programs affecting the retirement income of the elderly, with full recognition of the growing role of the private pension system. In the private sector, business executives, labor leaders, and interest groups have sometimes failed to understand the potential impact of their retirement policy decisions on the future employment of their workers, as well as the economic health of their industry and the overall economy.

We believe that unless basic changes are begun now in the way this nation views retirement income, and in the public and private systems that provide it, future working generations will face impossible funding burdens and future retirees will face insecurity and hardship. But we also believe that given certain changes, this nation can develop a retirement system that not only cares adequately for its retirees but also can be a positive force toward noninflationary economic growth.

Three Critical Forces

An Aging America

At the turn of this century, only 4 percent of the U.S. population was over sixty-five. Today this group already accounts for 11 percent of the population and that proportion is expected to double in the next fifty years.

Longer life expectancy has resulted in a higher proportion of the population reaching normal retirement age of sixty-five years. And more and more people are living and collecting retirement benefits well beyond sixty-five. In 1900, 29 percent of the elderly population was over age seventy-five. By 1970, that proportion had risen to 39 percent. By the year 2000, it is expected to be 43 percent.

Along with this rise in the number of retired workers has come a steady drop in the birth rate. The current birth rate is only half of what it was in the 1960s, and it is now well below the rate of 2.1 children per family needed to sustain the current population level.

Increased longevity coupled with a declining birth rate means that when the large post war "baby boom" generation begins retiring in the year 2010, there will be fewer and fewer workers to finance retirement benefits. Estimates suggest that the number of the elderly will increase by 120 percent by the year 2035, whereas the number in the age 18 - 65 category will rise by only 6 percent. Projections indicate that by 2035 there will be 52 beneficiaries per 100 workers. Assuming no significant increase in the labor force participation rate of the elderly, the dependency ratio of the aged to the active labor force could more than double by the year 2035. Even a decline in the dependency ratio of young age groups through a reduction in welfare dependency will fail to offset this dramatic increase in the proportion of nonworkers to workers in the population.

These trends foreshadow an increasingly heavy retirement burden on the relatively fewer and fewer workers who must produce the resources from which retirement income is drawn. For example, if no changes are made in Social Security, the tax rate needed to finance benefits fifty years from now could be double or even triple the current rate, thus diverting more and more resources out of the productive economy.

Inflation

While the overall domestic and international consequences of inflation have been profound, inflation has inflicted particular damage on retirement programs. Since Social Security benefits are mandated by law to rise with the Consumer Price Index (CPI), inflation has driven up the cost of providing benefits to retired workers. And rising benefits have caused a rapid rise in total Social Security taxes, thus serving both to fuel inflation and further depress the economy.

Retired people used to be the forgotten victims of inflation. Now, Social Security and other federal retirement systems provide benefits that are in some ways over-compensated by including rises in some costs that do not generally affect older people. Some question whether younger workers, not so protected, have an obligation to federal employees and to Social Security recipients to fully protect them from the ravages of inflation. During the past decade when the real income of elderly was rising, the real after-tax income for the median family (one full-time employed wage earner with two children) declined from $8,412 in 1970 to its present level of about $8,000.[2]

Inflation is also severely damaging private pension plans, most of which provide their retirees with a fixed monthly income. Prices rose by an average of 7.4 percent a year during this last decade. At this rate -- "modest" by today's standards -- the purchasing power of the private pensions of workers who retired ten years ago have already been reduced more than 50 percent. In addition, corporations find it increasingly difficult to predict and fulfill their pension obiligation in a time of uncertain and rising inflation.

Increased Concern with Social Equity

Policies to improve income security for the elderly have produced significant and generally appropriate benefits for this major group within the population. At the same time these improvements have also resulted in

2. Tax Foundation, Inc., Monthly Tax Features, (Volume 24, No. 8, September 1980), p. 1.

certain inequities. Large increases in the Social Security benefit levels mean that those retiring now or in the past receive much more out of the Social Security system than they put in. The reverse may turn out to be true for those retiring thirty years from now.

Complex problems of equity also arise from policies which protect a major share of income of the elderly against inflation while most of those paying for these benefits have no such complete and automatic protection. But on the other side, despite improvements in retirement policies, there are still some major coverage gaps in both private and public plans; and for some elderly groups, especially some elderly women, the incidence of poverty is still too high.

A Heavy Burden

During the last forty years, this nation has made a commitment to bringing America from a country that provided little formal protection for the elderly to a country that now provides a wide variety of both public and private supports. Until now, both public and private systems have generally been able to adjust to changing social and economic conditions. Congress was able to increase Social Security benefits by gradually raising taxes in a period of economic growth and broadening coverage to workers previously excluded.

Today, however, the situation is changing dramatically. Inflation is making the cost of providing retirement benefits a major burden for workers and employers. Declining birth rates mean that proportionately fewer younger people will be working in years to come to pay these higher costs. And unless there are major shifts in the direction of the economy, productivity growth will be insufficient to meet projected benefit levels without a significant reduction in the real standard of living of the productive work force. Such a reduction might further depress economic growth.

If the cost of retirement programs continues to rise at the present rate, it portends serious economic consequences for most groups in society. Between 1950 and 1977, costs increased from 2.3 percent of GNP to 8.2 percent, and projections indicate that this could rise to 14 percent by 1990 and even higher by 2020. We believe that if no changes are made in the current retirement structure, the outlook is grim for future generations of both workers and retirees.

If current provisions and trends are not changed, the enlarged total of retirement benefits needed to pay the doubled number of retirees, retiring earlier and living longer, would have to come out of the GNP that would have otherwise been consumed by the then working members of the population. What this means is that by the year 2035, (when the situation would probably be at its worst) increased taxes, premium payments, and other burdens could reduce the average real standard of living per worker to as much as one-sixth below what it is today.

We believe that it is inconceivable that this nation would deliberately choose to place this kind of burden on future generations or that future generations would in fact stand for it. While we believe that this nation must keep its commitment to promoting fair and humane retirement policies, we also believe that major readjustments need to be made not only in what Americans can reasonably expect in retirement but in whose responsibility it is to provide it.

A Better Balance

What is needed is a comprehensive and well-coordinated reform of U.S. retirement policies in light of long-term social and economic trends. Many of the problems of retirement programs, we believe, are the result of a number of well-intentioned pension and benefit actions aimed at immediate needs and desires without corresponding attention to costs and long-term consequences.

Policymakers should first recognize that retirement is not an isolated phenomenon. It is a key economic and social issue, one that is directly bound up in the nation's other major problems. Such problems as inflation, unemployment, lagging productivity, and reduced competitiveness are mutually aggravating and have all had a significant impact on the financing burden of the U.S. retirement system. And the vast amounts of money required to finance public and underfunded private pension payments have, on balance, inhibited capital formation, thereby reducing investment in the productive base of the economy.

Once the impact of retirement policies on the economy is fully realized, then we believe that the nation can take steps to restore a reasonable balance to the system. We believe that a primary national goal should be the forging of policies that will provide an assured minimum level of reitrement income for all workers and their families and at the same provide workers and employers with the incentive to contribute to an overall retirement system which provides a decent standard of living in retirement for employees and their dependents.

What we are recommending in this policy statement will not be easily achieved. We recognize that many view pension and Social Security benefits as fixed entitlements; therefore strong debate is bound to arise when any proposals for change are raised.

Nor are the choices involved clear and unarguable. Resources are limited, and expanding benefits in some areas may mean contracting them in others. We believe that the key to success in reforming the retirement system is achieving a proper balance -- a balance among existing systems, a balance among conflicting goals, and a balance between what we want and what we can afford.

A New Retirement Strategy

We believe there are a number of actions, well-coordinated and comprehensive in scope, that can be taken now that will assure a workable, equitable, and economically sound retirement structure for the future. But we also believe that enacting general policies that will promote a healthy, growing, productive and noninflationary economy are requisite companion measures. The United States must break away from its current vicious circle of low saving, low productivity, and high inflation. No specific reforms will succeed in solving the retirement problem without a more effective overall national commitment to productivity, saving, and noninflationary economic growth. Only a growing economy can allow the nation to increase real benefits for retired workers, expand coverage, and correct the system's inequities and inadequacies.

We recommend that the United States develop a broad-based and largely self-sustaining retirement system, supported by a healthy economy and in turn supporting the productive growth of that economy. In this policy statement we recommend measures which we believe will achieve this goal. In Chapter 2 we describe the current U.S. retirement system in more detail and outline what overall changes are needed. In later chapters we make specific recommendations for reforming Social Security (Chapter 3), encouraging private pensions (Chapter 4), and developing incentives for more personal saving (Chapter 5). A summary of these recommendations begins on page 14.

We recommend a comprehensive U.S. retirement strategy based on three tiers, each building on the other:

- Social Security is the first tier. We believe that Social Security should provide a minimum standard of living in retirement for virtually all working members of society and their dependents, but that the relative role of Social Security should be restricted to providing this minimum standard. Defining what constitutes a "minimum standard" will be a difficult task. In order to continue to provide this minimum level of support for future generations, we believe that a number of important changes are required, including revising the tax status of Social Security taxes and benefits, gradually raising the normal retirement age, and revising the indexing formula.

● Employer pensions provide the second tier. While most workers can expect some form of employer pension, certain changes in pension policies and regulations can improve funding, broaden coverage, help protect pensions from inflation, and increase private pension contribution to capital formation.

● Personal saving forms the third tier. We believe that not enough emphasis has been placed on encouraging personal saving and investment to form a significant part of retirement income. Indeed, many of our current tax regulations actually discourage personal saving. We call for a number of policy changes to make saving for retirement an attractive and achievable goal for more Americans.

While these are the three elements which should be the focus of any national retirement system, we urge policymakers to recognize that retirement need not and should not be the goal of all older citizens. We believe that those individuals who can and want to continue working should have every opportunity to do so.

On the other side, there will also be some people who through a variety of circumstances will not be eligible for sufficient retirement income to sustain even a subsistence level. While policy should be designed to make this group as small as possible, those elderly who are unfortunate enough to fall into this group should be cared for through supplemental benefits, welfare, and other in-kind protections.

In addition to bolstering financial soundness for the retirement system and encouraging access to pension coverage, the steps we recommend will also have broad and positive effects on the economy as a whole. For example, by providing an incentive for personal saving and restricting the growth of the Social Security burden, overall disposable income will be increased. With the proper tax policies this income can be available for investment in new private plant and equipment, a prerequisite for improving productivity and assuring real economic growth.

In addition, we believe that by gradually raising the normal retirement age, the nation can lighten the financing burden on the working population and at the same time achieve the desirable social goal of providing older Americans with more opportunities to contribute to the economy. Such actions could also help increase total real GNP enough to enable a rise in average real disposable income for both workers and retirees.

If work begins now, we believe that Social Security, private pensions and individual saving can be developed into workable, affordable, and humane sources of retirement income while at the same time helping the economy grow and produce more for all to enjoy. We are optimistic about the prospects for change. As concern with inflation and rising taxes heightens, we believe that most American voters will support policies to change the system now for the long-term benefit of all.

Summary and Major Recommendations

This Committee believes that if the recommendations presented in this statement are adopted, they would help the nation forge a balanced, affordable, and equitable retirement system. In addition, they would help promote economic growth and help rebuild a productive, noninflationary economy. The major recommendations, summarized below, would form a three-tiered system of retirement benefits based on Social Security, private pensions, and personal saving and investment:

- We believe that Social Security benefits have been expanded as much as they should be. Changes are needed to assure that in the future, Social Security can be both affordable to current workers and can provide an adequate minimum floor of benefits to the retired population.

  -- The current practice of automatic increases based on the Consumer Price Index exacerbates inflation, is inequitable, and is placing an inappropriate burden on the economy. We recommend that (1) as soon as feasible, benefit payments should be indexed to a price index that more accurately reflects consumption patterns of older Americans; (2) in years when the annual average wage of workers rises less than the annual increase in the price index, the annual automatic increase in Social Security benefits should increase at the same rate as average wages; (3) policymakers should review past trends in Social Security benefits and wages and consider some adjustment to benefit levels, such as less than 100 percent indexing for a period of several years, to partially offset the past differential between average wage rate changes and increases in Social Security benefits.

  -- We recommend that Congress gradually raise the normal retirement age for Social Security benefits to 68 and early retirement to 65 by the year 2000.

  -- We recommend that all early retirement benefits under governmental retirement systems be actuarially reduced from normal age benefits. Retirement systems should not be used to provide severance pay, hazardous duty premiums, or other personal benefits different from the need for income following retirement at normal retirement ages.

  - -- All non-covered workers, including state, local, and federal employees, should be brought into the Social Security system.
  - -- Internal Revenue Service regulations should be changed to permit more effective integration of employer sponsored disability benefits with Social Security benefits.

- We believe that certain changes can be made with regard to private pension plans that will not only encourage more employers to establish plans but will make existing plans better suited to a mobile labor force and more resistant to inflation.

  - -- We reject any proposal to require all employers to provide pension coverage for their workers. However, we do believe that certain changes in the tax law would make it more attractive for more employers to establish plans.
  - -- While we reject any government mandate that employers adjust pensions to compensate for inflation, we urge employers to voluntarily make partial upward adjustments in pension payments.
  - -- We believe that employers and employee representatives should be free to establish each company's retirement ages, but we also believe that, eventually, age 68 should become the national normal retirement age.
  - -- To encourage greater portability of pension benefits, we recommend that an employee leaving a plan be allowed to transfer vested benefits into an individual retirement account or life insurance company.
  - -- Because of the uncertainty of the magnitude and incidence of the inevitable cost increase from earlier vesting, we do not support any government action to mandate earlier vesting provisions than currently apply.

- We believe that the importance of personal savings in retirement income has been greatly neglected and that a number of public policies actually discourage saving and investment.

  - -- We recommend that eligibility for such personal retirement plans as Individual Retirement Accounts and Keogh Plans be liberalized and that the maximum contribution limits for all individual plans be raised.
  - -- We urge companies to establish savings and thrift plans for all their employers.

(END)

Senator CHAFEE. Now the next panel. Mr. Woodbridge, Mr. Holmes, and Mr. Hutchinson.

Gentlemen, we welcome you here. Mr. Woodbridge, please proceed.

Mr. WOODBRIDGE. Mr. Holmes and I have kind of a joint statement here together, so can we have the advantage of two times through the light.

PANEL OF HENRY S. WOODBRIDGE, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER OF RHODE ISLAND HOSPITAL TRUST NATIONAL BANK, KENNETH L. HOLMES, SENIOR VICE PRESIDENT AND GROUP EXECUTIVE OF HOSPITAL TRUST NATIONAL BANK, AND JAMES D. HUTCHINSON, PARTNER, STEPTOE & JOHNSON, WASHINGTON, D.C.

Mr. WOODBRIDGE. My name is Henry Woodbridge. I am the chairman and the chief executive officer of the Hospital Trust Corp. in Rhode Island. We are an old New England financial institution, the first trust company formed in New England. We have total pension and profit sharing assets under management of about $600 million under management and about $1 billion under administration.

We are grateful for this opportunity to appear here today, particularly since two out of the three of us come from Rhode Island and we do want to share with you very briefly, some of our real apprehensions respecting the recommendations of the President's Commission on Pension Policy, and we will also share with you our more general concerns respecting our Nation's retirement income systems.

Before introducing my associates, I would like to point out one natural but alarming consequence of the effort made by the President's Commission on Pension Policy. Staff and time are limited quantities for short-lived commissions, member and special interest viewpoints are always far less limited and forcibly pressed. And, as a result, rather sweeping recommendations arise without, we think, an adequate research base.

The Commission has contributed significantly to the retirement income debate, but its recommendations require far more study if sound legislation is ever to evolve.

More fundamental, of course, and important is the fact that none of our retirement systems in this country, either private or public, will ever be truly viable until we can get inflation under control and we applaud the efforts of the current administration in that regard.

We do support several recommendations of the President's Commission. Items strengthening the individual savings efforts such as deductions for employees contributions to social securities and to other pension plans certainly are desirable and important.

Some liberalization of the social securities earnings test is a positive recommendation and respecting related tax matters increasing IRA and Keogh deduction limits to levels which provide savings incentives and are more equitable in relation to other private plans is, in our opinion, essential.

With me today, James D. Hutchinson, on my left of Steptoe & Johnson, attorneys at law here in Washington and Ken Holmes, group executive of Hospital Trust Investors which is our corporation's institutional investment management and administration arm.

Jim Hutchinson is probably known to many of you as a Labor Department's pioneer administrator under ERISA and as a leading contributor to his profession and to the law and literature of fiduciary responsibility. And I'm also pleased to say that he's a member of our Hospital Trust Investors' Board of Advisors.

Ken Holmes, who will follow me now, has served the pension fund business for more than 25 years, and has, in that time, had responsibility for more than $10 billion of public and private employee benefits assets. Before coming to us in Rhode Island he had been a partner with Merrill Lynch and served as a consultant to both the Department of Labor and the Department of Treasury. And I've asked him to share with you several additional concerns that we have regarding the recommendations of the President's Commission.

Senator CHAFEE. Thank you very much, Mr. Woodbridge.

[The prepared statement of Henry S. Woodbridge, Jr., follows:]

SUMMARY OF TESTIMONY OF

HENRY S. WOODBRIDGE, JR.

CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER

RHODE ISLAND HOSPITAL TRUST NATIONAL BANK

AND

KENNETH L. HOLMES, GROUP EXECUTIVE

HOSPITAL TRUST INVESTORS

WITH ATTENDANCE OF

JAMES D. HUTCHINSON, ESQUIRE

STEPTOE & JOHNSON, WASHINGTON, D. C.

MEMBER, BOARD OF ADVISORS, HOSPITAL TRUST INVESTORS

ON

REPORT OF THE PRESIDENT'S COMMISSION ON PENSION POLICY

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS

AND INVESTMENT POLICY OF THE COMMITTEE

ON FINANCE

UNITED STATES SENATE

MAY 15, 1981

WE BELIEVE THAT RESEARCH BY THE STAFF OF THE PRESIDENT'S COMMISSION, IN PART BECAUSE OF TIME AND RESOURCE CONSTRAINTS, LEAVES SERIOUS QUESTIONS OF AFFORDABILITY TO BE ANSWERED BEFORE ANY PRIVATE OR PERISA LEGISLATION IS WARRANTED.

WE BELIEVE THE REFORM OF SOCIAL SECURITY AND RELATED PROGRAMS TO BE THE SINGLE IMMEDIATE NECESSITY.

WE BELIEVE THE CAPITAL AND SOCIAL UTILITY OF PENSION FUNDS UNDER PRESENT ERISA STANDARDS TO BE LIMITED ONLY BY THE IMAGINATION OF THE MARKETPLACE, AND THAT IS SCARCELY LIMITED. LEGITIMATE SOCIAL NEEDS WILL BE MET WITHOUT CASTING ASIDE THE FIDUCIARY STANDARDS UPON WHICH THE ENTIRE PENSION PROMISE RESTS.

FINALLY, WE BELIEVE NONE OF OUR RETIREMENT INCOME SYSTEMS, OR THE AMERICAN ECONOMY ITSELF, WILL BE VIABLE IF INFLATION IS NOT CONTROLLED AND REVERSED VERY SOON.

TESTIMONY OF

HENRY S. WOODBRIDGE, JR.

CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER

RHODE ISLAND HOSPITAL TRUST NATIONAL BANK

AND

KENNETH L. HOLMES, GROUP EXECUTIVE

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ON FINANCE

UNITED STATES SENATE

MAY 15, 1981

84-763 O—81——13

Mr. Chairman, members of the Committee, I am Henry S. Woodbridge, Jr., Chairman and Chief Executive Officer of the Hospital Trust Corporation in Providence, R. I. Our organization was created in 1867 as New England's first trust company and as the primary financial support of what has become Rhode Island's major hospital complex. Today we are a one bank holding company with important commercial banking and fiduciary facilities, and we are expanding rapidly within other financial services areas.

My associates and I are grateful for this opportunity to share with you some very real apprehensions respecting the recommendations of the President's Commission on Pension Policy. We shall also share more general concerns respecting our nation's retirement income systems, their roles in our capital markets, and their future economic and social viability.

We are not here to plead any special cause or to present merely a provincial view. We shall, however, have something to say about our region's position in the great pension fund debate.

Before introducing my associates I would like to point out one natural but alarming consequence of the effort made by the President's Commission on Pension Policy. Staff and time are limited quantities for short-lived commissions; member and special interest viewpoints are far less limited and forcibly pressed. As a result rather sweeping recommendations arise without an adequate research base. The Commission has contributed significantly to the retirement income debate, but its recommendations require far more study if sound legislation is ever to evolve.

More fundamental and important, however, is the fact that none of our retirement income systems, or our economy itself, will be viable if inflation is not controlled and reversed. We therefore applaud this Congress and the current Administration for fighting inflation first.

We can also support several recommendations of the President's Commission which promise to be longer-run inflation fighters. Items strengthening individual savings efforts, such as deductions for employee contributions to Social Security and to other pension plans, certainly are desirable and important. Removal of the Social Security earnings test, giving greater freedom for older workers to earn and be productive, is also a positive recommendation. Respecting related tax matters, increasing IRA and Keogh deduction limits to levels which provide savings incentives and are more equitable, in relation to other private plans, is in our opinion essential.

With me are James D. Hutchinson, Esquire, of Steptoe & Johnson, Attorneys-at-law here in Washington, and Kenneth L. Holmes, Group Executive of Hospital Trust Investors, our Corporation's institutional investment management and administration arm.

Jim Hutchinson is known to many of you as the Labor Department's pioneer Administrator under ERISA, and as a leading contributor to his profession and to the law and literature of fiduciary responsibility. I'm pleased to say that Jim Hutchinson is a member of our Hospital Trust Investors Board of Advisors, a body of seven nationally distinguished and diversely experienced pension and investment experts. These are the folks who permit no provincialism on our part.

Ken Holmes has served pension funds for more than 25 years, and has in that time had responsibility for more than $10 billion of public and private employee benefit assets. Before joining us at Hospital Trust he among other positions had been a Merrill Lynch partner and had served as a consultant to both the Department of Labor and the Department of the Treasury. I have asked him to share with you several additional concerns arising from the recommendations of the President's Commission or from what we see evolving in our retirement income systems.

KLH

Thank you. Mr. Chairman, I shall readily defer to my old friend Jim Hutchinson should questions arise concerning ERISA's legislative history and construction or the related regulations. And I shall certainly defer to Mr. Woodbridge, who is also a Director of the Federal Reserve Bank of Boston, should there be questions about our economic region.

To explain that region for you, we should note that our business outreach is not confined to New England. Our economic region encompasses the entire range of established industrial states. Our region is in fact properly viewed as co-terminus with the 18 states of the Northeast-Midwest Congressional Coalition. We call our part of the country QUADRANT ONE, for that has always been our region's place in the American industrial economy.

Before referring further to QUADRANT ONE, we want to set down in priority order the elements we believe to be crucial to any review of retirement income policy:

1. Inflation
2. Necessity
3. Affordability
4. Utility

We shall not dwell further upon inflation. However, we do believe that all of the Commission's recommendation must be researched thoroughly with respect to inflationary potential.

-- For example, recommended PERISA legislation "covering the same areas of concern as covered by ERISA": Such legislation implicitly includes funding standards applied to states and localities already straining their tax bases merely to stay afloat.

As to necessity, we agree with almost all Americans. There is only one immediate necessity respecting our retirement income programs, and that is the restructuring of Social Security.

-- Social Security is in itself inflationary; it is a payments transfer system and it is leveraged by indexing at a rate greater than the core inflation rate.

-- Social Security is already unaffordable; it will be bankrupt within two years if legislative remedy is not provided.

-- Social Security is without utility; it does not assist capital formation or distribution in a nation which has spewed at least a quarter-trillion dollars of would-have-been savings abroad, and is now seeking capital to restore internationally competitive productivity.

We respectfully submit that the Congress, the Administration, and the nation can no longer live with patch-work remedies for Social Security. We believe that benefit growth must be scaled back, that benefits not related to retirement income must be segregated, and that the harsh reality of funding the program must be faced.

As to affordability, we earnestly recommend that each member of this Committee, and of the Senate and the House, examine the paper published by Dallas L. Salisbury of the Employee Benefit Research Institute on March 25, 1981. That paper is "a commentary on the research sufficiency of the final report of the President's Commission on Pension Policy". We believe the paper demonstrates that, with the exception of research in the Social Security matter, far more research is required before any of the Commission's recommendations may stand the tests of affordability and thus viability.

Respecting the matter of utility, we would point again to our nation's need for capital. Beyond retirement income itself the greatest utility of our pension systems lies in capital formation.

I made that point in testimony before the President's Commission last December. We make it here again, and stress that retirement systems have become our primary means of capital formation and the foundation upon which our economic renaissance must rest. Obviously the funding of Social Security would contribute to that process of capital formation.

Capital distribution is another matter. Respecting it the President's Commission recommends yet another Presidential Commission because: "The Commission believes that concerns relating to the ownership and control of pension fund assets are among the most important social and economic policy issues facing the nation in the upcoming decades."

SUMMARY

The Associations believe that the report of the President's Commission on Pension Policy provides a basis for a careful review of our nation's retirement system. Because of the need to accommodate the income needs of the post World War II baby boom cohort when it reaches old age, policy decisions must be made soon.

The President's Commission has shown that it is in the nation's interest to encourage retirement income adequacy through the private sector. The Associations share this belief; however, Congress' position on the Commission's MUPS approach should not inhibit other basic reforms. Specifically, improvements must be made in current vesting and portability practices. Additionally, incentives can be provided to increase coverage so that the necessity of a MUPS can be more precisely evaluated.

The Commission's final report also reaffirms the status of social security as the primary program of income support for the elderly - a position which the Associations strongly endorse. However, the Associations, unlike the President's Commission, believe that social security will have to undergo a major and fundamental restructuring if it is to continue to serve the changing needs of the population. Additionally, the Commission's findings that people should be encouraged to help themselves through work and voluntary savings should be implemented by policymakers.

We can also add, Mr. Chairman, our own Quadrant One real estate program, now being developed. Beyond what we believe to be accessible real estate investment values superior to those which might be found elsewhere, it certainly will play a role in desirable investment and job retention in our Quadrant One. There are many other examples of regional funds with legitimate investment objectives and correlated "social" benefit.

In summary, we believe that research by the staff of the President's Commission, in part because of time and resource constraints, leaves serious questions of affordability to be answered before any private or PERISA legislation is warranted.

We believe the reform of Social Security and related programs to be the single immediate necessity.

We believe the capital and social utility of pension funds under present ERISA standards to be limited only by the imagination of the marketplace, and that is scarcely limited. Legitimate social needs will be met without casting aside the fiduciary standards upon which the entire pension promise rests.

Finally, we believe none of our retirement income systems, or the American economy itself, will be viable if inflation is not controlled and reversed very soon.

Senator CHAFEE. You may proceed, Mr. Holmes. We're glad you're here.

You may proceed, Mr. Holmes. We're glad you're here.

OPENING STATEMENT OF KENNETH L. HOLMES, GROUP EXECUTIVE, HOSPITAL TRUST INVESTORS

Mr. HOLMES. Mr. Chairman. Thank you very much. I would like to outline the basic concerns we have. First, however, I would like to say that should there be detailed questions concerning ERISA and its construction and its legislative history, I certainly would defer to Mr. Hutchinson.

I shall also talk a little bit about our home region and respecting that I certainly would defer to Mr. Woodbridge, who in addition to being a very fine banker in New England, is a member of the Board of Directors of the Federal Reserve Bank——

Senator CHAFEE. Well, I think you can skip the description of the region—I'm very familiar with it. [Laughter.]

Mr. HOLMES. All right. If I may first, I would like to submit as a part of our testimony a very fine paper by Mr. Hutchinson respecting legal standards, governing investment of pension assets for social and political goals. We feel that the committee will find it of very great guidance and value.

Senator CHAFEE. Without objection, it is so ordered.

Mr. HOLMES. Mr. Woodbridge has mentioned that inflation is our primary concern and we will not dwell further upon that point. I think there is universal acceptance of it.

We would say that the next major element of concern is that of necessity or its lack, and as we view the retirement income structure today, we come to the simple belief that the restructuring of the social security system is at this point and time the single eminent necessity.

Finally, I would like to mention in terms of the affordability of the proposals by the President's Commission, a paper by Dallas Salisbury which he refers to in part. That paper is a commentary on the research sufficiency of the final report on the President's Commission. And, again, we commend that sir, to your committee for its value.

Finally, we would say that pension funds have an addition to their primary purpose, the most important of fundamental utilities, and that is the creation of capital—the formation of capital in the United States, and we believe that we are heavily dependent upon the private retirement systems as the prime source of capital in this Nation for the decade during which we hope to rebuild our productivity and international competitive status.

The one thing that retirement systems do not do in another sense is distribute capital except as the market system permits that distribution, we respectfully submit that the system itself and ERISA as it now stands combined provide the imagination and the opportunity to distribute capital well within the United States without changing the law in the fiduciary provisions of ERISA.

Thank you very much.

Senator CHAFEE. Is your principal point concerned with the limitations under ERISA regarding the investments that are permitted?

Mr. HOLMES. No, sir. On the contrary. It is our belief that the current provisions of ERISA the safe harbor provisions as set down by the Department of Labor, provide a very wide spectrum, a totally adequate spectrum of investment opportunity that fiduciary sound should be maintained and that legitimate social and political interests can be met within the current framework.

Senator CHAFEE. Well, I'm interested to hear you say that, because I have set aside the social achievements of pension funds. Let's project that for a minute. But, I have heard complaints that ERISA placed such stringent limitations on investments that it cut off investments in new growth industries. But you don't find the limitations overly restrictive?

Mr. HOLMES. No, sir. We believe that the safe harbor provisions can be followed well and that other issues can be dealt with after those basic fiduciary responsibilities have been met.

Mr. Hutchinson might want to comment upon this.

Senator CHAFEE. That's an interesting point. Does that completes your testimony?

Mr. WOODBRIDGE. That's our basic comment, but again we would like to say that the fiduciary structure is the critical element in the operation of the entire program of retirement income provision and that that structure must be maintained and should not be broken.

Senator CHAFEE. In your testimony, Mr. Holmes, you discussed social security. You say it is in itself inflationary, already unaffordable, without utility it does not assist in capital formation, the Nation can no longer live with patchwork remedies for social security and believe that the benefit growth must be scaled back, benefits not related to retirement income must be segregated.

What specifically would you have us do on social security?

What would you do on extension of the age?

Mr. HOLMES. We think that that's a viable response to the need at this time, if it is coupled with the gradual reduction of the index benefit increases.

Senator CHAFEE. So suddenly you would recommend taking the lower of the CPI or the wage index?

Mr. HOLMES. Yes, specifically we think that the CPI tends to overreflect inflation at times, and of course, at other times it can underreflect the true rate of inflation.

Senator CHAFEE. Do you have any index of social security?

Mr. HOLMES. I would philosophically prefer not to, but that awaits the healing of the inflationary ill of the Nation I'm afraid.

Senator CHAFEE. Well, that's been very helpful. Mr. Hutchinson, do you agree that the ERISA investment rules are adequate now—not only adequate but not too restrictive?

Mr. HUTCHINSON. Yes, Senator. I think there was a fair amount of controversy concern back in 1975 and 1976 when the law was first passed, that it might retard investments in capital formation activities, like venture capital companies and smaller concerns. But, I believe that those concerns have been a laid over the last few years and it's not——

Senator CHAFEE. Why, have they eased it?

Mr. HUTCHINSON. The interpretations of law have become more clear, so people feel more comfortable making those kinds of investments.

Yes, as long as it's done carefully.

Senator CHAFEE. Do you get involved in—for instance—any listed security acceptable?

Mr. HUTCHINSON. It depends upon the investment needs of a particular plan, but the mere fact that the security is listed or not listed on a national exchange is no longer a cutoff test. Indeed, you can go to a limited partnership interest, or a different pool vehicles as long as they're underlyingly safe and sound and produce the kind of return your plan is looking for. There are no arbitrary——

Senator CHAFEE. Is there any percentage factors which regards venture capital, for example.

Mr. HUTCHINSON. There is none stated in the law or the legislative history, but I think most funds that approach venture capital do it at a small enough percentage in the 5- or 10-percent level, so that it wouldn't dramatically affect the viability of the fund if something went wrong.

But they often produce a great level of return in that area as well, as long as they're properly selected.

Senator CHAFEE. Well, I'm glad to have your testimony here, gentlemen, Mr. Woodbridge, Mr. Holmes, and Mr. Hutchinson, because I learned something. I was under the impression that there was some dissatisfaction on the limitations of ERISA.

Mr. HUTCHINSON. Senator, you may hear that some people are concerned about the complexity of what will be called the prohibited transaction rules which prevent banks and insurance companies and investment management firms from engaging in transactions with people who may be related to an employee benefit plan.

That is a morass that is complex, it's tedious and a regulatory action in that area is slow, but the basic rules on fiduciary conduct imprudence, we think are quite sound.

Senator CHAFEE. Thank you very much for coming here.

Next witnesses are Mr. David and Mr. Moran.

Mr. David, you may proceed.

PANEL OF FRANK H. DAVID, VICE PRESIDENT AND ASSOCIATE ACTUARY, PRUDENTIAL INSURANCE CO. OF AMERICA, AND CHARLES A. MORAN, SENIOR VICE PRESIDENT OF MANUFACTURER'S HANOVER TRUST CO. OF NEW YORK, N.Y.

Mr. DAVID. Mr. Chairman, I'm Frank David, vice president and associate actuary of the Prudential Insurance Co. I'm appearing here today on behalf of the American Council of Life Insurance, a major trade association of the Nation's life insurance companies.

We request that the full statement be included in the record of these hearings.

Senator CHAFEE. Without objection it so so ordered.

Mr. DAVID. But, in the time that you're allowing me, I just would like to discuss briefly three subjects the Commission considered. Social security, a compulsory minimum universal pension system and tax incentives for savings.

The Commission is to be commended for calling attention to the severe financial problems now faced by the social security program. There are both short-range and long-range problems and they're being aggravated by prices increasing at a faster rate than wages causing benefit payments to substantially exceed receipts.

The council believes that prompt action should be taken to resolve these problems, and we therefore support the following Commission recommendations.

First, authorizing the retirement, disability insurance, and hospital insurance trust funds, three separate trust funds, to borrow from each other, if that is necessary to prevent any of them from declining to inadequate levels.

Second, relying on payroll taxes to finance social security. We believe that social security should continue to be financed solely through payroll taxes paid equally by covered workers and employers. We think that sharing the cost of the program in this manner is a responsible way of financing it. Also, these taxes have the virtue of being highly visible, which helps to maintain the vital link between benefits and contributions.

Third, increasing the normal retirement age for social security benefits to 68, phasing in the higher retirement age over a period of time beginning not later than the end of this century.

Senator CHAFEE. You mention beginning in 1990. Are you referring to the phase in?

Mr. DAVID. We think that legislation should be passed now to start the phase in beginning in 1990 or possibly the year 2000. I don't think we feel too strongly about when, but we think action——

Senator CHAFEE. Well, hadn't we better do something before then, before we run out of funds?

Mr. DAVID. Yes; we feel however, that you can't increase the social security retirement age to age 68 right now. We also have a recommendation for the short-term which is the interfund borrowing, and I have another one that I'm coming to in a moment.

Senator CHAFEE. I don't understand your saying that we should extend the retirement age to 68, phase it in beginning in 1990. Why start the phase in 8 years from now?

Mr. DAVID. That is what the President's Commission recommended. Yes, and we are endorsing that recommendation.

We endorse it because there will be a substantial increase in the future in the size of the retired population relative to the working population. So, we think this action is necessary in order to maintain payroll taxes at reasonable levels.

We also think it is questionable whether the Nation can afford to give complete inflation protection to social security beneficiaries or indeed to any other group of individuals.

So we think measure should be adopted to reduce the heavy cost of indexing social security benefits for inflation.

This could be done by basing adjustments on the increase in wages or the Consumer Price Index whichever is lower. We also think that the present index should be reexamined to determine whether revisions are needed to avoid overstating increases in living costs for retired people.

Next, the minimum universal pension system. We strongly oppose the Commission's recommendation that a compulsory minimum system be established. We feel that voluntary means provide a better way of supplementing the basic protection provided by social security. Private voluntary arrangements, including pension plans and other private savings, offer flexibility to meet different needs and circumstances. They are based on the concept that once a floor of protection has been provided, there should not be a Government requirement to set aside additional funds for retirement. Instead, individuals, working together with their employers and through individual savings, should have the freedom to choose how much of their income should be set aside for additional retirement income and how much should be used for other purposes, such as savings to meet the expenses of educating children or buying a home.

Voluntary retirement programs are continuing to increase their coverage and their benefits. New plans are being started and old ones are being improved. Pension plans often start with modest coverage and benefit levels and increase the protection they offer later as conditions permit. Over time, therefore, gaps in the protection offered by voluntary retirement programs can be expected to diminish. This will be especially true if we concentrate on ways to improve voluntary programs.

Further, compulsory pension plans would inevitably result in financial hardship for many employers who cannot afford them. This contrasts markedly with voluntary plans, whose establishment and development tends to be closely correlated with financial ability.

Therefore, we urge you not to support the adoption of compulsory systems.

Our third point is the encouraging of voluntary retirement plans. We believe that the retirement needs of Americans will be served best if private pensions remain voluntary and, if they are to expand, then we need to create a favorable environment. We are very pleased that the President's Commission has recommended adopting tax incentives to encourage savings for retirement through voluntary programs.

Granting these tax deductions, would give similar tax treatment to employee and employer contributions. It would encourage adequate financing for pension plans, and would stimulate increased coverage and higher benefits. Adoption of this proposal we think would reduce the pressures on social security, increase capital formation, and provide a noninflationary tax cut.

We strongly support legislation that would carry out this recommendation of the President's Commission.

We previously testified on this point before this subcommittee and also other congressional panels, so I will not go into any further details at this time.

Mr. Chairman, I appreciate this opportunity to present the views of the council and would be glad to try to answer questions you may have.

Senator CHAFEE. First, the concern of permitting employee contributions to corporate or H.R. 10 qualified pension plans as deferred income up to the IRA amount—that's going to cost a lot of money without really making an incremental addition to savings.

If they are already making the contributions and you now permit them to take a deduction, how does that help capital formation in the Nation?

Mr. DAVID. You're discussing now the question of mandatory contributions.

Senator CHAFEE. That's right.

Mr. DAVID. Well we think that first of all if you do permit mandatory contributions to get the benefit of the deduction, it would encourage some employers to establish plans and others to improve plans which they could not otherwise afford to do, so we think there is a benefit there.

Also, if the mandatory contributions do not get the benefit of the deduction, I think that would be an incentive for employees to drop out of qualified plans and set up their own IRA's and get the deduction in that way, so that the revenue loss might occur anyway, at least to some extent.

Senator CHAFEE. All right. I see your point. Proceed, Mr. Moran. Thank you, Mr. David.

STATEMENT OF CHARLES A. MORAN, CHAIRMAN, EMPLOYEES' TRUST COMMITTEE, TRUST DIVISION, AMERICAN BANKERS ASSOCIATION

Mr. MORAN. Good morning, Mr. Chairman. My name is Charles Moran. I am here in my role as chairman of the Employees' Trust Committee of the Trust Division of the American Bankers Association.

The American Bankers membership has interest in today's hearing, both as employers and as trustees in investment managers of employee benefit funds.

We appreciate this opportunity to present our views on the report of the President's Commission.

I draw your attention to the fact that we tend to concentrate on the attacks leveled on the private pension system. I would like to share an experience which suggests the underlying strength of the private system is alive, well, and spreading.

Two months ago, I was in the People's Republic of China. Now you wouldn't expect to find support for the private sector in their collective system. Yet, I found not only the equivalent of private pension plans with benefits, funding, retirement age, et cetera set by the local committee. But even more startling, profit-sharing plans with the contributions based on productivity, and locally administered with part paid directly and part invested by the local committee in expanding the business plant and equipment, employee housing, et cetera.

Sounds a little bit like our cash and deferred profit-sharing programs.

The ABA concurs with the Commission's belief that a sensible coordinated and comprehensive national retirement income policy is needed to assure retirees of a reasonable standard of living.

In addition, we agree that an expanded private pension system is a highly desirable goal. However, the ABA opposes the proposed mandatory system. Instead, the Congress should adopt the comprehensive program of incentives, such as you have proposed, to encourage employers to establish plans and individuals to save for their retirement.

Incentives should include increased deductions for Keogh and IRA plans and broader eligibility. Employee contributions to qualified plans should also be given favorable tax treatment.

In addition, a way must be found to simplify the numerous, complicated and technical requirements presently entailed in establishing and administering employee benefit plans.

The most far reaching of the Commission's recommendation, was the minimum and mandatory universal pension system (MUPS) funded by employer contributions. We agree that expanded private pension systems is a desirable goal deserving of serious consideration. Nevertheless, the ABA opposes that mandatory private pension coverage.

At the time it enacted ERISA, Congress declined to go so far as to establish a mandatory system. Further, experience has shown and the Commission itself acknowledged that many small businesses terminated their pension plans rather than comply with the burdensome administrative requirements of ERISA.

The ABA has placed its wholehearted support behind the President's National Economic Recovery Program. The spending cuts recommended by the President and the priorities he has set for tax reduction are essential to controlling inflation.

Banks have consistently been leading supporters of IRA and Keogh plans, both of which encourage savings for retirement. Our association has so testified before this subcommittee in February and several times in the past before other congressional committees.

We believe that at the appropriate time, and within the framework of the President's priorities, the tax deductible amount should be increased and eligibility should be expanded.

Employee contributions to qualified employee benefit plans should be given favorable tax treatment. Also, plans should be permitted to accept contributions from employees, and I stress permitted.

Senator CHAFEE. And those would be tax deductible too?

Mr. MORAN. Yes.

Senator CHAFEE. In addition to the mandatory contribution.

Mr. MORAN. Yes.

Senator CHAFEE. Up to how much?

Mr. MORAN. Well, I think I would make sure that that was within the context of what the President's program is. I would not have it as a separate notion. I think you've got an awfully broad plate on those issues, and I would include it as an element of it. I would not want to separate it.

The tax credit approach goes hand-in-hand with the overall objective of tax deductible contributions.

In our written statement, which I would request be made a part of the record, we've made suggestions with respect to reporting and disclosure, prohibited transactions, the use of collective funds to encourage competition among those who offer IRA and Keogh investment services.

I won't elaborate on those comments here, but we would pleased to go into them in further detail with your staff at the appropriate time.

There is, however, a common theme that runs through these comments, and that is that while the objectives of ERISA are clear and valid, they have been eroded in the interpretation and administration of the law. We must establish a bias in administering the law that favors the expansion of the private pension system, while balancing the cost and benefits of the provisions which protect participants and beneficiaries.

Participants and beneficiaries of retirement income plans will benefit from your subcommittee's attention on issues such as these.

Senator CHAFEE. Did you hear the testimony of Mr. Woodbridge and Mr. Hutchinson?

Mr. MORAN. Yes. They were not only uncritical of ERISA but they were praising ERISA.

Senator CHAFEE. What do you say to that?

Mr. MORAN. Well, I think if you take a look at their comments, that they were directed at the fiduciary responsibility provisions of ERISA. And, I would agree that there are almost no problems with that. As a matter of fact, I think the clarifications that the Labor Department came out with was even unnecessary.

However, if you get into reporting, disclosure, prohibited transactions, and I think Jim Hutchinson mentioned that briefly, there you do have significant impediments.

Senator CHAFEE. Well, I thought that's exactly what they didn't say. I thought they said there were not impediments as far as investments go.

Mr. MORAN. The fiduciary standards are not impediments.

Senator CHAFEE. What are the impediments?

Mr. MORAN. The prohibited transaction provisions.

Senator CHAFEE. But, I thought they felt there wasn't a problem with prohibited transactions.

Mr. MORAN. I think Jim Hutchinson said at the end that that was not what he was saying.

Senator CHAFEE. Well, that went by me then. I thought I asked him rather specifically if he felt inhibited in the investments. I don't know what you mean by transactions, but I asked him specifically about the prohibition on investments and he felt that they were given considerable latitude. They had a prudent man rule. But, that they could go into venture capital and—items such as that.

Mr. MORAN. That's absolutely true under the fiduciary responsibility provision.

Senator CHAFEE. Oh.

Mr. MORAN. The problem is in the prohibited transactions with the party in interest and the way that that was self-dealing. Now the appropriate test of the self-dealing would be a test that recognizes some kind of a hind-sight look at it, the so-called fair value test.

Senator CHAFEE. Do you have any specific recommendations on those matters? I mean I know this is a little bit afield of the thrust of this—if you've got specific recommendations on ERISA, we'd be glad to hear them.

I notice on page 6 of your testimony you have some thoughts regarding Keoghs and the currently existing inhibitions against flective investments of Keogh. Is that right?

Mr. MORAN. That's right.

Senator CHAFEE. That's a good point. I think while we're at it, we should be doing everything we can to make these individual pension retirement accounts—individual IRA's as good as possible. Do you think that would be a step forward?

Mr. MORAN. Yes, I think it would. I think the more competition you have among the providers of those kinds of services, I think that's a definite plus as far as coverage is concerned.

Senator CHAFEE. OK, anything else?

Mr. DAVID. Mr. Chairman, I would——

Senator CHAFEE. Thirty seconds.

Mr. DAVID [continuing]. Mr. Chairman, I would like to make an addition just to clarify one point that you questioned me on. The phasing-in of the increase in the normal retirement age under social security to 68.

Senator CHAFEE. Yes.

Mr. DAVID. Now that is intended to deal with the long-range problems of social security in the next century when the "baby-boom" generation, post-World War II, reaches retirement age, and that is why it makes sense to phase that in beginning toward the end of the century.

Senator CHAFEE. Yes, but what are we going to do in the interim?

Mr. DAVID. Well, some of the other things, like the interfund borrowing and cutting back on the——

Senator CHAFEE. That illumination on borrowing—that's not going to solve our problem.

Mr. DAVID. Not for any length of time, but the cutting back on the inflation adjustments, I think would do quite a bit.

Senator CHAFEE. That would be helpful. No question about that. Fine, Thank you very much, gentlemen.

Mr. MORAN. Can I make a quick comment on ownership and control, social investment——

Senator CHAFEE. If it's less than 20 seconds.

Mr. MORAN. OK, it will be.

The issue of what I would call alternative investing——

Senator CHAFEE. What page are you on?

Mr. MORAN. I'm not on any page.

Senator CHAFEE. Go ahead, you've got 10 seconds.

Mr. MORAN. I'm on my scribbles.

Senator CHAFEE. Go ahead, quickly.

Mr. MORAN. So long as the potential power of pension funds exist they will tempt those who lack the capital resources to accomplish their objectives. Commissioner Stephen Friedman of the SEC has correctly pointed out that pension funds have been allowed to accumulate sizable assets because of the neutrality of the investment process.

In other words, the pursuit of investment returns only. The neutrality fosters the formation of capital and its deployment in the most attractive of competitive uses.

Before we explode that neutrality, we must look beyond the immediate motivations to the long-range impact on the private pension system and retirement income objectives generally.

Senator CHAFEE. Well no one suggesting—what did you call it—exploding the neutrality—who's suggesting that?

Mr. MORAN. I think a lot of the discussion on social investing and alternative uses are doing exactly that. They are introducing additional——

Senator CHAFEE. That's a shot at social investing you're taking, is that it?

Mr. MORAN. That's a fair statement.

Senator CHAFEE. OK, fine. Thank you.

Mr. MORAN. Thank you.

[The statements of the preceding panel follow:]

SUMMARY OF STATEMENT OF FRANK H. DAVID ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY OF THE SENATE FINANCE COMMITTEE

May 15, 1981

I am Frank David, Vice President and Associate Actuary of the Prudential Insurance Company of America and Chairman of the Pension Committee of the American Council of Life Insurance. I am appearing here today on behalf of the Council, a major trade association of the Nation's life insurance companies.

We are pleased that your Subcommittee is holding this public hearing on the recommendations of the President's Commission on Pension Policy. We have prepared an extensive statement detailing our views, and I request that this statement be included in the record of these hearings. In the time allowed me today, I would like to briefly discuss three subjects considered by the Commission: Social Security, a Mandatory Universal Pension System (MUPS) and tax incentives for savings.

Social Security

The Commission is to be commended for calling attention to the severe financial problems now faced by the Social Security program. There are both short-range and long-range problems, and they are being aggravated by prices increasing at a faster rate than wages, causing benefit payments to substantially exceed receipts. The Council believes that prompt action should be taken to resolve these problems. We therefore support the following Commission recommendations:

1. Authorizing the retirement (OASI), Disability Insurance (DI) and Hospital Insurance (HI) trust funds to borrow from each other, if necessary to prevent any of these funds from declining to inadequate levels.
2. Relying on payroll taxes to finance Social Security. We believe that Social Security should continue to be financed solely through payroll taxes paid equally by covered workers and employers. Such payroll taxes enable covered workers and employers to share the cost of the program in a responsible manner. They also have the virtue of being highly visible, which helps to maintain the vital link between benefits and contributions.
3. Increasing the normal retirement age for Social Security benefits to 68, phasing in the higher retirement age over a 12-year period beginning in 1990. The future will see substantial increases in the size of the retired relative to the working population. Therefore, we think this action is necessary to maintain payroll taxes at reasonable levels.

It is questionable whether the Nation can afford to give complete inflation protection to Social Security beneficiaries, or indeed to any other large group of individuals. Therefore, the recommendations of the Commission should be supplemented by measures designed to revise the present very costly procedures for adjusting Social Security benefits for inflation. This could be done by basing benefit adjustments on the increase in wages or the Consumer Price Index (CPI), whichever is lower. Moreover, the present CPI should be reexamined to determine whether revisions are needed to avoid overstating increases in living costs.

The Minimum Universal Pension System

We strongly oppose the Commission's recommendation that a mandatory Minimum Universal Pension System (MUPS) be established. Voluntary means provide a better way of supplementing the basic protection provided by Social Security. Private voluntary arrangements, including pension plans and other private savings, offer flexibility to meet different needs and circumstances. They are based on the concept that once a floor of protection has been provided, further retirement income protection should not be mandated by a government requirement to set aside additional funds for this purpose. Instead, individuals, working together with their employers and through individual savings, should have the freedom to choose how much of their income should be set aside for additional retirement income and how much should be used for other purposes, such as savings to meet the expenses of educating children or buying a home.

Voluntary retirement programs are continuing to increase their coverage and their benefits. New plans are being started and old ones are being improved. Pension plans often start with modest coverage and benefit levels and increase the protection they offer later as conditions permit. Over time, therefore, gaps in the protection offered by voluntary retirement programs can be expected to diminish. This will be especially true if we concentrate on ways to improve voluntary programs.

Further, mandatory pension plans would inevitably result in financial hardship for many employers who cannot afford them. This contrasts markedly with voluntary plans, whose establishment and development tends to be closely correlated with financial ability. The additional costs involved in financing the mandatory plans would be likely to result in reduction of cash wages or other fringe benefits for employees. Mandatory plans could also contribute to unemployment among the very people who are the intended beneficiaries of the proposal.

In view of these considerations, we urge you not to support the adoption of a system of mandatory private pension plans.

Encouraging Voluntary Retirement Plans

As I previously mentioned, we believe that the retirement needs of Americans will be served best if private retirement programs remain voluntary. However, if voluntary private retirement plans are to continue to expand, to cover more people and to provide higher benefits, then it is essential to provide a favorable environment for them. This is why we are pleased that the President's Commission has recommended a number of changes in the tax law to encourage savings for retirement through voluntary pension plans and other private savings.

In particular, we strongly support the Commission's recommendation that favorable tax treatment be extended to employee contributions to pension plans. Granting employees tax deductions for their own pension contributions would contribute to equality of tax treatment for employee and employer pension contributions. It would also provide more adequate financing for pension plans, which would stimulate increased coverage and higher benefits. Adoption of this proposal would reduce the pressures on Social Security, increase capital formation and provide a noninflationary tax cut.

Accordingly, we strongly urge the adoption of S. 1049, a bill which would treat employee contributions to corporate and H.R. 10 qualified pension plans as tax-deferred income up to the Individual Retirement Account (IRA) limits (currently the lesser of 15 percent of compensation or $1,500).

Moreover, if an employer does not choose to accept employee contributions to his qualified plan, S. 1049 would permit his employees to make their own tax deductible contributions to an IRA.

Under S. 1049, the tax deduction for employee contributions to corporate and H.R. 10 plans would be available regardless of whether the contributions are voluntary or mandatory under the plan. A deduction for mandatory contributions would make it feasible for many employers, especially small ones, to establish a plan they could not otherwise afford by having their employees share in the cost. It would also enable employers to improve benefits in situations where they could not bear the full cost of the improvement by themselves.

The Council's views on Employee Retirement Savings Deductions were set forth in greater detail in testimony before this Subcommittee on February 24 and before other Congressional panels. Therefore, I shall not go into any further detail at this time.

I appreciate the opportunity to present the views of the Council and would be glad to answer any questions the Subcommittee may have.

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STATEMENT OF FRANK H. DAVID ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY OF THE SENATE FINANCE COMMITTEE

May 15, 1981

I am Frank David, Vice President and Associate Actuary of the Prudential Insurance Company of America and Chairman of the Pension Committee of the American Council of Life Insurance. I am appearing here today on behalf of the Council which represents 519 life insurance companies. These companies account for 95 percent of the life insurance in force, 99 percent of the reserves for insured pension plans and 97 percent of the assets of all life insurance companies.

We are pleased that your distinguished Subcommittee is holding this public hearing on the recommendations of the President's Commission on Pension Policy as incorporated in the Commission's final report, "Coming of Age Toward a National Retirement Income Policy", which was issued on February 26, 1981. We share the Commission's objective of securing an effective and equitable means of providing for the retirement income needs of our older population. As I will indicate in detail, we believe that many of the Commission's recommendations represent important contributions toward this desirable goal. However, as will be noted below, we disagree with other Commission recommendations.

In evaluating the Commission's recommendations, we believe it is important to keep in mind that at present the retirement needs of our people are met through two basically different kinds of retirement programs: Social Security, which is compulsory and almost universal in coverage; and private savings, including pension plans, which are voluntary. While these two programs supplement each other, each has a different function to perform. Social Security provides the basic floor of protection for retired or disabled workers and for the survivors of deceased workers. Private pension plans and other voluntary savings then have the job of bringing retirement income up to levels which more nearly reflect the individual's pre-retirement standard of living, building on top of the floor of protection provided by Social Security. Private plans offer flexibility to meet different needs and circumstances.

Social Security

The President's Commission is to be commended for calling attention to the severe financial problems now faced by Social Security. The retirement program, OASI, now faces acute short-range financial problems which are being accentuated by stagflation which increases benefits and decreases receipts. According to recent estimates, unless appropriate remedial action is taken, the OASI trust fund could be depleted as soon as early 1982 when funds could become insufficient to pay the benefits that are due.[1] Social Security also faces long-run deficits on the basis of what now seems to be the most reasonable economic and demographic estimates. The

1/See Report of the Subcommittee on Social Security of the Committee on Ways and Means, Social Security and Economic Cycles, 96th Congress, 2d Session, November 12, 1980.

projected deficits increase substantially beginning in the second quarter of the next century when the ratio of Social Security recipients to active workers will rise to relatively high levels, placing heavy financial burdens on the active workers who support the system.

In our opinion, these financial problems should be resolved promptly by actions designed to assure Social Security adequate financing through payroll taxes and by curbing the undue growth in Social Security benefits which threatens to undermine the financial stability of the system. We therefore support the following recommendations made by the President's Commission on Pension Policy which are consistent with this objective:

1. Authorizing the retirement (OASI), Disability Insurance (DI) and Hospital Insurance (HI) trust funds to borrow from each other, if this is found to be necessary to prevent any of these funds from declining to inadequate levels. In our opinion, such borrowing authority should be provided as an aid in handling emergency situations. However, it should be noted that such borrowing merely represents a bandaid and provides only short-run relief. It does not resolve the underlying financial problems of the Social Security system and should not be permitted to distract from the basic actions that are required to place the system on a sound financial basis. Social Security is too important for our older population and the Nation to permit the present financial imbalances to continue.

2. Recognizing the importance of adequate payroll taxes to finance Social Security. We believe that Social Security payroll tax rates should be set at levels that are adequate to finance the benefits provided by law, which should be kept at reasonable levels

within the Nation's fiscal capacity. Social Security should continue to be financed solely through payroll taxes paid equally by covered workers and employers. Such payroll taxes enable covered workers and employers to share the cost of the program in a responsible fashion. These taxes have the capability of producing the large sums necessary to finance Social Security. Moreover, they have the virtue of being highly visible which helps to maintain the vital link between an employee's benefits and his or her contributions.

Failure to maintain payroll tax rates at adequate levels would require the use of general revenues to finance Social Security. In a sense, there is no general revenue available to finance Social Security in view of the large budget deficits confronting us. Accordingly, general revenue financing would reduce confidence in the Social Security system, as it would be widely construed as a sign that we are not willing to face up to the hard issues involved in placing the system on a sound financial basis.

We believe that the advantages to be gained from payroll tax financing apply to all the major Social Security programs--including OASI, DI and HI. Moreover, we believe that it would be a serious error to attempt to single out parts of the Social Security program, such as so-called "welfare elements", for general revenue financing. Social Security, historically, has taken both equity and adequacy into consideration in providing benefits and properly so. Moreover, once general revenue financing is introduced in financing part of Social Security benefits, there is strong danger that it will spread to the remaining portions.

3. Increasing the normal retirement age for Social Security benefits to 68, phasing in the higher retirement age over a 12-year period beginning in 1990. The Commission further recommends that the Social Security early retirement age, now 62, should be raised to 65. These Commission recommendations recognize that Americans are now living significantly longer and are generally able to work until a later age than they did in 1935 when the earliest retirement age for the receipt of benefits was set at 65. As life expectancy becomes longer, it is appropriate to reapportion an individual's life span between years of work and years of retirement. The Age Discrimination in Employment Act, as amended in 1978, recognizes this by generally prohibiting mandatory retirement prior to age 70.

Unless the retirement age is increased, the future will see substantial increases in the relative size of the retired population and relatively smaller numbers of active workers to carry on the Nation's productive process. This change will be especially marked in the early part of the next century when the front end of the post-World War II baby boom will begin to reach 65. At present, there are about 20 persons aged 65 or over for each 100 persons at the working ages 20-64. According to the most recent intermediate estimates of the Social Security Administration, this "retirement-dependency ratio" will increase only moderately over the next 25 years, but will then climb sharply, reaching a high of 38 in 2030 and thereafter.

Social Security should recognize these important demographic and social developments. A gradual increase in the minimum retirement age for receipt of full benefits would help to stabilize the financial position of the Social Security system and would avoid placing undue financing burdens on the working population. For example, an increase in the normal retirement age under Social Security, which begins to take effect gradually after a long notification period to avoid any possible hardship, would reduce the ratio of retirees to active workers in the next century and would eliminate about two-thirds of the long-term (75-year) average deficit projected on the basis of the intermediate assumptions of the 1980 Trustees Report.

4. Extending mandatory Social Security coverage to all new workers who otherwise would not be covered and eliminating benefit gaps and unintended subsidies to workers who have not had substantial Social Security coverage. These Commission recommendations are essential as a step toward elimination of the present gaps in the protection of federal government employees and many employees of State and local governments and nonprofit institutions. Adoption of the recommendations would permit the Social Security tax burden to be shared more equitably. It would also avoid the cost increases for Social Security which now result when employees in government service not covered by Social Security for most of their work careers qualify for comparatively large Social Security benefits by taking a job in covered employment and paying Social Security taxes for a relatively brief time.

For similar reasons, we also support the Commission's recommendation that the current option of allowing covered government and nonprofit groups to withdraw from coverage under the Social Security system be terminated.

5. Improving the special minimum benefit for long-service workers. We are sympathetic to the Commission's objective of targeting additional benefits to low income, long-service workers without affecting benefits to short career workers or to other beneficiaries with moderate to high earnings. The present "special minimum" benefit amounts to $14.45 times the number of covered years in excess of 10, but not in excess of 30. One possibility of improving this special minimum would be to give credit for up to 35 years of coverage (instead of 30 years) and to count up to 10 child care years as years of coverage.

These recommendations of the President's Commission should be bolstered by measures designed to revise the present very costly procedures for adjusting Social Security benefits for inflation. It is questionable whether the Nation can afford to completely insulate Social Security beneficiaries, or indeed any other large group of individuals, from inflation. One possible revision would be to limit the annual increase in Social Security benefits under automatic indexing to the increase in wages for years when wages increase less than the CPI. Moreover, the present CPI should be reexamined to determine whether revisions in the index are needed to avoid overstating increases in such living costs. The present indexing procedure, for example, gives undue emphasis to the increased cost of home ownership associated with rises in mortgage interest rates, since the bulk of the Social Security beneficiaries do not purchase new homes.

In our opinion, it is most essential in dealing with such indexing problems to prevent benefits from soaring to indefensible levels in order to keep benefits within the Nation's financial capacity.

Finally, we support phasing out the regular minimum benefit, which has outlived its usefulness, and benefits for full-time students aged 18-21, which are costly and inefficient means of providing educational assistance. We also support the concepts in the Administration's proposals to tighten the administration of DI benefits to prevent excessive benefits.

The Minimum Universal Pension System

The President's Commission recommends that a Minimum Universal Pension System (MUPS) be established for all workers. This system would be mandatory and would be funded by employer contributions with a 3 percent of payroll contribution as a minimum benefit standard. The system would cover all employees over the age of 25 with one year of service and 1,000 hours of employment with their employer. Vesting of benefits would be immediate.

This proposal, in effect, would impose an additional layer of required retirement benefits on top of Social Security. It is supported on the ground that mandatory pension plans would be preferable to a further increase in Social Security benefits as a means of providing additional retirement benefits to employees. Unlike Social Security, which is financed on a pay-as-you-go basis, MUPS would be pre-funded thereby adding to capital formation. Moreover, since MUPS would be administered by private companies, including insurance companies, banks and trust funds, the advantages of private management would be maintained.

We strongly oppose the adoption of such a system of mandatory pension plans. Our major reasons for this position are summarized in the following conclusion of the National Commission on Social Security which is presented in its final report, "Social Security in America's Future":

> The National Commission does not believe that the federal government should require employers to provide pensions. Workers not now covered by pensions tend to be lower-paid employees. Pension benefits would probably be financed through lower wages. Low-paid employees may be unwilling or unable to afford to forego part of their wages for pension contributions. Employers who do not provide pensions tend to be small businesses or less successful firms that are hard pressed to meet their current obligations. The added financial and administrative burdens of mandatory pensions would be more than some could bear and still remain in business.
>
> The Social Security program now covers about 9 out of 10 workers on a mandatory basis. It should continue to be the primary nationwide program for assuring workers a basic level of retirement income. The Commission believes it is neither necessary nor desirable for the federal government to set up and enforce a second separate system to achieve similar goals.2/

The Commission's MUPS proposal is wrong because it uses mandatory means rather than voluntary means to supplement the basic protection offered by Social Security. There are good grounds for using voluntary means for this purpose. Private voluntary arrangements, including pension plans and other private savings, provide flexibility to meet different needs and circumstances. They are

2/Final report of the National Commission on Social Security, March, 1981, p. 51.

based on the concept that once the floor of protection has been provided, further retirement income protection should not be mandated by a government requirement to set aside additional funds for this purpose. Instead, individuals, working together with their employers and through individual savings, should have the freedom to choose how much of their income should be set aside for additional retirement income protection and how much should be used for other purposes, such as saving to meet the expenses of educating children or buying a home.

Apparently, the Commission's recommendation for MUPS is based in large measure on the judgment that voluntary private pension plans are not capable of building sufficient retirement income protection on top of the basic Social Security benefits to bring total provision for retirement income to desired levels. However, voluntary private pension plans have a record of substantial accomplishments. Considerable attention has been given to estimates showing that only about one-half of all workers are now participating in pension or profit-sharing plans. These estimates, however, are based on a working population which includes workers as young as 16 years of age and part-time as well as full-time workers. The participation rate is considerably larger when attention is focused on full-time private sector workers age 25-64.[3/] Generally, these are the workers for whom the Commission recommended the MUPS. A recent study estimates that in 1974 between 62 percent and 67 percent of such workers were participants in pension and profit-sharing

3/Workers in this category represent about 58 percent of the total work force.

plans.[4/] Similar findings were noted under a Department of Labor/Social Security Administration survey.[5/] In our opinion, these are more pertinent figures than the frequently cited 50 percent participation rate. Moreover, about 69 percent of all workers are employed by firms with pension plans so that they have the potential to participate in a plan.

In evaluating the need for mandatory pension plans, it is also important to recognize that voluntary retirement programs have not yet reached their full potential. There are, it is true, gaps in the extensive retirement protection now offered by such voluntary programs. However, voluntary retirement programs are continuing to increase their coverage and their benefits. New plans are being started and old ones are being improved. It is fairly customary, for example, for pension plans to start with modest coverage and benefit levels and to increase the protection they offer later as conditions permit. Over time, therefore, whatever gaps exist in the protection offered by voluntary retirement programs can be expected to diminish. This will be especially true if we concentrate our primary attention on ways to improve voluntary programs.

As the National Commission on Social Security has noted, because mandatory pension plans would be imposed on very large numbers of employers in widely different economic circumstances, they would

4/See Employee Benefit Research Institute, Retirement Income Policy: Considerations for Effective Decision Making 1980, p. 25, and ICP Outline of Study Paper on Retirement Program Coverage, July 2, 1980, p. 2.

5/See Survey of Pension Plan Coverage, 1972 and 1979, Department of Labor/Social Security Administration, as described in Preliminary Findings of a Nationwide Survey on Retirement Income Issues, President's Commission on Pension Policy, May 1980.

inevitably result in financial hardship for many employers who cannot afford them. This contrasts markedly with voluntary plans whose establishment and development tends to be closely correlated with financial ability.

Even a relatively modest system of mandatory pension plans would ignore the question of whether the Nation as a whole and the specific firms involved can afford the supplementary retirement income protection. The additional costs involved in financing the mandatory plans would likely result in reduction of cash wages or other fringe benefits for employees. To the extent that the employees prefer the cash wages or other fringe benefits, their overall economic position would be impaired rather than improved. Many workers, particularly those at the younger ages, prefer higher cash wages and/or more life insurance and accident and health insurance protection to additional pension benefits. Mandatory plans could also contribute to unemployment among the very people who are the intended beneficiaries of the proposal. The overall welfare of employees is likely to be improved if they, working together with their employers, are given as much choice as possible as to the relative importance of each of the components in their total compensation package, instead of having one component, namely pensions, mandated by the government.

Encouraging Voluntary Retirement Programs

As noted above, we believe that the retirement needs of Americans will be served best if private retirement programs remain voluntary. However, if voluntary private retirement plans are to continue to expand, to cover more people, and to provide higher benefits, then it is essential to provide a favorable environment for them. Appropriate tax treatment is a major element, perhaps the single, most important element, in providing such a favorable environment for private sector pension plans.

The Council has previously testified before this Subcommittee and other Congressional panels in support of legislation that would encourage private citizens to save for retirement. We are therefore pleased that the President's Commission has recommended a number of changes in the tax law to encourage savings for retirement through voluntary pension plans and other private savings. We believe that appropriate tax measures would have much potential for stimulating increased pension coverage and improved retirement benefits.

There are a number of specific steps that should be taken now to encourage the development of private retirement programs:

1. We vigorously support the Commission's recommendation that favorable tax treatment be extended to employee contributions to pension plans. Present law frequently discourages employee pension contributions by failing to give any tax allowances for such contributions, thereby, in effect, requiring such employee contributions to be made with so-called "after-tax dollars", namely, income on which the employee has previously paid income tax. This differs markedly from the tax treatment afforded to employer contributions

to qualified corporate and H.R. 10 pension plans. The employer receives a tax deduction for such contributions which are not taxed to the covered employees until actually received or made available to them as pension benefits. Granting employees tax deductions for their own pension contributions would contribute to equality of tax treatment for employee pension contributions and employer pension contributions. It would also provide more adequate financing for pension plans, which would be likely to result in increased coverage and higher benefits.

During the past several years there has been increased realization that there is a critical need to increase long-term investment capital in the United States and to encourage individuals to save more. Illustrative of this is the fact that as of the fourth quarter of 1980, Americans saved only 5.1 percent of disposable income, which is significantly below the savings rate of other industrial actions.

This lack of savings is perceived as a major problem by a majority of Americans. A recent independent public opinion survey, commissioned by the Council,[6/] indicates that while 63 percent of all Americans feel they are saving too little, an even higher 72 percent of working Americans feel their savings toward retirement are inadequate. Moreover, almost half the work force feels they will not be able to afford to retire.

These concerns are an important reason for the overwhelming public opinion which favors tax incentives for retirement savings. Indeed, the survey indicates that Americans support this concept by an overwhelming 72 percent to 15 percent margin.

6/Roger Seasonwein Associates, "Americans and Retirement: The Financial Crisis", February, 1981.

As has been graphically demonstrated during the last several years, adequate retirement security for all Americans by Social Security alone is neither feasible nor desirable. In addition to private pension plans, individual savings are necessary to reach the goal of an affordable retirement income system. With the current low rate of individual savings, tax incentives are needed to increase individual savings and improve the adequacy of retirement income for a broad cross section of Americans. It is important to note that 89 percent of the public feels the current level of taxation keeps people from saving more. Moreover, the Canadian experience with Registered Retirement Savings Plans (RRSP) indicates that tax incentives will be widely used and can yield effective results.

In addition to increasing savings among people participating in pension and profit-sharing plans, and thereby improving the adequacy of retirement income, there are several other advantages to an Employee Retirement Savings Deduction (ERSD). These include reducing the pressures on Social Security, increasing capital formation, providing a noninflationary tax cut, and encouraging new plan formation:

Increased Capital Formation. Retirement savings are an important source of long-term investment in the capital goods so essential for a growing and dynamic economy. By the end of 1979, $363 billion in pension assets administered by life insurance companies were helping to create jobs and improve productivity in our Nation. ERSDs would significantly increase the availability of such capital.

Noninflationary. By encouraging long-term savings and thus contributing to the capital resources of the Nation, ERSD is one of the few individual tax cuts that is not inflationary, since money saved through this system will not be used for consumption.

Encourage New Plan Formation. By encouraging employee contributions, employers, who could not otherwise afford the cost of a plan, will now find a plan more affordable. This will be particularly true among small and newer employers who find it difficult to form plans because of costs.

Reduced Pressures on Social Security. By encouraging individuals to save more for their retirement and employers to establish qualified pension plans, ERSD will alleviate escalating pressures on the Social Security System. The pressures will otherwise become overwhelming during the next several decades, as fewer workers are required to fund benefits for a greater number of recipients.

Accordingly, we strongly urge the adoption of legislation that would provide a tax deduction for employee pension contributions if the Congress decides to develop a tax bill that will provide more than the straight rate reduction as proposed by the Reagan Administration. Specifically, we support S. 1049 which contains all the features we believe are necessary for a meaningful and successful retirement savings program:

(a) S. 1049 would allow employee contributions to corporate and H.R. 10 qualified pension plans to be treated as tax-deferred income up to the Individual Retirement Account (IRA) limits (currently the lesser of 15 percent of compensation or $1,500). Within these limits, employee pension plan contributions would be deductible for federal income tax purposes when made, and the retirement income flowing from these employee contributions would be taxable when received. Making the limits the same for plan participants and nonparticipants would eliminate any potential confusion on the part of employees as to the maximum amount that may be contributed for retirement savings and would simplify administration for employers and the government. It would also avoid any incentive to drop out of a plan in order to get a larger deduction.

(b) Moreover, if a particular employer does not choose to provide for employee contributions to his qualified plan, then we believe that the employees of that employer should be free to independently make their own tax deductible contributions to an IRA. S. 1049 allows this option.

(c) S. 1049 provides that the tax deduction for employee contributions to corporate and H.R. 10 pension plans would be available, regardless of whether the employee contributions are voluntary or mandatory under the plan. A deduction for mandatory contributions would make it feasible for many employers, especially small ones, to establish plans they could not otherwise afford by having their employees share in the costs of their retirement program, and/or make it possible for them to improve benefits in situations where the employers would, themselves, be unable to pay the full cost of the benefit improvement. In addition, allowing a deduction for mandatory contributions would discourage employees from abandoning their plans in order to contribute to an IRA because of the current tax benefit and would discourage employers from converting their plans, which currently require mandatory contributions, to arrangements where the employees contribute on a voluntary basis in order to get the tax deduction.

(d) In addition, the deduction for employee pension contributions under S. 1049 would not be phased out at a specified income level or completely denied to a specified income group. Such a phase-out or other limitation would have the most severe impact on the middle-income taxpayers, who are already most heavily burdened by our graduated income tax system, and are a group that should clearly be encouraged to save for their own retirement. While the low- or moderate-income worker can rely in whole, or in large measure, on pre-retirement income replacement through Social Security pension benefits, the middle-income wage earner cannot. Moreover, the denial of tax deductions for employee contributions for those individuals--for example, the principals of the so-called "Mom and Pop" family businesses, and other small and moderate-sized corporate entities--who are in a position to decide whether or not to establish a pension plan, would clearly reduce their incentive to set up plans, which will cover their employees as well as themselves.

2. As the Commission points out, our present tax laws accord nonuniform tax treatment to different kinds of retirement programs

described in the Internal Revenue Code. For example, the limits placed on deductible employer contributions to H.R. 10 qualified pension plans and on employer-sponsored IRAs established pursuant to section 408(c) of the Code are generally more severe than those applying to corporate qualified pension plans. At present, a self-employed individual's annual tax-deductible contribution--to all H.R. 10 plans maintained on his/her own behalf--is limited to the lesser of 15 percent of earned income or $7,500 a year. Tax-deductible contributions to IRAs are limited to the lesser of 15 percent of earned income or $1,500 a year ($1,750 where a married individual sets up IRA accounts for the spouse of himself or herself).

3. We believe that, at a minimum, the limits in the allowable tax deductible contributions to H.R. 10 qualified pension plans and IRAs should be increased to correspond with the substantial increase in the cost of living since 1974, when the present limitations were set. Provision should also be made for the automatic indexing of these limits for increases in the cost of living in future years. Actually, it would be desirable to raise the allowable limits on tax deductible contributions to H.R. 10 plans more than these minimum increases to reduce or eliminate the artificial disparity with the limits applicable to other plans. Consideration might also be given to further increases in the IRA limits. However, a careful balancing is needed in that, if the allowable tax deductible contributions to IRAs are made too large, owners and managers of businesses might be induced to use IRAs only for themselves, thus reducing the incentive

to establish any pension plans at all for the benefit of the rank and file employees.

Integration of Pension and Social Security Benefits

The Commission recommends that changes be made in the current integration rules which are applicable to voluntary pension plans ". . .so that the result is consistent with the fulfillment of retirement income goals". The Commission notes in this regard that certain aspects of the present integration rules are consistent with the goals of coordinating retirement programs while other aspects are not. It specifically indicates that the current integration rules may discourage the fulfillment of retirement income goals, particularly for low wage earners.

Because the details of the Commission's proposal are not spelled out, it is difficult to tell what specific changes in integration would be involved. Accordingly, we would like, at this point, to set forth some specific comments and principles in regard to integration.

It seems to us that if overall retirement programs are to be successful, we must not only utilize both Social Security and private programs; we must also coordinate the two kinds of programs so that the combined benefits that they provide are reasonable in relation to pre-retirement earnings at different income levels. This in turn requires that an appropriate method of integrating Social Security benefits and pension benefits be provided to assure that qualified pension plans do not discriminate in favor of high-paid employees and against low-paid employees.

The approach should recognize that it is the combined amount of pension and Social Security benefits received by retired employees and not their pension benefits alone that is pertinent for purposes of determining whether a pension plan qualifies for the tax treatment associated with qualified plans by meeting the test of not discriminating against low-paid employees. This is crucial since, unless Social Security benefits are recognized for this purpose, it will be impossible to coordinate the private pension system and Social Security in any coherent manner. Fortunately, our tax laws have recognized the general principle that Social Security benefits should be recognized for purposes of applying the nondiscrimination tests of the Internal Revenue Code since those tests were first adopted. In effect, this is done by treating employer financed pension contributions or benefits as nondiscriminatory under the tax laws if such contributions or benefits plus Social Security benefits do not constitute a higher percentage of pre-retirement pay for high-paid employees than for low-paid employees.

A pension plan should continue to have the option of taking Social Security benefits into consideration for purposes of satisfying the nondiscrimination rules of the Internal Revenue Code. The present integration procedures for determining whether a pension plan qualifies under the Internal Revenue Code have this general objective in mind, but are overly restrictive and unnecessarily complicated.

Moreover, in designing an integration procedure, it is important to guard against a basic philosophy such as seems to be implicit in the integration proposal made by the Treasury Department in 1978.

This proposal would require qualified plans to provide many covered employees in the lower-pay brackets with private pensions large enough to bring their combined pension and Social Security benefits above their pre-retirement gross earnings. Such a requirement is not consistent with the basic objective of pensions--namely, to provide retired individuals with a replacement of their previous earnings--and should be avoided. In addition, public purpose would seem ill-served by forcing employers to provide excessive pensions to lower-paid employees in order to provide adequate pensions for higher-paid employees. Money spent on excessive retirement benefits for any employees may well come at the expense of current wages and may therefore decrease their present standard of living.

To assure equitable integration procedures, the following three principles should be followed:

1. No pension plan should be qualified which provides a higher combined replacement ratio (counting Social Security plus private pension benefits) for higher-paid employees than for lower-paid employees.

2. The entire Social Security benefit should be taken into consideration in determining total retirement income--there should be no adjustments on the assumption that a portion of Social Security taxes is paid by employees. Social Security benefits represent an intergenerational transfer of income, and the benefits paid to the current retired individuals are, in effect, financed by the contributions of current taxpayers. Accordingly, any attempt to distinguish between "employer provided" and "employee provided" Social Security benefits for purposes of integrating Social Security and

pension benefits is meaningless and should be abandoned as a component in the integration formula.

3. No plan should be required to provide a benefit which, together with Social Security benefits, replaces more than 100 percent of pre-retirement earnings of any individual.

Finally, we support the Commission's recommendation that the current integration rules be made less complex. The Council believes the integration rules now in use are outdated and lack needed flexibility. However, simplification should not be pursued with such single-mindedness that current plans are forced to make radical changes in their contribution or benefit structure or that the basic rationale for the integration rules is discarded. Therefore, a grandfather clause should be provided when there is any change in the existing rules so that plans which met the integration rules prior to the change will retain their qualification as long as there is no change in plan benefits.

Vesting

We support the Commission's recommendations that ERISA's vesting standards should not be changed for pension benefits above the MUPS minimum and that private plans should be encouraged, but not required, to provide faster vesting.

The Employee Retirement Income Security Act of 1974 (ERISA) already mandates adequate minimum vesting standards for pension plans. It requires every plan to meet one of three minimum vesting formulas to help assure workers the right to a future pension benefit.[7/]

7/Specifically, the three minimum vesting formulas provided by ERISA are as follows:

Moreover, in administering the anti-discrimination rules of the Internal Revenue Code, the Internal Revenue Service requires faster vesting than the ERISA formulas for most small plans as a condition for a favorable ruling as to qualification.

We believe that the Commission was wise in not recommending new tighter vesting standards. Although additional time is needed to assess their full impact, the present ERISA vesting standards appear to represent a reasonable balance between the need to protect employees' pension rights and the need to keep the cost of pension plans within feasible limits. Mandating new stricter minimum vesting standards for pension plans would involve the danger of disturbing this balance and would discourage the adoption of new plans and expansion of existing plans by increasing their costs for short-term employees. Reliance on voluntary action to provide further improvements in vesting avoids these undesirable results because it gives employers the flexibility to provide such improvements when they are compatible to the firm's financial situation.

Moreover, just the fact that new vesting standards would require pension plans to be amended again would have a disturbing effect. During 1976 and 1977, plans were amended to conform to the ERISA requirements. Recently, plans have been further amended to conform to final ERISA regulations. The adoption of still another set of

7/Continued:

1. Total vesting after 10 years of service.
2. Vesting of 25 percent of accrued pension benefits after 5 years, increasing by 5 percent each year for the next 5 years and by 10 percent for the following 5 years, resulting in 100 percent vesting after 15 years.
3. Fifty percent vesting when age and length of service totals 45 years with a minimum of 5 years of service, or, if earlier, after 10 years of service. Vesting is then increased 10 percent a year in each of the next 5 years so that 100 percent vesting is attained at the end of that 5-year period.

vesting standards would require present plans to be amended again at a time when they are still adjusting to the ERISA rules. Further changes would have an unfavorable impact on the development of pension plans. The resulting additional costs and administrative burdens might very well cause an additional number of small employers to say "enough is enough" and to simply terminate their plans.

It should be noted that the ERISA vesting formulas are minimum standards and pension plans frequently provide faster vesting than is required. Throughout their history, pension plans in the United States have continued to provide substantial improvements in the vested rights accorded to covered employees on a voluntary basis. The usual practice is for pension plans to be adopted with relatively modest features and then to be continually improved by providing more desirable features, including more rapid vesting. Judging from past experience, pension plans will continue to improve vesting through voluntary action.

The evidence indicates that vesting of pension rights has become more prevalent in recent years. In a 1979 national survey, jointly sponsored by the Social Security Administration and the Department of Labor, 48 percent of the workers covered by retirement plans indicated that they had vested rights to pension benefits.[8/] This compares with 32 percent who stated that they had vested pension rights in a 1972 survey.

8/Pension Coverage and Vesting Among Private Wage and Salary Workers, 1979: Preliminary Estimates From the 1979 Survey of Pension Plan Coverage, Gayle Thompson Rogers, Division of Retirement and Survivors Studies, Social Security Administration, June 1980. It is probable that more than 48 percent of the covered employees had vested rights in 1979 because 18 percent of all workers covered by the survey said they didn't know whether they had vested rights and some of these may have had such rights.

Moreover, vested rights become more prevalent as the age of the covered workers increases. For example, in the same 1979 survey, 68 percent of the workers aged 55 and older said they had vested rights.[9/] This is highly significant since it indicates that a very substantial portion of covered workers approaching retirement age had vested rights. The future will undoubtedly see a considerable increase in the number of employees with such rights under present law.

We oppose, however, the Commission's recommendation that cash-outs of pension benefits over $500 be prohibited unless transferred to an IRA or the plan of another employer. We believe this proposal would drastically reduce the ability of pension plans to respond in a flexible manner to the needs of individual participants. Moreover, the effectiveness of such a requirement in preserving benefits for retirement age is questionable when the amount involved is only slightly in excess of $500. In addition, there would be some administrative expense and reporting requirements that would outweigh any benefits to the participants. We prefer the flexibility of the "cash out" rules currently in ERISA (section 204(d) of ERISA).

Increase in Retirement Ages Under Private Pension Plans

The Commission recommends that ERISA be amended to permit private pension plans on a voluntary basis to increase their normal retirement age in tandem with Social Security.

We support this recommendation. It is extremely likely that the normal retirement age under voluntary private pension plans will

9/More than 68 percent of these workers probably had vested rights because 14 percent of the workers aged 55 and older covered by the survey indicated that they did not know whether they had vested rights and some of these workers may have had such rights.

increase should the retirement age under Social Security be raised. However, such increase in retirement age under private plans should, as the Commission recommends, be entirely voluntary. Private pension plans differ substantially from Social Security, which is provided on a mass basis and is financed through compulsory contributions. In accordance with their voluntary nature, private plans should be allowed to adjust their features to accommodate the particular needs and circumstances of the parties involved.

Ownership and Control of Pension Fund Assets

The Commission believes that concerns relating to the ownership and control of pension fund assets are among the most important social and economic public issues facing the Nation in the upcoming decade. One question to be studied is whether private and public pension funds should invest to achieve various social goals. The Commission further believes that not enough is known about these issues to make any recommendations. Therefore, the Commission recommends that a Presidential Commission be established to study these issues. In the interim, the Commission recommends that ERISA's prudence standards not be construed so as to prevent pension funds from making "social investments". We oppose these recommendations.

The Council strongly believes that the prudence standards of ERISA, which are designed to enhance and protect the retirement security of plan participants, should not be compromised in order to accommodate social investments. Jeopardizing yield or safety of principal would be contrary to the best interests of plan participants and the underlying theory of ERISA.

Conclusion

Retirement income for Americans should continue to be provided through Social Security and voluntary private retirement arrangements. Social Security should provide the basic floor of retirement income protection. Private voluntary retirement arrangements should supplement this basic floor of protection in order to bring retirement incomes closer to levels which will enable retirees to maintain their pre-retirement standards. However, a number of actions are required in order to make this retirement system work effectively.

Social Security should not be expanded beyond its proper floor of protection role to provide benefits which can be better provided by private voluntary retirement arrangements. The system should continue to be financed by payroll taxes, without general revenue financing. Social Security costs must also be kept within the limits of the Nation's fiscal capacity. In particular, ways must be found to reduce the projected sharp increases in Social Security expenditures in future years. The Commission has made a number of recommendations which would be helpful in this regard, including a later retirement age under Social Security and coverage under Social Security of all newly-hired government workers and employees of non-profit institutions who would not otherwise be covered. In addition, we urge that present methods of indexing benefits for inflation be revised to reduce the soaring costs which are in prospect under present procedures.

The private sector is making an important and indispensable contribution towards supplementing the basic floor of protection provided by Social Security through voluntary private pension plans and private savings. It is important to create a favorable environment for such voluntary private retirement arrangements in order to encourage provision for adequate retirement income and, in so doing, to supply the capital formation needed for a dynamic economy. For this it is necessary to have appropriate procedures to integrate pension and Social Security benefits, which avoid discrimination against low-wage earners and at the same time do not require the combined amounts of Social Security and private pension benefits to provide unreasonably large replacement of wages.

However, we believe that the Commission's proposal for the adoption of mandatory pension plans (MUPS) would be unproductive and not in the best interests of employees. Instead, tax policies should be designed to encourage all individuals and their employers to save whatever funds are necessary to finance an adequate retirement income, building on top of the floor of protection offered by Social Security. This involves continuing and expanding the present tax treatment to encourage the growth of private pension plans and private retirement arrangements. We therefore endorse the Commission's recommendations to allow employees covered by pension plans to take tax deductions for their contributions to such plans and to give more consistent treatment to all types of retirement savings.

I appreciate the opportunity to express the Council's views and would be happy to answer any questions the Subcommittee might have or to furnish any additional information the Subcommittee might desire.

SUMMARY OF TESTIMONY

OF

CHARLES A. MORAN

AMERICAN BANKERS ASSOCIATION

ON THE PRESIDENT'S

COMMISSION ON PENSION POLICY

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSION AND INVESTMENT POLICY

COMMITTEE ON FINANCE

UNITED STATES SENATE

May 15, 1981

ABA concurs with the Commission's belief that a sensible, coordinated and comprehensive national retirement income policy is needed to assure retirees of a reasonable standard of living.

In addition, we agree that an expanded private pension system is a highly desirable goal. However, ABA opposes a mandatory system. Instead Congress should adopt a comprehensive program of incentives to encourage employers to establish plans and individuals to save for their retirement. Incentives should include increased deductions for Keogh and IRA plans and broader eligibility. Employee contributions to qualified plans should also be given favorable tax treatment.

A way must be found to simplify the numerous complicated and technical requirements presently entailed in establishing and administering employee benefit plans. It is widely recognized that these requirements discourage employers from establishing plans for their employees. Reporting and disclosure requirements should be eased. Restrictions on the use of bank collective investment funds, especially for Keogh and IRA accounts, should be removed.

The prohibited transactions provisions should be eliminated in favor of an "adequate consideration" test. These provisions deprive employee benefit plans of many first class investments.

With respect to the investment of employee benefit funds, ABA continues to believe that the "exclusive purpose" of employee benefit plans to provide retirement benefits to participants and their beneficiaries, together with the rule of prudence, provides the guidance and flexibility for investment of employee benefit funds.

TESTIMONY

OF CHARLES A. MORAN

ON BEHALF OF

AMERICAN BANKERS ASSOCIATION

ON THE PRESIDENT'S

COMMISSION ON PENSION POLICY

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSION AND INVESTMENT POLICY

COMMITTEE ON FINANCE

UNITED STATES SENATE

May 15, 1981

Mr. Chairman and Members of the Committee: My name is Charles A. Moran. I am Chairman of the Employees Trust Committee of the Trust Division of the American Bankers Association and Senior Vice President of Manufacturers Hanover Trust Company, New York.

The American Bankers Association (ABA) is a trade association composed of more than 13,100 banks - over 90% of the nation's full service banks. Approximately 4,000 of these banks are authorized to serve as fiduciaries and many are serving as trustees and investment managers of employee benefit funds. We appreciate this opportunity to present our views on the report of the President's Commission on Pension Policy.

The President's Commission was charged with a large and important mission to analyze the present retirement systems, review the problems and make recommendations for change. Our Association concurs with the belief expressed by the Commission that a sensible coordinated and comprehensive national retirement income policy is needed. Only then will today's workers and beneficiaries be assured of a reasonable standard of living in their later years.

The most far reaching of the Commission's recommendations was a minimum (and mandatory) universal pension system (MUPS) funded by employer contributions. This recommendation results from the Commission's conclusion that more than 50% of workers are not covered by a private pension plan. With the result, Social Security bears an unreasonable proportion of the pension burden when, in fact, it was established to provide a minimum floor of retirement income. This conclusion is based on information that has been interpreted differently by many professionals. We recommend you consider the professional commentary and not just the Commission's interpretations and conclusions.

An expanded private pension system is a socially desirable goal deserving of serious consideration. An expanded system would assure many more employees of an additional source of retirement income permitting them to maintain a standard of living reasonably related to pre-retirement standards.

ABA opposes mandatory private pension coverage. At the time it enacted ERISA Congress declined to go so far as to establish a mandatory system yet experience has shown that, even so, the Congress went too far. The Commission itself acknowledged that many small businesses terminated their pension plans rather than comply with the burdensome administrative requirements of ERSIA.

Rather than increasing the presence of the Federal government in the private pension system, government interference should be reduced. ABA continues to believe that if employers are given further encouragement to establishment pension plans for employees and individuals are encouraged to save for their later years plan participation will increase.

Rather than mandatory pension coverage, we urge the Congress to adopt a comprehensive and coherent system of incentives. In addition disincentives in present law and the way it is being administered should be addressed. Currently, compliance with ERISA requires of employers a great deal of reporting and disclosure information which is neither necessary nor used.

Individuals are now encouraged through a tax deduction for contributions to set up an individual retirement account, but only if they are not already covered by a plan. Contributions are limited to $1,500 and other restrictions are imposed. For many lower paid workers tax deductibility is an insufficient incentive to save. Employees already covered by a plan who contribute to their retirement whether through an employer plan or separately are not now given a deduction.

Self employed people have larger contribution limits than other individuals but must comply with many of the reporting and disclosure reqirements.

For many years the private retirement system has struggled with the diverse contributions and benefit limitation rules applicable to different types of pension programs. Citizens generally have extreme difficulty in understanding the complex rules. This tends to discourage the establishment of retirement plans. Individuals in all types of pension programs should be treated more equally with respect to contribution and benefit limitations.

A way must be found to simplify the numerous complicated and technical requirements entailed in establishing and administering pension plans. Whether centralized administration of all pension laws in a single agency, as the Commission recommends, will bring about needed simplification is problematical. What is urgently needed is recognition by the Congress that simplification is necessary and a willingness to work toward the goal.

ABA has recognized and would lke to suggest a few specific areas for needed belief. We urge the committee to consider these as a beginning step toward creating a regulatory climate which will foster growth of our private pension system.

Reporting and Disclosure

The ABA urges that ERISA be amended to streamline the paperwork requirements and encourage the Secretary of Labor to exercise greater flexibility to modify such requirements. We feel that the inflexibility of approach taken in ERISA as interpreted by the Department of Labor is fundamentally wrong, in delineating how, what, where and when information must be reported. We would suggest eliminating the statutory specifics currently found in Section 103 and giving the Secretary authority to require such reports as he deems necessary to carry out the policy of ERISA. Such authority, however, should be limited by requiring that he recognize that the disclosures must be cost-justified and not unduly burdensome and be consistent with encouraging formation of plans and broadening their coverage. If Section 103 is amended in this way, Section 104 should also be modified since it is directly tied to the existing requirements of 103.

If Congress does not favor repealing all the statutory specifics in Section 103, we would recommend that a serious review of the provisions be undertaken to determine what information is really of benefit to the regulatory agencies and participants.

Further, we strongly support an amendment to Section 103(a)(3)(C) which would mandate that accountants rely on statments prepared and certified by a bank or similar institution. We have been dismayed at the position taken by the auditing community that reliance on a bank's certification of assets does not meet generally accepted auditing standards and thus further testing and confirmation must be done.

Use of Bank Collective Investment Funds for Keogh and IRA Funds

Under current law the assets of corporate pension plans may be collectively invested without registration regardless of the size of the company, under the exemptive provisions of section 3(a)(2) of the Securities Act of 1933. Collective trusts for self-employed (Keogh) plans, however, are excluded from this exemptive provision of the 1933 Act. Nevertheless, banks, with very few exceptions have not registered their collective trusts for Keoghs relying upon the intrastate exemption of section 3(a)(11). This has resulted in some strange consequences. In multistate communities such as Washington, D.C., New York, Chicago or St. Louis, Keogh plan trusts that are invested collectively have been tailored carefully so that the interest of any participant who resides out-of-state will not be invested in the collective fund with the others. Rather, the interest of such a person in the plan normally is invested in an interest bearing deposit account. Thus, Keogh 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 nonproductive 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.

Many smaller banks do not hold sufficient assets to maintain two separate collective trusts and have considered collectively investing their Keogh plan trusts and their corporate pension trusts in one fund under the Securities Act's common trust fund exemption. However, they have had to decide against such action because, according to SEC, this exemption is not available to pension trusts. Thus registration would be required unless all the corporate and Keogh plans to be collectively invested, including all their participants, reside in one state. The reason for this result is that a pension trustee according to SEC is not a trustee and the intrastate exemption requires all interests in a fund meet the intrastate requirement.

When Congress created individual retirement accounts, it attempted to remove impediments to the collective investment of such accounts with Keogh plan assets and other pension plan assets (See IRC Section 408(a)(5)). 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 argue, as some do, it was to avoid the exemptive provisions of the securities laws. Nevertheless, the SEC holds to the position that banks may not invest IRAs collectively without registration and compliance with the 1940 Investment Company Act. As a consequence, banks generally do not invest IRA accounts in securities except for large rollover accounts where they can be managed economically on an individual basis. Banks should be able to offer their IRA customers the same advantages of a collective fund as they may offer their corporate pension customers.

The same problem exists under the securities laws where a smaller bank wishes to invest collectively assets it holds as trustee for personal trusts and assets it holds as trustee for pension trusts because it does not hold sufficient assets to establish two separate collective trusts. Presumably, the intrastate exemption would be available under the 1933 Act to avoid registration if all the accounts met the residency requirement or, maybe, even the common trust fund exemption coupled with the corporate pension trusts exemption might be available. However, according to the SEC such a collective trust would still be caught by the Investment Company Act because the pension trust exemption and the common trust fund exemption are found in different subsections of the Act and there is no intrastate exemption. The common trust fund exemption alone would not suffice because, as mentioned before, the SEC holds that the trustee of a pension trust is not a trustee.

It is long past time to straighten out this quilt work created by the SEC 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 may each be collectively invested without registration. But assets from different types of trusts may not be combined in one fund without registration. Thus, smaller banks 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 they would like to invest collectively, but because they do not have sufficient assets to establish a separate collective fund for each type of trusts -- personal, corporate pension and Keoghs. Worse still, the customers of these banks are then deprived of the benefits of a professionally managed diversified collective investment portfolio.

Prohibited Transactions

As fiduciaries and investment managers, banks have found that their overriding problem under ERISA is its prohibited transaction provisions. These provisions found in almost identical form in both the labor law and Internal Revenue Code sections of ERISA are prophylactic in nature, prohibiting transactions or dealings between a plan and "parties in interest." The code provision imposes excise taxes for such transactions even if they are entered into without knowledge. These provisions are a clear case of regulatory overkill.

Section 406(a) of ERISA and Section 4975 of the Internal Revenue Code prohibit 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. Regrettably, our concerns have proven correct.

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. The number and variety of possible transactions that are prohibited by the statute are enormous, and the vast majority of such transactions would not only be innocently entered into but would be in the plan participant's 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 formulated that the exemption procedure would be significantly liberal so as to alleviate any unnecessary severity of these provisions. The ABA has found the exemption procedure to be practically unworkable. We have obtained four class exemptions. Our first application was filed in December 1976 and was granted more than four years later in January, 1981. Our second application filed in January, 1977 only took 3½ years, while our third filed in March, 1979 was processed in a little less than two years except the Labor Department has not yet cleared banks being compensated for the securities lending service involved.

We urge the Congress to change the basic concept of prohibited transactions as they relate to dealings with parties in interest. After five 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, 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 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 them no substantive protections that they do not already enjoy under Section 404. There is no overt misconduct that the Congress 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.

Collective Trust Funds and Plan Assets

The Labor Department has taken the position that if a pension plan trust is invested in a collective trust fund the assets of the collective trust fund are assets of the plan. As a consequence, collective trust funds are subject to an additional layer of regulation. It seems clear from the legislative history of ERISA that Congress did not intend this result. In fact, the Congress specifically provided that the assets of a mutual fund whose shares are held by a pension plan are not assets of the plan. Bank collective trust funds should be treated the same.

Unfortunately, we failed to request such an exemption while ERISA was before the Congress because we believed it unnecessary. Banks are a fiduciary to their collective trusts, as well as fiduciary to each of their individual plan trusts. Thus, it is unnecessary to consider collective fund assets plan assets to provide fiduciary protection to plan participants.

Indeed, it is inconsistent. We urge the Congress to amend ERISA to provide that the assets of bank collective trust funds are not assets of the plan, similar to the treatment now accorded to mutual funds.

Other Provisions in ERISA Needing Review

We 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."

We are also 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.

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Tax Incentives

The effects of inflation on retirees as it erodes the value of pensions is well recognized. Inflation has had much the same effect throughout our economy. For this reason ABA has placed its wholehearted support behind the President's National Economic Recovery Program. The spending cuts recommended by the President and the priorities he has set for tax reductions are essential to controlling inflation.

Banks have consistently been leading supporters of IRAs and Keogh plans both of which encourage savings for retirement. Our Association so testified before this subcommittee in February and several times in the past before other Congressional committees. We believe at the appropriate time within the framework of the President's priorities the tax deductible amount should be increased and eligibility should be expanded. An increase in the tax deductible amounts will provide an incentive for greater long term savings and bring these amounts more in line with their original economic value.

Employee contributions to qualified employee benefit plans should be given favorable tax treatment. Also, plans should be permitted to accept contributions from employees. The vast majority of those involved with emploee benefit plans have strongly supported the concept that tax-free employee contributions (increasing savings for retirement) will help alleviate future retirement income problems. At the same time, these additional contributions to private plans add to the supply of capital needed to strengthen our economy--a critical concern today.

The Commission's suggestion of a tax credit for low and moderate income people to encourage individual retirement savings is noteworthy. The tax credit approach goes hand-in-hand with the overall objective of tax deductible contributions. Studies show the low income group is the one most in need of retiremnet supplements. Some form of tax credit would be most helpful for this group since presently they might have trouble making contributions without this assistance.

Treating, for tax purposes, all savings for retirement in the same manner as the tax treatment given pension plans is a reasonable concept. Employees should be encouraged to set aside savings to augment the benefits provided by employers. Obviously, the mechanics of any eventual scheme will be of paramount importance in this type of situation.

In addition, we suggest that the ERISA limitations be reexamined. The limits on defined contribution plan contributions (particularly the 25% of compensation limit) have, in practice, hurt a number of lower-paid employees.

Summarizing, the ABA supports the thrust of the creative and constructive tax policy recommendations of the Commission. It is important that the major role played by the private retirement system is recognized in the overall retirement scheme. Providing tax incentives to the private sector is the first step. Hopefully, this will help close the retirement income gap for all Americans. The stronger the private retirement system, the less pressure on Social Security.

Pension Fund Investments

There is one additional subject we would like to discuss which was considered by the Commission and recommended for further study. That is the ownership and control of pension fund assets. The Commission expressed the belief that this should become one of the most important social and economic public policy issues facing the nation in the coming decades. At the same time, the Commission felt that not enough is presently known to make conclusive recommendations and recommended that research, public debate and policy development be continued.

Bank trust department have had considerable experience in investing trust funds, personal trusts as well as pension funds, before and after the enactment of ERISA. We have also given considerable thought to various own behalf. However, the law is clear that where conflicts unavoidably arise, they must be resolved in the interest of the plan participants and beneficiaries. Beyond the law, the traditions of the trust business compel those of us who serve as corporate fiduciaries to adhere to the highest standards of disinterested professionalism. We are proud of our record in meeting these obligations to employee benefit plan participants.

It must be remembered that the "exclusive purpose" of employee benefit plans, in the words of ERISA, is to provide "benefits to participants and their beneficiaries". The trustee, in choosing particular investments, must take into account all the present facts and circumstances and the prospects for the future. Additionally, ERISA requires that the investments be diversified so that the risk of loss is minimized. Thus, in picking the investments which make up a particular portfolio there is no built-in bias toward any particular type of security. The portfolio consists of a mix of securities chosen in such a way as to balance the level of risk of the portfolio in relation to the potential for income and capital appreciation. ERISA's prudent man rule allows for investment in all types of businesses including small and locally situated ones. If there are local investments which offer good economic prospects at an acceptable level of risk, the trustee is free to choose them.

Any plan that wishes to utilize its investments to pursue social, moral or political goals has the ability to do so, within the limits of the fiduciary requirements of ERISA. That some have chosen to interject these non-traditional or "divergent" criteria is evidence of this ability; that more have not is a tribute to the proper reluctance of plan managers to be distracted from the proposals to utilize pension funds for one or another socially desirable goal and would like to share our thoughts with the Subcommittee.

When a trustee is given discretion over certain plan assets the standard he must adhere to is prescribed by Section 404 of ERISA. The trustee, as a fiduciary, must discharge his duties with respect to the plan solely in the interest of the participants and beneficiaries, and "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

Further, ERISA Section 406 prohibits a fiduciary from dealing as an individual with trust assets, from acting in his individual capacity or any other capacity in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or its participants or beneficiaries, and from deriving personal gain from his position other than a reasonable fee for his services.

Thus, ERISA makes it clear that the assets of the plan are held for the participants and beneficiaries of those plans, not for the trustee. Under law, the trustee is required to exercise some of the rights and duties of an owner. But, the trustee does this sole in his representative capacity in behalf of the particpants and beneficiaries and not for his own benefit. And not, for that matter, in futherance of anyone else's interest, no matter how meritous such interest might be. Thus, the participant's interest is the trustee's interest.

It has been suggested that the position in which professional trustees find themselves gives rise to the potential for irreconcilable conflicts of interest and the possibility of using their authority to wield economic power in their own behalf. However, the law is clear that where conflicts unavoidably arise, compelling financial requirements of plan participants and beneficiaries.

In our view, the conceptual weakness in the argument for non-traditional criteria is that they invariably involve some financial risk to be measured against some potential non-financial gain. Very often those whose interests are exposed to the risk have no commensurate interest in the potential benefit to be derived. Whether a plan should embark on such a course is clearly not within the purview of a bank trustee's authority.

Consider, for example, a defined benefit plan. It places the responsibility of fulfilling the pension promise solely on the sponsor, usually a corporation. The liabilities are funded by corporate contributions. The obligations are codified in ERISA and future liabilities must be disclosed to the corporation's shareholders.

Very different from that is a defined contribution plan under which a participant's benefit is based solely on the investment experience of the contributions. If such a plan offers a choice of funds, the traditional fixed income, equity and diversified funds as well as special purpose funds for residential mortages, regional companies or a fund which excludes investment in companies which fail to meet some "social" test, then each participant may elect how to balance his own retirement and social interest.

Unlike the defined contribution plan, where the investment risk is borne by the employee, the investment risk of a defined benefit plan is borne by the employer who will have to contribute additional amounts if the fund cannot meet its pension obligations.

Further, unlike a defined contribution plan, the employee's beneficial interest in the defined benefit fund at any given time cannot be determined since the benefit is a function of future variables: the employee's salary level at retirement date, years of service, and the date of his death.

We are constantly exposed to the concept that all things being equal, other incidental social benefits may be properly pursued. That is an attractive notion. I would submit, however, that directing the investment of assets on other fundamental investment risk/return considerations has a very real potential cost that can only be quantified after the fact.

Fund managers are now being called upon to re-examine our duties and responsibilities. Very simply, do we continue following the "sole benefit" and "exclusive purpose" rules or should pension assets now be "used" to achieve other social goals? Which goal takes priority, the interest and welfare of the participants in those plans or the presumed need to supply capital for low cost housing, or to rescue a faltering business in a depressed area of the country, or "???" The list of uses is substantial and impressive.

Is it possible to achieve both types of objectives? Can we invest in the best interests of the participants, and at the same time achieve social goals? Should we attempt to reconcile what may be conflicting objectives? This is the challenge.

Can these objectives be achieved? Obviously, the control over investments is vital. To date, most pension fund assets are invested by professionals who follow economic criteria. The issue arises, should control of investment decisions be turned over to others.

Regardless of how we may feel as individuals about the wide variety of social objectives, and many are nearly universally accepted, we believe the greater the number of objectives and the less clear the relationship of each to the other, the less likely it is that any objective will be met. Adequate retirement income must be the overriding objective for a retirement plan, just as medical care is for a medical plan. The other "social objectives" diminish the flexibility that investment managers have to meet the retirement income objective.

"Ownersip and control", "social investing" or "reindustrialization", whatever called and however, defined, and whatever our individual perspective, is neither a simple issue nor an unimportant one. The risk is that conclusions may be based more on how the issues are presented rather than on their merits, or most importantly, on how they fit a healthy retirement income scheme. We recommend the Subcommittee's efforts to meet this objective.

ABA appreciates having had this opportunity to comment on the recommendations in the Commission's Report. We will be pleased to answer any questions.

Senator CHAFEE. Mr. Bruce and Mr. Hacking, please.
Alright gentlemen, Mr. Hacking, why don't you proceed.

PANEL OF JAMES M. HACKING, ASSISTANT LEGISLATIVE COUNSEL, NATIONAL RETIRED TEACHERS ASSOCIATION-AMERICAN ASSOCIATION OF RETIRED PERSONS; STEPHEN BRUCE, STAFF ATTORNEY, PENSION RIGHTS CENTER, AND CHARLES M. LOVELESS, COUNSEL FOR EMPLOYEE BENEFITS, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES

Mr. HACKING. Thank you, Mr. Chairman. I'm here representing both the National Retired Teachers Association and the American Association of Retired Persons. These organizations have a combined membership of about 12½ million persons age 55 and older. I'd like to submit my statement for the hearing record. I shall proceed with a brief summary of that.

While the associations disagree with a number of specific recommendations of the President's Commission we do agree with the general policy directions the Commission took.

Clearly, demographic trends indicate that a greater responsibility for retirement income must be accepted by advanced funded pension programs. Additionally, the mix of retirement income sources must be increased and strengthened. While social security is and must remain the base of retirement income, there must also be strong roles for private pensions, individual savings and especially work effort.

While the President's Commission presents a clear case for the need to fund in advance a significant element of the future retirement income structure, questions remain about the means of implementing this approach. In general, we agree with the Commission that the private pension sector must be called upon to provide a universal, reliable and significant source of income for the future elderly population. But we urge this subcommittee to review a number of aspects regarding the effectiveness of private pensions in providing retirement income.

Significant areas of concern should be: coverage, vesting, portability, and the effects of inflation on benefits, both before and after those benefits are awarded.

The response of the President's Commission to the problems in the private pension area is the minimum universal pension system. The associations basically agree with the direction taken by the Commission concerning MUPS, however, the proposal certainly has its deficiencies and problems, the most important of which is the cost.

Also, because MUPS takes the form of a defined contribution plan, consideration must be given to whether it will be able to keep up with inflation prior to retirement.

While the President's Commission has apparently seen MUPS as the answer to coverage, vesting and portability problems, it has left the private pension component above the MUPS virtually unchanged from present ERISA standards.

We feel the Congress should act now to provide for a fairer and more efficient private pension system. It should start by shortening vesting requirements and by designing a portability mechanism in order that people can take their credits with them when they change jobs. The Commission found that individual efforts to save for retirement should be strengthened through tax policy.

Our associations strongly agree with the Commission's recommendations in the savings incentives area. We believe, for example, that your bill, S. 243, would be a significant step toward the goal of encouraging people to save for their own retirement. Also the legislation would benefit the Nation's economy.

With regard to social security, the President's Commission has recommended an acceleration of scheduled payroll tax increases and interfund borrowing as a means for dealing with social security's short term financial problem.

Our associations support the Commission's efforts to increase revenue rather than reduce benefits to address the short-term problem. We disagree, however, with the source of that increased revenue, but nevertheless believe it is significant that the Commission recognized that large, precipitous benefit cuts in the short term would unfairly disadvantage current recipients as well as defeat the reasonable benefit expectations of persons who are approaching retirement age.

Proposals to reduce social security's cost-of-living protection as a means for addressing the system's short term financial problem pose a major threat to the elderly's income security and are totally unacceptable to us.

Over the long term our associations advocate a comprehensive restructuring of social security's benefits and financing structures. The major trends with which the system must deal in the future include the adverse economic trends of inflation, unemployment and low economic and productivity growth which are curtailing the system's financial resources, and the combination of demographic and declining labor force participation trends which portend a large elderly population heavily dependent upon a relatively smaller younger work force.

In response to these trends, the President's Commission has recommended an increase in the normal retirement age from 65 to 68 with a concomitant increase in the early retirement age from 62 to 65.

This age 68 proposal is unacceptable to us. In our view, instead of getting additional work effort and therefore additional tax revenue from the future elderly population, the age 68 proposal will merely cut social security expenditures leaving a very large segment of the elderly population to subsist on substantially reduced benefits with an enhanced likelihood of poverty.

Instead of the age 68 proposal, our associations have long advocated, what we call a work incentive concept to deal with social security's long-term problem.

Our associations were pleased that the administration in announcing its package of social security changes this week did include the beginnings of a work incentive concept. We think there is much to be gained by making changes in social security that are consistent with the objective of encouraging and rewarding work effort.

In analyzing older worker employment issues, the Commission correctly labeled the social security earnings limitation as a major disincentive to work. However, in our associations' opinion the Commission makes a fundamental policy error when it links to elimination of the earnings limitation to the taxation of social security benefits.

I'll conclude my remarks with that, Mr. Chairman. I thank you for having had this opportunity to present them.

Senator CHAFEE. Thank you. First you have said that we should use the general funds to make up the social security deficits that arise. Is that correct?

Mr. HACKING. Yes, in the short term.

Senator CHAFEE. In the short term.

Second, you would not increase the age, but what you would do is have the so-called work incentive, namely, remove the earnings limitation.

Mr. HACKING. Yes, but in addition we would keep the age for full benefits at 65, and we would dampen down early retirement benefits to try to reverse the early retirement trend.

Senator CHAFEE. Do you mean that you would reduce the percentage of retirement benefits permitted to early retirees?

Mr. HACKING. Yes, now at 62 you get 80 percent of what you get at 65. We would reduce that to around 70 percent. But that kind of change would have to be phased in, it couldn't be done immediately.

Senator CHAFEE. Did you say that in your testimony?

Mr. HACKING. Not in this, but we have said it in reacting to the administration's proposals that came out on Tuesday.

Senator CHAFEE. I see. Thank you very much, Mr. Hacking.

Mr. Bruce, you may proceed.

STATEMENT OF STEPHEN BRUCE, STAFF ATTORNEY, PENSION RIGHTS CENTER

Mr. BRUCE. Mr. Chairman, my name is Stephen Bruce and I am a staff attorney for the Pension Rights Center. With me today is Karen W. Ferguson, the center's director.

With your permission, I would like to submit our statement for the record and proceed to summarize.

Senator CHAFEE. Mr. Bruce, can I interrupt 1 minute?

Mr. Hacking, I would be interested to see if you could submit for the committee, statements you've made as far as reducing the benefit levels for early retirees. Did you ever make a formal statement on that?

Mr. HACKING. Most of our statements have been extemporaneous reactions to press inquiries, but we are going to reduce what we have been saying to writing for our own volunteer leadership's information. I would add that we have long emphasized the need to reverse the early retirement trend.

Senator CHAFEE. Well, I would appreciate it if you would send that to the committee.

Mr. HACKING. Certainly.

Senator CHAFEE. Thank you very much.

Please proceed, Mr. Bruce.

Mr. BRUCE. The Pension Rights Center was formed 5 years ago in 1976 to educate the public about pension issues, specifically ERISA and to represent the interests of people who look to pensions for a secure retirement.

The President's Commission's report and working papers are impressive. For the first time we have facts and figures and analyses of retirement income programs, much of which was heretofore missing.

The report documents what at one time was probably the greatest secret in America. That social security benefits are not enough. Everybody in this room knows that and every member of the working population must be fast becoming aware of it.

The Commission's report also documents, however, that the odds are very good that for most people there will be precious little more at retirement than social security.

My remarks will be limited to private pensions as a source of retirement income. There are five major problems in this area.

The first is that too many people do not have pension plans. That's the problem of coverage.

The second as the chairman recognizes is that too many people who are in a pension plan come away without a pension. That's the problem of vesting.

The third problem is the problem of people who have pension plans who work long enough to vest but then get little or no benefits from this plan. Usually this is because their pension benefits have been offset with social security. This goes under the rubric of social security integration.

The fourth area is the fixed pension. People who are getting pensions, but the pensions were fixed as of the day they left the company. These pensions may have been fairly substantial 10 to 12 years ago, but they have not been adjusted for inflation, or if at all, they have been adjusted on an ad hoc basis of ad hoc and the increases have been very slight.

Finally, there is the problem of women who stayed at home to take care of family responsibilities and who find that their husband's pension, which they had counted on, has disappeared with his death.

The primary focus of the President's Commission as you heard earlier was on the coverage problem, the people who do not have pension plans.

The Commission made a judgment that this was the singlemost important problem. It is extremely important, but it is not, as they say, the whole ball of wax.

The factory worker who doesn't get a pension because he is laid off after nine and a half years does not think that coverage is the only problem. That factory worker thinks that shorter vesting is a must.

The secretary whose pension is offset by social security after years and years on the job and she ends up getting practically nothing from her pension, thinks that social security integration is the most important problem.

The pensioner—this committee must know—is concerned about what the last decade's inflation has done to his pension. This is really one of the areas where the private pension system is the most vulnerable. Whether or not the private pension system can do something to adjust the fixed benefit plans for an inflation that was not expected when many of these people came into the plans and was not expected when they retired. The Lou Harris poll in 1979 showed this as the No. 1 concern not only among retirees, but also among current workers.

Homemakers, particularly the widows whose husbands worked a lifetime under a pension plan, think survivor's benefits are the problem. The most tragic kinds of letters we get are from the widows whose husbands work for, say, 30 years under a pension plan and the husband had a right to a pension, he was vested. Then he dies maybe a day or a month or a year before the plan's early retirement age. In some cases, this can be age 55 and in other cases it's age 60 or 62. The widow gets nothing under current law, even though the pension was vested. And the letters almost always say, "but we thought that the pension would take care of me."

MUPS may be a solution to the coverage problem. It is worth very serious consideration, particularly if employee options with regard to portability and investment management are built in.

I'm not going to talk today, though, about whether MUPS is the best solution to the coverage problem, because it is difficult to tell at this point. Perhaps there is the voluntary tax incentive approach that will work and that will yield the needed coverage, and at the same time not be too costly. And, perhaps there are other alternatives. Perhaps an advanced funded layer of social security or some public/private alternative. It is not clear at this point.

With regard to the condition of existing plans, it is notable that in the MUPS the President's Commission recommended that there be vesting after 1 year, as opposed to 10 and the so-called integration with social security would be eliminated.

Mr. Chairman, in conclusion we would ask that when you consider the recommendations in the report of the President's Commission, that you consider especially the conclusion that employee pension programs typically reward only long-service, higher paid employees. These are programs which are largely the creation of created by Federal tax policy. They are encouraged currently by revenue losses in excess of $19.8 billion. Surely, we can get more equity, a better and a more reliable delivery of retirement income in exchange for this amount of lost tax revenue.

Thank you, Mr. Chairman.

Senator CHAFEE. Thank you, Mr. Bruce, for a fine statement.

Mr. Loveless, you may proceed.

STATEMENT OF CHARLES M. LOVELESS, COUNSEL FOR EMPLOYEE BENEFITS, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES

Mr. LOVELESS. Mr. Chairman, I appreciate the opportunity to present this statement on the final report of the President's Pension Commission, on behalf of AFSCME, the American Federation of State, County, and Municipal Employees.

My union, AFSCME, represents approximately 1 million State and local government workers across the country. On several occasions, we testified before the President's Commission, expressing our views on various retirement issues of primary concern to our members.

With your permission, I would like to submit a written statement for the record and proceed to summarize.

Senator CHAFEE. Fine.

Mr. LOVELESS. Issued by the Commission was its—enactment of a Public Employee's Retirement Income Security Act (PERISA) to correct the major abuses existing in State and local government retirement plans.

Thus far most of the discussion of this hearing has focused on problems associated with interpretation and application of ERISA from encouraging retirement savings and how to encourage the growth of pensions in the private sector.

But it also needs to be pointed out that governmental employees are not covered by the substantive provisions of ERISA, and, in fact, the millions of State and local government workers have no Federal statutory retirement income protection whatsoever.

We had asked—expressed in the President's report and in the voluminous report issued in 1978 on Public Employee Retirement Systems by the House Education and Labor Committee's Pension Task Force, that there is a major crisis in the operation of the 6,000 State and local government pension plans.

With assets that are conservatively valued at over $120 billion and that this crisis urgently requires Federal Government reformation.

Whether you look to the President's Commissions report or the Pension Task Force report which was mandated by the Congress when it enacted ERISA in 1974, or in the 1979 and 1978 GAO reports on public plans, or to a host of other studies both public and private, we believe that certain conclusions are inescapable.

One, to clear up what I so charitably referred to as the regulatory framework applicable to State and local government retirement plans is entirely inadequate to safeguard the billions in public plan assets, and entirely inadequate to protect the interest of public plan participants and beneficiaries who, in most cases, unlike their counterparts in the private sector make sizable personal contributions to their pension plans.

And, second, that the Federal Government has largely evaded its responsibilities for protecting public plan participants and protecting the other vital national interests involved.

Let me state for the record a couple of the findings from the House Pension Task Force survey of the thousands of State and local government retirement plans. I'm suggesting that report makes some very interesting reading.

Approximately 40 percent of State and local government general employee plans do not regularly furnish members with booklets or other materials describing basic plan provisions. In fact 18 percent were unable to furnish plan descriptions to participants even upon request.

Over 70 percent of all public plans do not compute the market value of assets, and this was just confirmed again, Mr. Chairman, by a report that was just put out last month by the Urban Institute on Public Plans.

Approximately one-quarter of the State plans and 40 percent of local plans do not have actuarial valuations performed on a regular basis. In fact, the report found only 25 percent of the local government plans have not conducted an actuarial valuation within the past 10 years.

Well I think it's fairly obvious that a regular actuarial valuation is essential of a true understanding of a plan's emerging costs is to be reached.

In addition, the report documents numerous conflicts of interest in public plan management and investment practices and other clear examples of fiduciary abuse which have occurred due to the absence of a uniform standard of conduct which is applicable to public plan fiduciaries.

As a constructive means of addressing the public pension crisis, Mr. Chairman, my union supports the enactment of Federal reporting disclosure, and fiduciary standards for public plans.

In the past Congress, we were strong supporters of H.R. 6525, the Public Employee Retirement Income Security Act of 1980, which was sponsored by Congressman Erlenborn, ranking minority member of the House Labor Management Relations Subcommittee.

We would respectfully submit that this is hardly a radical proposal. It merely accords public plan participants certain minimal Federal statutory protections. Namely, that their plans be operated openly and without the discrimination, dishonest or fiduciary abuse.

It carefully limits the degree of Federal Government intrusion in State and local government affairs by providing that States will have responsibility for administration and enforcement of certain of the act's provisions.

We think it's a bill, Mr. Chairman, that's in the interest not only of plan participants and beneficiaries, but also of the taxpayers and the general public, who have every right to know how well State and local government pension plan assets are being managed.

Thank you very much for the opportunity to present this statement, Mr. Chairman. And I'd be pleased to answer any questions you may have.

Senator CHAFEE. Well, Mr. Loveless, I share your deep concern. If you had been here earlier, you would have heard me mention my concern for municipal, and to some degree State plans, although I suspect the State plans are in better shape than municipal ones.

The problems you mentioned are very real and I will look into Mr. Erlenborn's legislation. It may be the kind of thing I'd be interested in sponsoring. At this time I can't say I definitely will, because I just don't know enough about it.

One of the problems obviously is that, as you are well aware, looking at it from the organization that you represent that the benefits under the municipal plans are extremely generous. Any mayor who finds it far easier to permit earlier retirement under a pension plan, rather than give an immediate wage raise, because it postpones the impact, and that's one of the reasons that the plans are in great difficulty. But, unquestionably all the points you made also are extremely valid, the conflicts, the lack of actuarial attention, and so forth.

I suppose looking at it nationally the greatest—well, I suppose the social security has enough problems itself, but I must say those municipal pension funds are in terrible shape from what I hear.

Well, thank you all very much. I appreciate your coming.

[The statements of the preceding panel follow:]

STATEMENT

OF THE

NATIONAL RETIRED TEACHERS ASSOCIATION

AND THE

AMERICAN ASSOCIATION OF RETIRED PERSONS

BEFORE THE

SUBCOMMITTEE ON SAVINGS,

PENSIONS AND INVESTMENT POLICY

SENATE COMMITTEE ON FINANCE

ON

THE FINDINGS OF THE PRESIDENT'S

COMMISSION ON PENSION POLICY

MAY 15, 1981

SUMMARY

The Associations believe that the report of the President's Commission on Pension Policy provides a basis for a careful review of our nation's retirement system. Because of the need to accommodate the income needs of the post World War II baby boom cohort when it reaches old age, policy decisions must be made soon.

The President's Commission has shown that it is in the nation's interest to encourage retirement income adequacy through the private sector. The Associations share this belief; however, Congress' position on the Commission's MUPS approach should not inhibit other basic reforms. Specifically, improvements must be made in current vesting and portability practices. Additionally, incentives can be provided to increase coverage so that the necessity of a MUPS can be more precisely evaluated.

The Commission's final report also reaffirms the status of social security as the primary program of income support for the elderly - a position which the Associations strongly endorse. However, the Associations, unlike the President's Commission, believe that social security will have to undergo a major and fundamental restructuring if it is to continue to serve the changing needs of the population. Additionally, the Commission's findings that people should be encouraged to help themselves through work and voluntary savings should be implemented by policymakers.

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Introduction

With a membership of 12 million persons over the age of 55, the National Retired Teachers Association and the American Association of Retired Persons have a natural interest in the nation's retirement policy. The Associations' concern extends to retirees and to those who have yet to retire. Because of this interest, the Associations carefully monitored and at times participated in the deliberations of the President's Commission on Pension Policy. We are pleased that the Subcommittee on Savings, Pensions and Investment Policy is reviewing the findings of this important Commission.

While the Associations disagree with a number of specific recommendations of the Commission, we feel that the direction the Commission offers should be followed by public policymakers. Specifically, we are impressed that demographic trends indicate that a greater responsibility for retirement income must be accepted by advance-funded pension programs. Additionally, the mix of retirement income programs must be strengthened. While social security is and must remain the base of the retirement income structure, there must also be a role for private pensions, individual savings and work effort.

Perhaps the Commission's most controversial recommendation calls for the creation of a minimum mandatory pension tier. This recommendation was generated from the Commission's concern that "the retirement income system and federal retirement policies are contributing to a two-class system of retirement." Those who fare well by the private pension system appear to have a more secure retirement than those who rely solely on social security. While the Associations feel that, because of inflation, even private pensioners suffer if they stay retired for any length of time, we believe that the Commission's premise is basically correct. As we state in the Section on Private Pensions, the Associations also believe that the Commission's direction -- strengthening the private pension component -- is the proper approach to the problem.

In addition to the private pension recommendations, the President's Commission also suggests improvements in individual "self-help" efforts. The position that people should be encouraged to save on their own for retirement is an important one if efforts to provide an adequate retirement income are to be successful. Also, the Commission is perhaps the first "blue-ribbon" panel to suggest that work effort be considered a significant part of an older person's income mix. The Associations hope that this suggestion can be used as a catalyst to construct a policy that discourages the waste of the tremendous resources we have in our nation's older workers.

<u>Private Pensions</u>

While the President's Commission presents a clear case for the need to fund in advance a significant element of the future retirement income structure, questions remain about the means of implementing this approach. A key issue involves whether advance funding can best be accomplished through the private sector or through the introduction of an additional tier in the social security system.

The arguments in favor of the social security approach are strong. Social security is the only system presently in place that provides nearly universal coverage, early vesting, complete earnings portability, and effective cost-of-living protection.

Private pensions, on the other hand, do not completely succeed in providing a reliable amount of retirement income as presently structured. For one thing, coverage is not universal. Only about one-fourth of all people over age 65 receive private pension benefits. The President's Commission found that in 1975 less than half of the nation's work force was participating in private pension plans. Only 25 percent of the total working population age 18 and over has a vested right to a pension provided by their current employer.

People who are presently not participating or vested in private pension plans may, in later years, acquire the right to a pension. However, the data from the President's Commission indicates that many are not being served well or at all by the private pension sector.

Judging present accomplishments alone, the Associations would choose to fund in advance a tier of social security in order to reach retirement income goals for the future. However, such a decision must consider other factors; introducing advance funding into social security would create new problems. Specifically, a large pool of capital would be centralized in a single place. If the public funds were to be invested in the private sector, marketplace considerations might not govern investment decisions. Resulting investment practices could prove economically inefficient.

An additional concern is that somewhat higher social security replacement rates might crowd out the private pension industry. Employers could assume that the federal government will provide for the retirement income security of their employees. If the new social security replacement rates by themselves do not yield an adequate retirement income and, if an important component of benefit supplementation -- the private pension sector -- diminishes in size, retirement incomes would suffer.

The problems that would result from funding in advance a tier of social security lead the Associations to agree with the President's Commission that the private pension sector must be called upon to provide a universal and reliable source of income to the future elderly. Keeping pension assets in the private sector would be economically sound since it would decentralize the large pool of capital that will be generated from an advance-funded pension trust. Additionally, the existence of private sector plans would encourage supplementation by both the employer and the employee., thereby enhancing retirement planning.

The Associations were very pleased that the President's Commission took the direction of strengthening the private sector. In light of these recommendations, we feel that the Subcommittee on Savings, Pensions and Investment Policy should review a number of aspects regarding the effectiveness of private pensions in providing retirement income. Significant areas of concern should be:

1. Coverage - Statistics revealing the inadequacy of present private pension coverage were mentioned earlier. It is also important to note that forecasts conducted by the Commission indicate that, without any changes in present law,coverage is not expected to increase significantly in the future.

2. Vesting - The most common means of vesting provides the right to a benefit only after ten years of work. This standard conflicts with the reality of a mobile labor force, and it causes many people to lose the opportunity to receive a pension.

3. Portability - Even for those who acquire a vested right to a pension benefit, mobility is still a problem. Pension rights and credits are very rarely portable from the

pension plan of one employer to another. As a result, benefits can become frozen when a person leaves a plan; a vested benefit owed a person who leaves an employer at age 45 will be worth very little in an inflationary environment by the time he/she reaches the normal retirement age of 65.

4. The Effect of Inflation - Once a person retires, the impact of inflation on the pension benefit is often severe. Only about 5 percent of all private pension plans provide automatic inflation adjustments, and even then the adjustments are usually limited to a maximum of around 3 percent a year. Although many more plans provide ad hoc adjustments, private pension benefits have not kept pace with inflation.

The response of the President's Commission to the problems in the private pension sector is the Minimum Universal Pension System (MUPS). The Commission would have all employers contribute 3 percent of payroll to the MUPS for all employees over the age of 25 with one year of service and 1,000 hours of employment with their employer. This contribution would be immediately vested and completely portable. Additionally, the Commission recommends that tax breaks be provided to help offset the cost of the MUPS for businesses.

While the Associations fundamentally agree with the direction taken by the Commission concerning MUPS, the concerns of its detractors should also be heard on this issue. For example, cost may be a reason that private pension coverage should not be mandated for certain people. For instance, perhaps the administrative cost of the MUPS for transient workers would exceed potential benefits. Additionally, the tax breaks proposed must be analyzed in terms of revenue loss to the Treasury and compensatory effect for business. Also, because the MUPS takes the form of a defined contribution pension, consideration must be given to whether it will be able to keep up with inflation prior to retirement. If the MUPS were in a defined benefit form, an implicit inflation adjustment would be made by providing a pension according to a person's earnings record.

While the President's Commission has apparently seen the MUPS as the answer to coverage, vesting and portability problems, it has left the private pension component above the MUPS virtually unchanged from present ERISA standards. The Associations believe that the debate centered around the MUPS is unfortunately detracting attention from additional remedies to these problems of the private pension system.

Our Associations feel that Congress should act now to provide for a fairer and more efficient private pension system. It should start by shortening vesting requirements and by designing a portability mechanism in order that people can take their credits with them when they change jobs. The coverage issue might be addressed first through a "carrot" to small employers in the form of tax credits. (More will be said on employee efforts in the next section.) If the incentive approach fails, then Congress should be willing to provide mandatory pensions. Congress must, however, move quickly on this issue, because the future elderly generation must begin to save now if their retirement income is to be adequate.

Although the Associations were generally impressed with the analysis provided by the President's Commission, we do not believe that the Commission dealt adequately with the effects of inflation on a retiree's benefit. Because a constant retirement benefit rapidly approaches worthlessness in this inflationary environment, it is important to pursue policies that will help to maintain income adequacy throughout a person's retirement years.

The Associations know of no mechanism for mandating cost-of-living adjustments by Congress without causing massive plan terminations by employers. However, other approaches should be investigated. The Associations are currently reviewing the following ways that employers might be encouraged to provide some inflation compensation: tax incentives, the extension of federal labor law to specify that retirees' benefits are a mandatory subject of collective bargaining, and the issuance by the federal government of indexed bonds.

Retirement Savings Incentives

The Commission found that individual efforts to save for retirement should be strengthened through tax policy. A tax deduction or an optional tax credit would be provided for retirement savings.

Our Associations strongly agree with the Commission's recommendations in the savings incentives area. We appeared before this Subcommittee on February 24, 1981 to present our views on the inadequacy of present tax treatment for retirement savings. We ask that the Subcommittee refer to that statement for a detailed analysis of current retirement savings problems.

The Associations believe that S. 243, sponsored by Subcommittee Chairman John Chafee, is an effective response to the concerns of the President's Commission that people be encouraged to help themselves. S. 243 would provide tax deductions for contributions to either an employee's pension plan or an Individual Retirement Account (IRA). Not only would this legislation increase a person's ability to plan for retirement, but the incentive to save created will be a significant benefit to the nation's economy. The Associations would like to see S. 243 become law with the passage of the next tax bill.

While we urge Congress to include the provisions of S.243 in its tax cut package, questions remain about utilization rates of these tax benefits among various income groups. The Commission's use of an optional credit should be reviewed with this thought in mind. The tax benefit for anyone in a low tax bracket making a retirement contribution would be greater under a credit approach. Therefore, the incentive to contribute will be larger if a credit is rewarded to the saver.

If Congress makes the decision that it is affordable, the credit would be a good addition to the deductible contribution approach. In the meantime, action should be taken to remove the inconsistencies in the tax law so that incentives will be provided to all who save for retirement. With the entire work force eligible for retirement savings devices, the desire will be far greater for financial institutions to market them. As the public becomes more aware of IRA's or pension plan opportunities and the need to save of its own for retirement, utilization of these instruments should become more widespread. Success will finally be achieved when the IRA is seen as more than a tax shelter for the wealthy.

Social Security Reform: Short-Term Financing

The President's Commission has recommended an acceleration of scheduled payroll tax increases and interfund borrowing as a means for dealing with social security's short-term financing crisis. Our Associations strongly support the Commission's efforts to increase revenue rather than reduce benefits to address the system's many problems. We disagree to some extent with the source of that increased revenue, but, nevertheless, believe it is significant that the Commission recognized that large, precipitous benfit cuts would unfairly disadvantage current recipients as well as defeat the resonable benefit expectations of persons approaching retirement age.

Rather than increasing revenue by increasing payroll taxes (a manner of financing which we believe would feed directly into the wage-price spiral), we recommend the use of two counter-cyclical general revenue financing devices that would specifically shield the system from high inflation on the expenditure tide and high unemployment on the revenue side. The social security payroll tax mechanism cannot be expected to yield enough revenue in our current adverse economic climate. To prevent the cyclical recurrence of short-term deficits, general revenues must be used to supplement the payroll tax mechanism in a manner that isolates and responds to the causes of social security's financing problems. Additional payroll taxes would not accomplish this.

Proposals to reduce social security's cost-of-living protection as a means for addressing the system's short-term crisis pose a major threat to the elderly's income security. Social security is not the only source of income for the elderly -- in fact, it represents approximately 40% of their total income. Over one-third of their income comes from private sources such as private pensions, savings and other dollar-denominated assets. Not only are these private income sources fixed or not adjusted for inflation, but their real values have been severely eroded by a decade of high-rate inflation.

We believe that it is this erosion in private income sources that precipitated the largest rise in the elderly poverty rate -- from 13.9% in 1978 to 15.1% in 1979 -- since the Census Bureau began collecting poverty statistics.

The 1979 poverty data also revealed the degree to which the elderly, relative to other population groups, are vulnerable to inflation. While the aged poverty rate escalated, the rate for persons under 65 remained static at 11.1%. Near poverty rates (125% of the poverty level) for the elderly are also disproportionately high; in 1979, 24.7% of the elderly were concentrated in this category compared to 15.2% of the under 65 population.

Given the elderly's severely disadvantaged and vulnerable income situation, we believe they cannot sustain any diminution in the only inflation protection they have.

Although it has been argued that the current construct of the CPI overstates inflation's impact on the elderly because of its exaggeration of mortgage interest costs, most detailed studies of this issue do not support this contention. A recent study on this topic conducted by economist Dr. Thomas C. Borzilleri indicates no significant under- or overcompensation of social security recipients by the current CPI. Although the CPI sometimes overstates housing costs for social security recipients, it frequently understates the impact of the rapidly rising costs of medical care, food, and fuel and utilities on their budgets. The President's Commission recognized this inaccuracy of the current CPI and, therefore, recommended the development of a special index that would correctly reflect increases in retirees' cost-of-living.

Social Security: Long-Term Financing

Over the longer-term, our Associations would like to see a comprehensive restructuring of social security's benefit and financing structures. The major trends which the system must accommodate in the future include: the adverse economic trends of inflation, low economic and productivity growth which are curtailing the system's financial resources, and the combination of demographic and declining labor force participation trends which portend a larger elderly population becoming heavily dependent upon a smaller work force.

In response to these trends, the Pension Policy Commission has recommended on increase in the normal retirement age from 65 to 68 with a concomitant increase in the early retirement age from 62 to 65. The age 68 proposal appears to provide a simple, straightforward response to the adverse demographic and employment trends. However, in our opinion, the age 68 proposal would be the wrong policy option to exercise at this time. Not only would this proposal substantially decrease and, in some cases, eliminate benefits to older persons, between the ages of 62 and 65, who are involuntarily unemployed or physically unable to continue working, but it would also represent a highly visible benefit cut (and reduction in the expected rate of return on contributions) for future retirees which could undermine younger workers' already precarious support for the system.

As life expectancy rates have been increasing, so has the incidence of chronic illness. The majority of the elderly, particularly minority groups, are continuing to elect early retirement benefits despite the 20% actuarial reduction in benefits they incur when they elect benefits at age 62. One recent survey indicated that about half of the persons surveyed who had recently retired cited impaired health as the reason for their retirement decision.

These trends indicate that, instead of getting additional work effort and therefore additional tax revenue from the future elderly population, the age 68 proposal would merely cut social security expenditures, leaving a large segment of the future elderly population to subsist on substantially reduced benefits with an enhanced likelihood of poverty.

The major and most visible work disincentive in the current social security structure is clearly the earnings limitation. The limitation must be abolished for persons age 65 and over.

We believe that the economic "cost" in terms of lost production and lost tax receipts that results from having the earnings limitation is greater than the "cost" of the additional social security outlays that repeal would entail.

In analyzing older worker employment issues, the President's Commission correctly isolates the social security earnings limitation as the "biggest disincentive to work". However, in our Associations' opinion, the Commission makes a fundamental policy error when it links the elimination of the earnings limitation to the taxation of social security benefits.

The Commission's proposal to tax social security benefits is one which is not directly related to the issue of older worker employment. (In fact, the Commission provides little rationale for its linkage of the recommendation to eliminate the social security earnings test to the taxation of benefits.) The taxation issue is more closely related to the social security benefit structure. Until the social security benefit formula is unweighted and made into a strictly proportional one, we believe it would be extremely inequitable to impose additional tax burdens on higher-income beneficiaries who will be receiving the lowest rate of return on their social security contribution. In addition, given the present high rate of inflation and its extremely adverse impact on the present elderly's income situation, we think it is important to eliminate the test as soon as possible and not make it contingent upon acceptance of any other proposal. Because we are not likely to witness any benefit improvements in the near term, wage income offers retirees practically the only means of preventing an inflation- induced deterioration of their living standards.

By suggesting elimination of the earnings limit, the Commission has focused on what we consider the major work disincentive for the elderly. The Commission, however, must not ignore the other side of the coin: the need to provide strong work <u>incentives</u> within the social security system benefit structure. Additional work incentives within social security need to be created for two reasons. First, they are needed to counter the strong work disincentives which exist in the current procedures used to update wage records of workers who delay their retirement date past age 65; and second, once the earnings test is eliminated, particularly strong work incentives will be needed to encourage older persons to remain fully employed past age 65 and off the social security rolls. Therefore, our Associations recommend a substantial increase in the delayed retirement credit -- at least to the actuarial

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level of approximately 8 to 10%. Under present law, individuals who elect not to receive social security benefits because they continue working beyond age 65 are entitled to a 1-percent bonus for each full year of delay between age 65 and 72. In 1977, Congress raised the delayed retirement credit to 3-percent per year for people who become 65 in 1982. We believe this 3% bonus, however, does not provide sufficient encouragement for individuals to work beyond 65.

If the question of taxation of social security benefits is to be raised at all, it should be raised in a way that would make such taxation a further inducement for persons to delay the election of social security benefits. In the context of elimination of the earnings test, the taxation of benefits could discourage persons from electing to receive social security benefits while they are still working because of the higher marginal tax rate that would be imposed. However, as we pointed out earlier, taxation of benefits would still be unacceptable to us unless the benefit formula were made proportional.

In addition to encouraging elderly work effort, Congress should rationalize the social security financing and benefit structures to insure that scarce resources are not wasted and that the financing mechanism used contributes to, rather than detracts from, our future economic health. To achieve these objectives, social security's earnings replacement function should be clearly separated from its welfare/social adequacy function within the system's benefit and financing structure.

Employment of Older Workers: ADEA and ERISA

As found in the social security system, problems regarding the employment of older workers also exist in the private pension sector. Policies contained in the Age Discrimination in Employment Act (ADEA) and ERISA which discourage or -- in the case of mandatory retirement, prohibit-- work effort by older persons must be eliminated.

It is laudable that the President's Commission recognizes that the 1978 amendments to ADEA which raised the mandatory retirement age in the private sector from 65 to 70 may not go far enough (The Commission recommended that consideration be given to eliminating mandatory retirement completely but only after sufficient experience in raising the age has been gained). We, however, continue to recommend that forced retirement based solely on age should be completely prohibited under ADEA. Additionally, statutory sanctions which exist in current law, such as the bona fide occupational qualification provision, should be eliminated. Finally, the Equal Employment Opportunity Commission should enforce the ADEA as vigorously as possible to assure that the Act's full potential is realized in the case of middle-aged and older workers who continue to be victims of various discriminatory practices.

In another respect, private pension plans are going to have to change to treat older workers more fairly than they presently do.

Under a current Labor Department interpretation of ERISA and the ADEA, employers do not have to provide additional pension credits to workers who stay on the job beyond age 65. This interpretation discourages older workers by denying them any additional deferred compensation despite extra years of work. Moreover, these older workers may actually lose some of their benefits if the plan's payments do not commence until the worker actually retires. The Equal Employment Opportunity Commission, which enforces the ADEA, could change the interpretation in this area, but legislation appears needed to remedy the problem.

Given demographic trends and the benefits inherent in the productive capacity of the older worker, policy decisions must be made to encourage people to remain in the workforce. The President's Commission took the first step by including wages as a viable component of the elderly's income. The Subcommittee should go forward by implementing the key elements of this approach.

NATIONAL RETIRED TEACHERS ASSOCIATION
AMERICAN ASSOCIATION OF RETIRED PERSONS

May 22, 1981

Senator John H. Chafee
Chairman, Subcommittee on Savings,
Pensions and Investment Policy
Senate Committee on Finance
2227 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Chairman Chafee:

You had asked, during the course of my May 15 presentation before your Subcommittee, that I submit for the benefit of the Subcommittee and for inclusion in the record of those hearings, the Associations' comments upon the "Work Incentive Concept" which the Administration incorporated in its May 12 social security proposals.

As I indicated, the work incentive concept, which is one the Associations have long advocated, has as its objectives: (1) encouraging and rewarding persons who continue to work beyond the age of 65; (2) discouraging persons who are able to work from retiring before age 65; and (3) providing reasonable options for persons who, either because of chronic ailments or inability to find employment, are unable to continue to work until that age.

Given the demographic shift that is coming in the population as the post-World War II baby boom cohort approaches old age, it makes sense to try to encourage those who can work to continue to do so. By doing that, much more revenue of all kinds will be generated (both for the support of social security's programs and for the support of other government programs). Moreover, by encouraging these people, in effect, to help themselves by supplementing their income in old age with wage income, they will, as a result of their tax payments, be helping to provide the resources that will be necessary to fund those programs that will provide the benefits to those among their peer group who cannot continue to work. Thus, the burden of providing for the elderly will not be thrust solely upon younger workers but will be shared by a significant segment of the elderly population itself. By helping themselves, they will be helping others.

Mildred Moore
President, NRTA

Olaf J. Kooso
President, AARP

Cyril F. Brickfield
Executive Director

National Headquarters: 1909 K Street, N.W., Washington, D.C. 20049 (202) 872-4700

As you can see from the statement outlining the Associations' reaction to the Administration's May 12 proposals, the timing and/or substance of many of the elements that make up the Administration's version of a work incentive concept were in our view highly objectionable. However, the concept itself goes in the right direction in terms of long-term social security changes. By retaining age 65 as the age for full benefits, the Administration has implicitly rejected current proposals which would move the age for full benefits up to age 68. The Associations are vehemently opposed to the "age 68" proposal and continue to advocate a work incentive concept as a clearly preferable alternative.

Sincerely,

James M. Hacking
Assistant Legislative Counsel

NATIONAL RETIRED TEACHERS ASSOCIATION
AMERICAN ASSOCIATION OF RETIRED PERSONS

NRTA-AARP STATEMENT ON REAGAN SOCIAL SECURITY CUTBACKS

In announcing the details of the Reagan Administration's proposed social security cuts, Richard Schweiker, Secretary of Health and Human Services, claimed the massive cutbacks were necessary to maintain social security's short- and long-term financial solvency. The main elements of the Administration's proposal would:

* sharply reduce early retirement benefits beginning in 1982;
* phase-out the social security earnings limit;
* trim payments for all future retirees;
* delay payment of the 1982 cost-of-living increase; and
* reduce disability protection, particularly for older workers.

Over the next five-year period, the Administration's package would cut benefits by $9.1 billion in 1982 and by over $81 billion cumulatively during the next five-year period, 1982-86. Over the long term (defined as the next 75-year period), total social security payout would be reduced by nearly 25% as a result of these reforms.

The main provisions of the Administration's package which would more than eliminate the system's short-term deficit are cutbacks in cost-of-living increases, early retirement benefits and disability protection. For the long term, the reduction in early retirement benefits combined with cuts in basic benefit levels for all future retirees would wipe out nearly 90% of the system's projected long-term deficit.

<u>NRTA-AARP Reaction</u>. The Associations object to the proposed package because in the short term it would cut benefits excessively and far too abruptly. Older persons --both current retirees and those approaching retirement-- are an economically vulnerable segment of society with few options. They can least afford substantial cuts in a basic income program like social security. The Administration's

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proposals would force the elderly to bear a disproportionate share of the Administration's budget cuts--in 1982, cuts in social security represent nearly one-quarter of the total budget cuts the Administration has recommended.

For current retirees, the proposal to delay payment of the 1982 cost-of-living increase from July to October would result in a $3.3 billion benefit loss in that year. NRTA-AARP remain steadfast in our belief that cost-of-living protection should not be reduced since it is so vital to the elderly who are extremely vulnerable to inflation and, as a result, suffer a higher incidence of poverty than any other population group.

Overall, the Associations are pleased that the Administration has adopted a work promotion strategy to social security reform by recommending abolition of the earnings limit and by maintaining the full benefit retirement age at 65 rather than raising it to 68. However, the Administration's proposal to reduce drastically early retirement benefits goes too far--it is too much, too soon. The cut is abrupt and more punitive than what is necessary to discourage early retirement. It would also severely and permanently disadvantage workers who retire involuntarily due to unemployment or poor health.

A more reasonable strategy for dealing with social security's short-term financing problem would be to provide, on a temporary basis, sufficient revenue to the system to stabilize it over the next five years. Raising revenue for social security could entail having to reduce other government expenditures or increasing revenues from non-payroll tax sources -- as, for example, a temporary surtax on the income tax. The point here is to avoid frustrating the effort to balance the budget, one of the things that must be done to bring down inflation.

As limited and temporary amounts of general revenue are used to stabilize social security in the short term, Congress should move to gradually phase in well-conceived changes in the system's benefit structure. These changes should reshape social security so that it will encourage older and younger persons to increase their work effort and, over the long term, make the system more equitable in its treatment of individual workers and more adequate for retirees.

I. EARLY RETIREMENT BENEFITS CUT

Proposal: A permanent, sharp reduction in early retirement benefits beginning next year.

Under current law, persons retiring at age 62 receive 80% of the benefit amount they would have received if they waited to age 65 to retire. The Administration proposes to pay only 55% of the age-65 benefit amount to early retirees who reach age 62 on or after January 1, 1982. Persons who reach age 62 prior to January 1, 1982 and who elect early retirement will not be affected by this proposal. Benefits provided to spouses and survivors of early retirees would also be reduced since they will be equal to one-half of a reduced benefit amount. The spouse benefit would be reduced from 40% to 27.5%. Benefits paid to the children of early retirees would be eliminated entirely by the Administration's plan.

Impact: Total social security benefits would be cut by $19.5 billion over the next five years and, over the next 75 years, total social security payout would be reduced by 6%.

For a worker who has average earnings and retires at age 62 in 1982, this proposal would reduce his/her benefit from the current law level of $372.80 per month to $246.80 per month. The spouse's benefit (which is equal to one-half of the retired worker's benefit) would be similarly reduced from $186.40 per month to $123.40. Surviving spouses of deceased workers who elected early retirement would also sustain large benefit reductions.

NRTA-AARP Position: The Associations oppose such a large and precipitous cut in early retirement benefits. Millions of older workers approaching age 62 and planning on retirement would find their own benefits and their spouses' benefits slashed by over one-third. This benefit reduction, because it would be permanent and carried throughout older persons' retirement lives, is likely to swell the poverty rolls and create a new class of impoverished older persons. Such a large benefit cut would also play havoc with workers' retirement financing plans since many of them are locked into early retirement decisions by collective bargaining agreements or similar contracts.

Such a large early retirement penalty would be particularly harsh for older workers who lose their jobs and have no employment prospects or who are unable to keep working due to poor health. Surveys indicate that more than half of workers who involuntarily retire cite poor health as the reason for retirement and these retirees tend to be a low-income group.

Maintaining age 65 as the full benefit retirement age and avoiding an elevation of that age to 68 are important legislative objectives for the Associations. Therefore, we would support some reduction in early retirement benefit levels (from the current 80% to 70% of the full benefit amount) in order to encourage later retirement and help deal with the system's long- and short-term solvency. However, such a reduction would have to be phased-in very gradually over a period of at least five years and accompanied by other work incentives (see Earnings Limit Section for further discussion).

In addition, to ensure that chronically ill and involuntarily unemployed older workers are not unduly harmed by such a proposal, the Disability Insurance and Supplemental Security Income programs must be made more accessible to these older workers. For chronically disabled or unemployed and discouraged older workers who would continue to have no other option but to elect early retirement, our Associations would want the tests for disability under the DI program liberalized and would want the Federal Government to guarantee at least poverty-level income through the SSI program by lowering that program's eligibility age to 62 and by increasing the SSI payment standard to the poverty threshold.

II. EARNINGS LIMIT PHASED-OUT

Proposal: Phase-out of the earnings limit for persons age 65+.

The current earnings limit reduces social security benefits for persons age 65+ by $1 for every $2 of annual earnings in excess of $5,500 (the limit will rise automatically to $6,000 in 1982). The Administration's proposal would phase-out this limit over a three-year period, moving the ceiling to $10,000 in 1983, $15,000 in 1984, $20,000 in 1985, and eliminating it completely thereafter.

Impact: The proposal is expected to increase social security benefits by $6.5 billion over the next five-year period. Persons who have earnings above the limit will benefit from this provision as well as the many thousands of low-income older workers who currently keep their earnings below the limit and would be allowed to increase their wage income.

NRTA-AARP Position: The Associations strongly support elimination of the earnings limit. It has acted as the major work disincentive for the elderly and its elimination must be a key element of any attempt to stabilize social security financing through a work incentive strategy.

Some analysts argue that higher income persons would exclusively reap the benefits of eliminating the earnings limit. These analyses ignore the fact that over half of workers age 65+ hold their earnings below the earnings limit and they would also benefit from repeal of the limit. Their benefit would be in the form of the higher wages which they could earn, not in the form of higher social security benefits. SSA statistics indicate in 1977, 51% of male workers age 65-71 kept their earnings below $3,000 (the earnings limit in effect at that time).

In addition, surveys show that persons with low retirement incomes want to work more than those with higher incomes. A 1974 Louis Harris survey indicated that 43% of persons age 65+ with incomes less than $3,000 would like to work compared to 31% of the retired population as a whole.

To repeal the earnings limit for persons age 65+, SSA calculates approximately a $2.5 billion cost in 1982. This cost calculation, however, does not take into account increases in payroll and income tax receipts that are likely to result from older workers' increased work effort. A 1979 SSA study calculated that if 10% of workers age 65-69 continued to work full-time, then 79% of the cost of eliminating the limit would be offset by increases in income and payroll tax receipts.

Our Associations would add another element to the Administration's work promotion strategy--an increase in the delayed retirement credit. Beginning in 1982, current law provides a 3% credit to older workers for every year they delay their retirement (and collection of social security benefits) past age 65. In order to act as a stronger incentive for older workers to remain fully employed and off the social security rolls, we believe the credit should be raised to 10% per year.

If a sufficient number of older workers respond to this more aggressive work incentive strategy and increase their work effort, then tax revenues (both payroll tax and general tax revenue) would increase and help to reduce social security's deficit. Raising revenue in order to offset the deficit is preferable to cutting benefits. Given the magnitude of cutbacks recommended by the Administration, it is clear that incoming revenue generated by work incentives was not considered a factor in reducing the deficit. This is one reason why the Associations believe the Administration has requested benefit cuts in excess of what is necessary to stabilize social security financing.

III. REDUCED BENEFITS FOR ALL FUTURE RETIREES

Proposal: Reduce basic benefits awarded to all future retirees.

Current law provides a worker who has average earnings and who retires at age 65 with a benefit equal to approximately 41% of his/her pre-retirement earnings. Beginning January 1, 1982, the Administration is proposing to reduce gradually this "replacement ratio" from 41% to 38% of prior earnings. This will be achieved by altering the formula used to calculate the basic benefits of all persons retiring in and after 1982. This reduction will be phased-in by changing the benefit formula during the next six years to take into account only 50% of the growth of wages (instead of 100% of wage growth as under current law).

Impact: Although total social security benefits would be cut relatively slightly (by $4.2 billion)over the next 5 year period, this provision would reduce total social security payout by a substantial 9% over the long-term.

For a worker with average earnings, benefits payable at age 65 in 1987 would be reduced by 4% (from $719 to $691.90 per month). For a low earner, benefits would be reduced by 6% (from $477.10 to $447.40 per month) and for a maximum earner, benefits would be reduced by 9% (from $942.80 to $860.30 per month). Benefits paid to spouses, children and survivors of retired workers would be similarly affected by this cutback.

NRTA-AARP Position: Our Associations oppose this method of dealing with social security's long-term deficit. The Administration proposes to perpetuate the current social security benefit structure and equally reduce everyone's benefits. Our Associations have long advocated a complete restructuring of social security over the long-term. We want to see it comprehensively reformed and reordered so that the multiplicity of functions it presently performs--using a single benefit and a single financing structure--would be sorted out among separate structures each one specifically designed to perform each function and financed appropriately. In this manner much of the inequity, waste and duplication inherent in the system's current structure would be eliminated and we would come to rely on more than just the payroll tax to finance benefits.

Our reform proposal, in the process, would also make social security more equitable in its treatment of individual workers--both men and women. We are recommending that the payroll tax, which is levied directly on workers' wages be used solely to finance the cost of benefits to workers and the amount of an individual worker's benefit ought to be more strictly related to the prior earnings/payroll tax contributions of that worker. But the ratio of that benefit to final average wages of the worker should be increased to about 55% (from the current 41%).

Those elements of the present social security system which are now financed by the payroll tax and which are welfare in nature (i.e. social security's weighted benefit formula, minimum benefits, etc.) or can be characterized as "social adequacy" in nature (i.e. student benefits, dependent and spouse benefits, etc.) should be gradually phased-out as higher benefits for workers are phased-in). Simultaneously, new social security programs should be established to perform these welfare/social adequacy functions. For example, to assure benefit adequacy for a worker whose wages were very low or who had sporadic attachment to the labor force, social security would have a separate program with a separate benefit structure financed from general revenues that would supplement the basic earnings-related benefit.

The Associations support this type of long-term restructuring because it will help to relieve cost pressures on the system, and in the process make it a more equitable and therefore popular program. In addition, this type of restructuring will provide current young workers with the assurance that they will get a benefit from social security that reflects what they earned and paid for and represents a "good buy" in terms of their expected rate of return on investment. In addition, they would have the assurance that, in their later years, they would have good prospects for achieving income adequacy and avoiding poverty. This is an assurance that the system as presently structured cannot provide.

IV. COLA DELAYED

Proposal: A one-time delay in payment of the 1982 cost-of-living adjustment.

In 1982, the Administration proposes to shift payment of the cost-of-living adjustment (COLA) from July to October, resulting in a one-time reduction in cost-of-living protection. This proposal is quite different from other proposals such as Sen. Hollings' proposal, which would result in recurring benefit losses by delaying payment of the COLA in every year, not in just one year. The Administration is also proposing to change the CPI computation period to cover a full year, July through June. This lag-time between the end of this new measuring period and payment of the COLA would be 3 months, the same as under current law.

Impact: This proposal would reduce social security benefits by $3.3 billion in 1982 and by $6.3 billion over the next 5 year period. The average retiree with a monthly benefit of $375 is likely to lose about $100 in benefits in 1982 (assuming a 9% COLA in 1982).

NRTA-AARP Position: The Associations oppose any reduction in social security's cost-of-living protection since it is so vital to current retirees. We recognize that the Administration's proposal is a temporary, one-time-only reduction, and therefore is far less detrimental to retirees' interests than other proposals that would make permanent cuts in cost-of-living protection. Nevertheless, we oppose it.

Despite full COLAs provided by social security, the elderly have suffered large real income losses as a result of sustained, high-rate inflation. These losses have occurred with respect to those private income sources--private pensions, savings and other dollar-denominated assets--which represent over one-third of the elderly's total income and which are not protected against inflation. We believe it is this situation which prompted the largest rise in the elderly poverty rate--from 13.9% in 1978 to 15.1% in 1979--while poverty rates for the non-elderly remained static.

V. DISABILITY PROTECTION SUBSTANTIALLY REDUCED

Proposal: Restrictions placed on Disability Insurance (DI) protection, particularly affecting older workers.

The Administration proposes to make it more difficult for all workers--and particularly older workers--to qualify for DI benefits. The proposal includes:

* use of "medical" factors only in establishing entitlement to DI. Under current law, workers (especially older workers) can quality for DI based on a combination of medical and non-medical factors (such as age, education, re-employment prospects and work experience). More than one-third of DI beneficiaries age 60 to 65 are determined to be disabled based on non-medical factors.

* increase the recency of work requirement needed to be insured for disability. Current law requires a worker to have been employed in five out of the preceding ten years in order to qualify for DI. The Administration proposes a work requirement of 7 1/2 years out of the previous 10. This provision would deny benefits to older workers who become progressively disabled and thus have long spells of illness which would prohibit their being able to meet this increased work requirement. Women who leave the labor force for child rearing or other family responsibilities could also lose disability protection under this provision.

* requirement that a disability be expected to last at least two years (rather than one year as under current law).

* lengthening of the waiting period for receipt of DI benefits from five to six months.

Impact: The combined impact of these four DI proposals would reduce disability payments by $21.9 billion over the next five-year period. These proposals will deny DI benefits to two groups of older workers: those with progressively degenerative diseases and those who are only partly disabled but, because of their age, lack of education or up-to-date skills, cannot be expected to be reemployed.

NRTA-AARP Position: The Associations oppose these cutbacks in the DI program particularly since they are being proposed along with drastic cuts in early retirement benefits. The combined impact of the DI and early retirement cuts would leave thousands of disabled older workers with no option but to take early retirement and live on extremely low benefit levels for the duration of their later years. If age-62 benefits are to be reduced in any manner as part of a work promotion strategy, then the DI program must be made more, not less, accessible to older workers.

VI. MISCELLANEOUS PROVISIONS

A. Raise Benefit Computation Point from Age 62 to 65. This change has the effect of lengthening by three years the period over which earnings must be averaged for purposes of calculating benefits. When computing their benefits, older persons who elect early retirement will be required to average in zero earnings for every year they retire before age 65. This proposal would have the effect of reducing benefit levels for all future retirees and particularly for early retirees. Social security benefits would be cut by $1.3 billion over the next 5-year period and by an overall 3% over the next 75-year period.

NRTA-AARP oppose this provision, because, in connection with the proposed stiffening of the early retirement penalty, it would be overly harsh on early retirees.

B. Impose Lower Family Maximum. Current law limits total family retirement benefits including those benefits received by spouses, children or other dependents to as much as 188% of a worker's prior earnings. The Administration proposes to lower that family maximum cap to 150% of a worker's primary benefit amount or 85% of his prior average earnings. This proposal would reduce social security benefits by $2.9 billion over the next five-year period.

NRTA-AARP would oppose this provision because it would discriminate against certain social security recipients, especially those who have dependents. Although the Administration argues that such a reform is needed to restore equity in the social security benefit structure, we believe inequities are best addressed through comprehensive, not piecemeal, reform of the benefit structure that does not single out particular groups of beneficiaries.

C. Reduce Windfall Benefits. Under current law, a person who spends the majority of his working career under non-covered employment (federal, state or local) can work under social security for a short period of time and receive disproportionately high benefits. The Administration proposes to reduce that windfall and give such retirees a social security benefit that reflects their payroll tax contribution to social security. This proposal would reduce social security benefits by $600 million over the next five-year period.

NRTA-AARP believe it is unfair to single out this group of retirees. Windfall benefits ought to be reduced through the comprehensive social security reforms we have outlined earlier. These reforms would move toward treating all social security recipients in a more fair-and equitable manner.

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STATEMENT BY

AMERICAN FEDERATION OF STATE, COUNTY
AND MUNICIPAL EMPLOYEES, AFL-CIO

BEFORE THE

FINANCE SUBCOMMITTEE ON SAVINGS,
PENSIONS, AND INVESTMENT POLICY

ON

THE PRESIDENT'S COMMISSION ON PENSION
POLICY'S REPORT, "COMING OF AGE: TOWARD
A NATIONAL RETIREMENT INCOME POLICY"

MAY 15, 1981

in the public service

84-763 O—81——20

Mr. Chairman and distinguished members of the Subcommittee on Savings, Pensions and Investment Policy, I am Charles M. Loveless, Counsel for Employee Benefits of the American Federation of State, County and Municipal Employees (AFSCME), AFL-CIO. I am here representing the more than one million members of AFSCME who work in state and local governments across the nation. I appreciate the opportunity to appear before your Subcommittee today to present our views on the President's Commission on Pension Policy's final report, entitled "Coming of Age? Toward a National Retirement Income Policy", and on some of the major national retirement issues of primary concern to state and local government employees.

Public employees, like other members of our society's labor force, have a need for retirement income sufficient to provide economic security in old age or in the case of permanent disability. Accordingly, AFSCME has worked to secure for its members retirement benefits which are adequate to maintain an employee's pre-retirement standard of living. At the same time, we long have been at the forefront of various federal, state and local efforts to correct the major abuses existing in state and local government pension plans.

One of the Commission's most important policy recommendations was that a Public Employee Income Retirement Security Act (PERISA) should be enacted. In this regard, the Report states:

> The Commission recommends that, because state and local government employees deserve the same protection as employees in the private sector, a Public Employee Retirement Income Security Act (PERISA) should be enacted covering the same areas of concern as covered by ERISA.

In calling for the enactment of federal statutory retirement income protections for state and local government employees, the President's Commission's Report thus joins the Pension Task Force Report on Public Employee Retirement Systems, issued in May 1978 by the House Committee on Education and Labor (Pension Task Force Report).

AFSCME strongly endorses the view expressed in the President's Commission's Report and the Pension Task Force Report that state and local government pension plans urgently require federal government reform action. They face problems which threaten not only their own fiscal stability and the rights of plan participants and beneficiaries but also the fiscal integrity of state and local governments as well. The benefit design of many of these plans is ill-conceived, and many are dangerously underfunded. No comprehensive and uniform set of legal principles exist to adequately regulate state and local government plans. Conflict of interest problems are pervasive, and the absence of meaningful reporting, disclosure and fiduciary standards is the order of the day. A coherent federal regulatory framework which recognizes the unique problems and characteristics of state and local plans has yet to be established.

We believe the Federal Government has a responsibility which heretofore it has largely neglected for regulating state and local government pension plans with particular emphasis in the areas of reporting and disclosure, fiduciary conduct and tax qualification requirements. As noted in the exhaustive Pension Task Force Report, public employee pension plans with combined assets conservatively valued at over $115 billion exert substantial influence on the political and economic affairs of the nation. We strongly concur with the central conclusion of the Pension Task Force Report that current regulation of state and local plans is inadequate and that federal legislation must be enacted to protect the vital national interests involved. In our view, the adoption of uniform federal standards of fiduciary conduct, reporting and disclosure such as proposed in H.R. 6525 which was introduced in the 96th Congress by Congressman John Erlenborn, ranking minority member of the House Labor-Management Relations Subcommittee, is necessary in order to protect plan participants and the public from the wasting of plan assets and plan mismanagement and to conform public plan administration, reporting and investment practices to the practices expected and required in the private sector pension community. We set forth below, in greater detail, our views concerning some of the major problems facing state and local plans and our recommendations regarding the scope and substance of federal reform legislation required to rectify these problems.

I. THE ABSENCE OF MEANINGFUL REPORTING AND DISCLOSURE IS THE ORDER OF THE DAY FOR STATE AND LOCAL PENSION PLANS.

The Pension Task Force Report concluded that one of the most disturbing features of most state and local plans is that important benefit and financial information is not reported and disclosed to plan participants, public officials and taxpayers. In many instances, the Report stated, plan participants are not even informed of their basic benefit rights through a simple plan booklet, not even to mention being apprised of the financial condition of the plan. Specifically, the Pension Task Force Report found that approximately 40 percent of the state and local general employee plans surveyed do not regularly furnish participants with booklets or other material describing plan provisions; plan participants in approximately 18 percent of the plans were unable to obtain plan descriptions even upon request. And where plan descriptions were furnished, the Report noted, their utility as disclosure devices varies widely; most are either too brief or elaborate.

The Pension Task Force Report further found that over 70 percent of all public plans and over 60 percent of the federal and the largest state and local plans do not compute the market value of plan assets and thus were unable to supply this information for the Task Force survey. In addition, the Report disclosed that approximately one-quarter of the state plans and 40 percent of the local plans surveyed do not have actuarial valuations performed on a regular basis; indeed, it was found that 5 percent of the state plans and 25 percent of the local plans have not conducted an actuarial valuation within the past ten years. Certainly, as was emphasized in the Report, a regular actuarial valuation is essential "...if a true understanding of a pension plan's emerging pension costs is to be realized." Pension Task Force Report, p. 158.

While the Pension Task Force Report cited numerous other shortcomings in state and local plan reporting and disclosure practices,[1] suffice it to state that the majority of state and local pension systems do not provide for regular, meaningful reporting and disclosure. The result has been that such systems "...are not operated in accordance with the generally accepted financial and accounting procedures applicable to private pension plans and other important financial enterprises." Pension Task Force Report, p.3. Due to the absence of strong reporting and disclosure requirements, few pension plan participants and beneficiaries have a realistic assessment of their pension entitlements or of the financial status of their plans.

Two recent studies by public pension experts corroborate the Pension Task Force's position that reporting by most public plans, including many of the largest, is inadequate. The national accounting firm of Coopers and Lybrand, in a survey of the financial disclosure practices of 46 major municipal public employee retirement systems, found "(s)erious deficiencies (to) exist in the extent to which key information is reported and reviewed, creating great potential for abuse."[2] Coopers and Lybrand found that:

- o 76% of the annual reports studied did not disclose the actuarially computed value of unfunded vested pension liabilities;

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[1]For example, the Report found that nearly one-third of all state and local plans surveyed, including 37 percent of the larger plans, do not provide for an annual system audit of any kind.

[2]Coopers and Lybrand, Financial Disclosure Practices of the American Cities III: Managing Pension Costs (New York: Coopers and Lybrand, 1979), p.6.

- o 63% did not disclose the accounting policies related to their plans;
- o 35% did not disclose their funding policies and
- o Actuarial assumptions used in a number of the valuations appeared invalid.

A study released last month by the Urban Institute of the annual reports of 86 state and local plans representing more than 20% of public plans having 1,000 or more members also expressed concern regarding the reporting and disclosure practices of state and local plan administrators and sponsoring governments.[3] The Urban Institute study noted, for example, that "...current financial reporting does not provide sufficient information to judge the financial performance of many of the funds". Many plans do not disclose the current market value of plan assets, "(n)or do they typically provide information that would permit the evaluation of investment manager performance."[4]

It should be emphasized that the lack of regular, systematic reporting and disclosure practices does not merely pose a problem for plan participants and beneficiaries; taxpayers, investors and even government officials are kept in the dark regarding the true costs and investment practices of the plan. As was noted by Louis M. Kohlmeier in his study of the asset management practices of state and local pension funds:

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[3]The Urban Institute, The Future of State and Local Pensions (1981).

[4]Ibid., p. 16-17

> Most public pension plans make financial reports of some kind to the legislature, to the governor or mayor, to employees and/or to the general public. The great majority of such disclosures are wholly inadequate to allow legislators, employees or the public to judge the inadequacy of funds administration... Rarely do reports disclose (investment information capable of being analyzed).[5]

Accordingly, the "...potential for abuse is great due to the lack of independent and external reviews of the operations of many plans." Pension Task Force Report, p. 3.

II. CONFLICT OF INTEREST PROBLEMS AND OTHER FIDUCIARY ABUSES ARE PERVASIVE IN THE MANAGEMENT OF STATE AND LOCAL PLANS.

Like those of their private sector counterparts prior to the enactment of ERISA, the legal rights and remedies of public plan participants are controlled by state and local law. In calling for the adoption of a uniform federal standard of fiduciary conduct for public plan judiciaries, the Pension Task Force Report found that state and local control over the management of plan assets frequently has been inadequate and that existing legal protections for public plan participants are far less than they should be. Conflicts of interest in management and investment practices and other clear examples of fiduciary misconduct have occurred due to the absence of a uniform standard of conduct applicable to public plan fiduciaries. While (t)here is virtual unamimity within the pension community that those who have control of pension plan assets should be held to high standards of behavior and should face liability upon failing to satisfy that standard ... throughout the universe of state and

[5] Louis M. Kohlmeier, Conflicts of Interest: State and Local Pension Fund Asset Management, (Twentieth Century Fund 1976), pp. 9-10

local government retirement systems there is a virtual absence of clear guidelines in this vital area." Pension Task Force Report, p. 188.

Kohlmeier's study of state and local pension asset management practices, noted above, documents the pervasive nature of conflicts of interest in the management of state and local government retirement systems. The study points, in particular, to a recurring tendency on the part of plan fiduciaries to manage and invest plan assets in a manner consciously calculated to benefit interests other than those of plan participants and beneficiaries. Kohlmeier stated:

> One of the most persistent conflict-of-interest situations in the management of public pension funds results from the policy, followed by many plans, of hiring local bankers, brokers and investment advisors and the practice of investing in local securities, even though better or lower cost-services and higher yielding investments may well be available outside local boundaries.[6]

And, as noted in both the Pension Task Force and Kohlmeier studies, "(t)his investment and management proclivity becomes undesirable when plan trustees and fiduciaries favor locally oriented service providers and investment despite the fact that such investments may not be in the best interest of the plan and its participants." Pension Task Force Report, p. 191. Indeed, whether mandated by custom or statute, this policy frequently has operated to the substantial detriment of plan participants and beneficiaries.

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[6]Ibid., p. 23. See also Michael T. Leibig and Robert W. Kalman, "How Much Federal Regulation do Public Funds Need," Pension World, August 1978, p. 22, and the Pension Task Force Report, pp. 190-192, which discuss the Kohlmeier study.

An additional example of widespread fiduciary abuse documented in both the Pension Task Force and Kohlmeier studies is the absence in many state and local plans of professional investment management. Typically, investment professionals are not on the board of pension fund trustees which under statute is generally responsible for plan asset administration and investment management. Needless to say, the placement of investment management and asset administration responsibilities in the hands of non-expert officials "...often produces investment policies and practices that are significantly less valuable than that expected from professional investment advisors and managers, and generally found in private sector plans." Pension Task Force Report, p. 190. To the extent that the plan consequently yields a lesser return on its investments, it is of course the plan participants and beneficiaries that suffer.

Contrary to the view espoused by some opponents of federal reform action, reform of state and local pension plan fiduciary requirements is moving slowly, and the prospects for significant improvement in the foreseeable future are not encouraging. A review of a recent update of Appendix 5 of the Pension Task Force Report, prepared by the Congressional Research Service, confirms the fact that, with a few notable exceptions, the control over the management and investment plan assets remain inadequate.[7]

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[7]Congressional Research Service, An Analysis of the Fiduciary Responsibility Requirements of the Major Pension and Retirement Plans for Employees of the 50 States (April 4, 1979).

appears to provide significant protection for plans and plan participants, the law frequently has been judicially interpreted in such a manner as to limit its actual protective effect.[10]

The Federal Government already has certain important responsibilities for regulating state and local pension plans, but it has largely neglected its responsibilities. In another article by Leibig and Kalman, entitled "Federal Policies Toward State and Local Pensions: Benign Neglect or Negligence?",[11] set forth below as Attachment B, various of these responsibilities are catalogued: the Internal Revenue Service's public pension obligations, the Department of Labor's public pension policies and other areas of federal involvement particularly in the areas of preventing fraud and enforcing fiduciary duties. See also Part II of the Pension Task Force Report, entitled "Federal Law Presently Affecting Public Employee Retirement Systems," pp. 7-42. Certainly the most significant body of federal law presently applicable to state and local plans is the system of tax qualification requirements found under Internal Revenue Code Sections 401(a) and 501(a). However, the enforcement of these requirements

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[10] See, for example, the Illinois Supreme Court's decision in <u>People ex rel. Illinois Federation of Teachers vs. Lindberg</u>, 60 Ill. 2nd. 266, 326 N.E. 2nd. 749 (1975), <u>cert</u>. <u>denied</u>, 423 U.S. 839 (1975) and the Pension Task Force Report's discussion of the case. Pension Task Force Report, pp. 45-46.

[11] Michael T. Leibig and Robert W. Kalman, "Federal Policies Toward State and Local Pensions: Benign Neglect or Negligence," <u>Employee Benefits Journal</u>, Fall 1978, p. 16.

III. CURRENT FEDERAL-STATE REGULATION OF STATE AND LOCAL PLANS IS CLEARLY INADEQUATE.

In their article, "How Much Federal Regulation do Public Plans Need,"[8] set forth below as Attachment A, Michael Leibig and Robert Kalman concluded that the current statutory and common law framework applicable to state and local retirement systems has failed to provide an adequate means of protecting the interests of plan participants and beneficiaries. They stated:

> For the most part, private remedies are technically available. Common law, and often, statutory fiduciary protections do exist. State freedom of information and consumer protection systems are available.
>
> These remedies, however, are cumbersome and expensive. They are not designed to provide specific remedies to pension participants or beneficiary problems. Fiduciary duty litigation against the state systems face difficult separation of power and sovereign immunity problems. For the most part, these problems cannot be overcome without sophisticated, expensive legal skills.[9]

Leibig and Kalman's conclusions reinforce the findings of the Pension Task Force that the states have generally failed to establish clear fiduciary standards and effective legal remedies for plans and plan participants in the event of fiduciary misconduct. Even in those instances where state statutory law

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[8] Michael T. Leibig and Robert W. Kalman, "How Much Federal Regulation do Public Plans Need," Pension World, August 1978, p. 22.

[9] Ibid., pp. 24-25.

generally has been neglected in the public sector; indeed, according to the Pension Task Force Report, "enforcement of the qualification standards against public plans has been for the most part non-existent." Pension Task Force Report, p. 33. Leibig and Kalman cited Robert Tilove's discussion of the problem in his study of public pension funds:

> Some difficulty arises when rules designed for corporate pension plans are applied to public plans. However, with rare and only very recent exception, the rules have in fact not been applied, except when question has been formally raised. The answer is given, at least in the first instance, by the local director of the Internal Revenue Service. Consequently, answers differ from one state to another, as is to be expected when a complex set of rules written to assure even-handed treatment of corporate executives and the rank-and-file in private industry is applied to public plans. Many public systems have never asked for rulings as to whether their plans qualify; they and their members have simply assumed that there is no problem.
>
> Nonenforcement by the Internal Revenue Service has in fact been the rule. If enforcement were attempted, it would confront the question whether to assess most state and local judges for thousands of dollars of back taxes because of their superior benefits. Awkwardness has arisen -- at least until 1973 -- only for those system trustees or officials meticulous enough to ask for a ruling.[12]

The Internal Revenue Service's lack of enforcement of the non-discrimination and other plan qualification requirements can

[12] Ibid., p. 19, citing Robert Tilove, Public Employee Pension Funds (New York: Columbia University Press), p. 248F.

also be graphically illustrated by the Pension Task Force Report's finding that over 80 percent of state and local systems were either unfamiliar with the application of the tax qualification requirements to public plans, or, for whatever reason, neglected to apply for qualified status. The Task Force survey further found that only 23 percent of the local plans applied for and received favorable plan determination letters in the past and that the great majority of these determination letters were issued over five years ago, raising the inference that they may not be up to date.

The Pension Task Force Report included a comprehensive examination of federal law presently affecting public sector plans. The Report noted that, in many instances, the precise impact of these laws on public plans is not yet clear and that inconsistent interpretation and enforcement of various federal legal requirements is not uncommon. "The absence of any single federal agency to coordinate the administration and enforcement of the various federal laws relating to retirement income," the Report stated, "has precluded the development of a unified national policy with regard to either public employee retirement systems or private pension plans." Pension Task Force Report, p.2.

IV. FEDERAL LEGISLATION MUST BE ENACTED TO PROTECT THE VITAL NATIONAL INTERESTS INVOLVED.

Federal legislation in the form of a Public Employee Retirement Income Security Act -- PERISA -- must be enacted to regulate the operation of state and local government retirement systems. This legislation which should recognize the unique problems and characteristics of public pension plans is necessary in order to effectively deal with the major national problems enumerated above. Such legislation should not mandate the existence of a state or local pension plan or the level of benefits to be provided. Instead, it should seek to provide some assurance that benefits promised under a voluntarily adopted plan are paid and that the plan is operated without discrimination, dishonesty and fiduciary abuse.

In our view, the PERSIA bill introduced by Congressman Erlenborn in the past Congress -- H.R. 6525 -- not only serves as an effective federal response to the public pension crisis but minimizes the degree of federal government intrusion in state and local government affairs. Title I of H.R. 6525 would establish minimum federal reporting and disclosure and fiduciary standards for state and local government pension plans. The bill contains specific authorization for state governments to have responsibility for administration and enforcement of certain of PERISA's provisions. If a state's laws in the areas of reporting and disclosure, bonding, civil and criminal penalties and protection of participant rights are "substantially equivalent" to the requirements of the federal legislation, the state may apply for authority to assume the responsibility in those areas.

Public plan compliance with a uniform federal reporting and disclosure standard, as set forth in H.R. 6525, should be mandated in order to protect the rights and interests not only of plan participants and beneficiaries but also of the public at large. While ERISA imposes certain minimal reporting requirements on public plans,[13] the reporting and disclosure practices of state and local plans fall woefully short of the standards established for private plans under ERISA. PERISA must be enacted to ensure, at the minimum, that important benefit and financial information is regularly reported and disclosed to plan participants and public officials. Plan participants have an interest not only in the disclosure of information regarding the specific provisions of the plan which cover them but also in information as to whether or not the plan is being efficiently operated and in a lawful manner.

A uniform federal standard of fiduciary conduct is urgently required for state and local public employee retirement systems. We concur with the view shared by the Pension Task Force and the great majority in the private pension community that "(f)iduciaries should be required to act prudently and for the exclusive purpose of providing benefits to plan participants and that the associated plan assets therefore 'belong' exclusively to them rather than to the sponsoring government." Adoption of the ERISA fiduciary standard, as proposed in H.R. 6525, is necessary in order to protect plan participants from the wasting of plan assets and plan mismanagement. Certainly, no less should be expected from those individuals involved in the management and disposition of public funds than that expected and required of fiduciaries in the private pension community.

[13] See the Pension Task Force Report, p. 34.

We believe that enactment of federal reporting, disclosure and fiduciary standards legislation is necessary in order to protect the vital national interests involved and will overcome any possible constitutional objection raised by the United States Supreme Court's decision in National League of Cities v. Usery, 426 U.S. 833(1976).[14] PERISA will not only serve to protect the rights of public plan beneficiaries and participants but also will protect a compelling public interest as well.

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[14] The question of the permissible scope of Congress' authority to reform state and local public employee retirement systems was carefully examined in the House Pension Task Force Report, pp. 17-22. The Report persuasively concluded that federal legislation limited to such areas as reporting and disclosure and fiduciary standards would not encounter the constitutional barrier recognized in Usery.

In Usery, the Supreme Court, based on its reading of the constitutional relationship of the states to the Federal Government under the Commerce Clause, declared unconstitutional the application of the mandatory minimum wage and maximum hour provisions of the Fair Labor Standards Act to state and local governments. The Court held that imposing these provisions on such governmental entities would "impermissibly interfere with the integral governmental functions" of the states exercising their Tenth Amendment rights and impair their "ability to function effectively in a federal system". Importantly, as was emphasized in the Pension Task Force Report, federal reporting and disclosure and fiduciary standard legislation "...would produce a very slight cost impact in terms of compliance by state and local governments" and in fact may result in "...a net reduction in cost..." and thus would not reach the level of intrusion in integral state government functions which the Court found objectionable in Usery. See California v. Blumenthal (No. 5-78-356, August 24, 1978).

CONCLUSION

For the foregoing reasons, AFSCME believes that enactment of PERISA legislation should be a major priority of the Congress. We thank the members of the Subcommittee for the opportunity to present this statement, and we look forward to continuing to work with you on this matter of utmost concern to state and local government employees. We will be pleased to answer any questions you may have.

Senator CHAFEE. The next panel are Mr. Hart, Mr. Pantos, and Mr. Dearnley.

Mr. Hart, why don't you start.

Mr. Dearnley.

All right, Mr. Hart, why don't you proceed.

PANEL OF JEFF HART, EXECUTIVE DIRECTOR, ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.; GEORGE J. PANTOS, PARTNER, VEDDER, PRICE, CAUFMAN, KAMMHOLZ & DAY; AND IRVINE H. DEARNLEY, VICE PRESIDENT, CITIBANK, N.A., NEW YORK, N.Y.

Mr. HART. Alright, Mr. Chairman, recognizing the problems that the Nation is suffering in terms of social security and personal savings and recognizing that both have been and will continue to be the subject of separate hearings, I wish to focus my remarks today on the Commission's recommendations for a mandatory universal pension system.

Our association is both opposed to the concept that is recommended and disappointed in the manner in which the Commission has presented the need for such an alternative.

All of us would like to share in the Commission's dream of providing every American in retirement 100 percent of preretirement disposable income.

However, in the harsh light of reality there is a marked difference between that for which we would dream and that which can be.

The association considers the establishment of MUPS is not justified by the data developed and presented by the Commission.

The report's method of presenting private pension coverage statistics is potentially misleading in that it takes focus away from the nature and location of noncoverage.

The report provides a static treatment of coverage and does not look forward to the increasing probabilities for coverage.

Furthermore, the impact of inflation and the cost involved in the report's recommendations are treated inadequately. This is not to say, however, that the association does not favor greater private pension plan coverage. We do.

But, private employers must be provided adequate opportunity through voluntary means to expand coverage and benefits within the realities of the marketplace.

The private pension system with appropriated incentives and less burdensome regulation, holds great potential for continuing increases in the benefits it provides and in the percentage of workers it covers.

However, the system has its natural limitations, as would MUPS, which would leave a segment of the population uncovered. But that segment of the population which remain beyond the natural reach of the private pension system, the association endorses the appropriate role of Government in providing a minimum floor of social income security for this segment.

However, the private pension system should not be forced beyond its structural limits in an effort to do so by the imposition of Federal mandatory standards.

If I might in the interest of time, just close by saying that I've referred both incentives and less-burdensome regulations. As you know the association is very supportive of the efforts of the Senate Finance Committee and other committees in moving forward on employee deductibility, and I might add that last week the association, in terms of S. 243, has seen the light on that aspect that would provide for retirement savings to be opened up to other nonretirement needs such as mortgages and tuition expenses.

It is the considered opinion of the association that, that in fact, would leverage or increase total new savings.

Second, the association has just completed a 2-year effort in developing ERISA member proposals that we would seek during the coming years to have reflected in legislation.

This 2-year effort was going through one of our committees comprised primarily of actuaries and attorneys and people that work the pension area.

Trying to clean up the burdensome aspects of ERISA, not in any way to weaken its protections, but to make it more fluid in terms of new plan creation. And that, in fact, covers some of the investment and prohibited transaction and dialog that was going on earlier this morning, and we'll soon be contacting your staff in that regard.

Senator CHAFEE. Have you completed a report on that?

Mr. HART. Yes, we have. It will be of interest, we think.

And, in closing, I would like to log your leadership effort in maintaining a national sounding board to continue this desperately needed dialog on retirement income security.

Thank you.

Senator CHAFEE. Thank you, Mr. Hart. I appreciate your coming. Mr. Pantos.

OPENING STATEMENT OF GEORGE J. PANTOS, PARTNER, VEDDER, PRICE, KAUFMAN, KAMMHOLZ & DAY, REPRESENTING THE ERISA INDUSTRY COMMITTEE [ERIC]

Mr. PANTOS. Thank you, Mr. Chairman. My name is George Pantos, and I appear today on behalf of the ERISA Industry Committee, a national association of some 100 major corporations which are concerned with national retirement issues.

In the interest of time, I will just concentrate on two issues that are in the Commission report; namely, incentives for individual retirement savings, and the MUPS proposal. With your permission, Mr. Chairman, I would like to reserve the right to file a more detailed statement for the record.

If time permits, however, I would like to touch briefly on several impediments in current law which we believe might be of interest to this committee.

In developing the principal recommendations, the final report is focused on needs to increasing pension coverage.

The Commission advocates that gaps in coverage and pension adequacy can be addressed by a Federal tax system which encourages personal retirement savings. We concur that much can be accomplished in expanding the role of private savings. Specifically, ERIC strongly endorses the Commission's view that reasonable amounts of employee contribution for retirement security should be deductible from income for Federal income tax purposes, and taxed instead when withdrawn upon retirement.

This would parallel the present treatment for employer contribution to qualified plans.

We believe that a change in the tax laws is needed to permit deductible employee contributions which would spur added pension coverage. In addition, this approach has the advantage of adding substantially to the Nation's capital base. In the interest of time, I shall not comment further on this point, Mr. Chairman, since on February 24, ERIC submitted some very specific and detailed suggestions regarding certain savings incentive tax bills that are currently before the subcommittee.

Turning to the MUPS proposal, which is the centerpiece of the final report, if such a program could create pensions for those who now are without them and, I would emphasize, at no cost to anyone, who would not support it? But there is, of course, a price for every economic benefit, and it is naive to overlook it.

The report appears to expect that the cost of mandated pensions would be borne by the employer. If so, payroll costs of business would rise, which would favor the use of machines over people.

To the extent that employment could not be cut to offset its higher cost, a business would earn a lower economic return, and the equity capital supporting it would now have a new inducement to apply itself elsewhere, in a business that is less people-intensive.

Hence, the economic burden of mandatory pensions would fall most heavily on employers most affected by payroll-related costs.

In other cases, the cost of mandatory pensions could be passed on to the consumer, thereby adding to inflation.

In still other cases, the cost of mandatory pensions would be borne by the employees, through wages that fail to rise, or rise more slowly, so as to offset the new payroll cost. It's questionable whether employees will appreciate a cut in current earnings so that a pension can be accumulated for them that they would not have chosen to fund voluntarily.

More broadly, the proposal is objectionable because it goes too far in having the Government determine the allocation of private objectives. American society has already established, through social security, an organized program of a minimum floor of protection to continue income after retirement, death, or disability.

If now the Government is to require, not a minimum floor of protection but some higher goal, looking ultimately to full continuation of income after retirement, shall we expect similar proposals for mandatory purchase of "adequate" life insurance and disability income coverage? And what further diversions of current resources should be made, against the will of the producers of those resources, to accord with the better judgment of the Government?

In short, Mr. Chairman, we are deeply concerned that the proposal is, in plain terms, a proposal for compulsory plan coverage. We oppose compulsion for benefits beyond a concept of a minimum floor of protection. We believe it would be a mistake to endorse the concept which diminishes the voluntary character of pension security above the mandated minimum level of social security.

In the brief time remaining, Mr. Chairman, I would briefly like to comment on certain impediments to the expansion of the private pension system.

Over the past 5 years, ERIC itself has followed very carefully the development of ERISA regulations and rules and we believe that there have been fundamental changes that have taken place.

More specifically, we are disappointed that the Commission failed to address certain impediments to the growth of the private pension system which could be resolved by a simplification of present ERISA requirements.

Complex and burdensome ERISA requirements, particularly in the reporting and disclosure area, have had an adverse impact on retirement plans and have precipitated plan termination, particularly by smaller employers.

In addition, Mr. Chairman, fundamental changes have taken place in the ERISA title IV program in recent years which have signaled the need to overcome the deficiencies in this termination insurance program for single employers.

I will close by simply stating that the present law actually encourages certain financially troubled plan sponsors who have extended basic pension promises beyond 30 percent of their net worth to terminate their plans and pay only a limited liability to the PBGC which guarantees certain pension benefits under title IV.

Another deficiency in present law is that voluntary plan termination is now an event insurable by the PBGC. These title IV problems and others were recently corrected by the Congress in terms of multiemployer plans, and the relevant principles of the new multiemployer legislation should be extended by the Congress to single employer plans.

Senator CHAFEE. OK, well we're aware of that problem. I must say that is a mare's nest of—but, I think you're right in drawing our attention to it.

Whether we will do anything about it this year, I don't know—single employer situation.

All right fine, well, thank you very much, Mr. Pantos.

Mr. Dearnley.

OPENING REMARKS BY IRVINE H. DEARNLEY, VICE PRESIDENT, CITIBANK, N.A., NEW YORK, N.Y., REPRESENTING THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. DEARNLEY. Mr. Chairman, my name is Irvine Dearnley and I am a vice president of Citibank. I am before you today representing the National Association of Manufacturers. The NAM is an organization of nearly 12,000 members covering every State.

Our members employ a majority of the country's industrial labor force and produce over 75 percent of its manufactured goods.

Many of our members provide some form of retirement program for their employees, and have had a vital interest in the activities of the President's Commission.

Over the past 2 years, the NAM has testified and submitted statements on several issues under review by the Commission. They include disability retirement, universal social security coverage, ownership and control of pension fund assets, and the Federal administration of pension programs.

In its final report, the President's Commission recommended that the Federal Government establish and administer a minimum universal pension system for all workers.

The system would be funded by employer contributions of 3 percent of payroll as a minimum benefit standard. All employees more than 25 years of age, with 1 year of service and 1,000 hours of employment would be participants in the system. Benefits under the program would vest immediately.

The NAM is opposed to such a system.

Currently, the percentage of wages that is deferred until retirement to pension plans by employers varies from group to group. Each employer bases his decision on numerous factors that include external competitive forces, profitability, the absolute level of wages being paid out in cash, the age and size of the firm, the nature of its workforce, and the firm's capital investment needs. The Commission's proposal would impose mandatory coverage on groups that have decided on the basis of their own pertinent demography that the maximum portion of their labor costs should be paid out in current wages or current benefits rather than deferring it to retirement income.

The NAM believes that employers should have the right to make these decisions for themselves.

The Commission's suggestions, designed to minimize the cost of MUPS, may still not suffice for a struggling young company with limited credit lines and a pressing need for capital in order to preserve the jobs of its present employees.

Further, these attempts to minimize costs might not be enough for an older company, large or small, paying most of its employees wages at close to the minimum legal level. The cost may simply be too much to allow such a company to remain in business and thereby pay even this level of wages.

One of President's Reagan's most important goals, with the full support of the American people, is to more clearly define, limit, and ultimately reduce the scope of Government regulation of the economy.

The NAM believes the Commission's proposal would inevitably lead to another unresponsive and unmanageable Government bureaucracy with excessive regulation and redtape.

The NAM's material submitted for the record indicates there are some proposals in the Commission's report believed worthy of support, but they can't be covered in the time available to us here.

They include, with respect to social security, opposition to the use of general revenues, allowing interfund borrowing, covering all Federal and State and local government employees, and raising the normal retirement age beyond 65.

We thank the subcommittee for the opportunity to appear, and hope our statement will be useful in its work.

I welcome your comments and will be happy to try to answer any questions you may have.

Senator CHAFEE. Thank you very much, Mr. Dearnley. We appreciate the testimony you've given us and the full statement that you have submitted.

Thank you all, gentlemen.

[The prepared statements of the preceding panel follow:]

STATEMENT OF

JEFF R. HART

EXECUTIVE DIRECTOR

ASSOCIATION OF PRIVATE PENSION & WELFARE PLANS

MAY 15, 1981

The Report of the President's Commission on Pension Policy

A Hearing of the

Subcommittee on Savings, Pensions & Investment Policy

Senate Finance Committee

STATEMENT OF

THE

ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.

SUMMARY

- Our inability to expand the Social Security System is clear--in fact, a phased-in trimming of benefits is inevitable.

- The Nation's savings rate is the lowest in the industrialized world--and Congress must create incentives to increase personal savings, particularly in regard to retirement savings.

- The Commission's recommendations for government-mandated MUPS is rejected as unrealistic within our current economic framework, particularly in terms of redirected working capital and significant revenue losses.

- The Commission has failed to support adequately the assumptions upon which the "need" for MUPS has been based.

- The presentation of coverage statistics by the Commission is misleading in that it does not address the workforce relevant to the private pension system, does not elaborate adequately on the uncovered segment of the population, and does not focus on the potential for coverage expansion over time.

- Either under a voluntarily expanded private pension system, or a Federally-mandated MUPS alternative, a percentage of Americans who have worked will remain uncovered by private pensions--this reality must be recognized and addressed through social income security programs, not through the "forced expansion" of a voluntary system.

INTRODUCTION

Mr. Chairman and members of the Subcommittee, my name is Jeff R. Hart, and I am the Executive Director of the non-profit Association of Private Pension and Welfare Plans, Inc. (APPWP). I submit this statement to you today on behalf of the membership of APPWP.

The APPWP is a national association dedicated to the survival and growth of the private employee benefits and compensation field. The APPWP represents one of the largest industries in the world, with over 500 firms composing its basic membership. The Association is representative of the entire private benefits system of this Nation. We are comprised of a broad spectrum of active and concerned employers--from some of the very largest through to many of the smallest. Our employer membership is matched by an equal number of the Nation's leading actuarial and benefit professionals--from insurance companies, banks, law firms, accounting firms, investment firms, and actuarial consulting firms.

APPWP's composition is reflective of its focus on the broad, benefits funding and delivery policies of this Nation. We are firm in contending that the best interests of our Nation's citizens are served when these national policies reinforce the diversified and balanced sharing of the benefits load among the Social Security system, the employer-sponsored private system, and the savings, contributions and investments of the individual citizen. It is within this context that APPWP submits this statement on the Final Report of the President's Commission on Pension Policy.

The Commission's report addresses a broad spectrum of <u>both</u> social and retirement income security issues. Given the complexity of many of the issues, it is, of course, impossible to address them all toda

I request, therefore, that the Association be afforded the opportunity to supplement its testimony with a later filing.

When viewing the report in its entirety, the Association finds itself in general agreement with many of the recommendations relating to the current Social Security system and with some relating to increased incentives for personal savings. There are now few who would question the severity of the financial strains that face the Social Security system--rather, the difficulty for many today is in comprehending the magnitude of the strain, particularly as it relates to the health care elements of the program. And there are now few who would question the increasing paucity of the Nation's personal savings rate. During recent years, our tax laws and regulations have evolved to discourage personal savings. When coupled with inflation and a populace intuitively sensitive to present value theory, these disincentives have made our savings rate the lowest in the industrialized world.

SUMMARY

Recognizing the problems that the Nation is suffering in terms of Social Security and personal savings, and recognizing that both have been--and will continue to be--the subject of separate hearings, I wish to focus my remarks today on the Commission's recommendations for the establishment of a so-called "Mandatory Universal Pension System", which has come to be commonly referred to as "MUPS". Our Association is both opposed to the concept as recommended and disappointed in the manner in which the Commission has presented the "need" for such an alternative.

During a time in our history when Americans are coming to recognize very clearly the inalterable linkage between general economic vitality and income security, it is unconscionable that recommendations would be forwarded that would redirect working capital away from the small business sector of our economy--the very sector where vitality and growth is needed in terms of retirement income security. More specifically, during an economic period when this Committee and others must struggle with the revenue implications inherent in the relatively modest step of expanding deductibility for employee contributions to IRAs and qualified private plans, it is unrealistic to propose a government-mandated MUPS program that represents such significant revenue losses.

Virtually all of us in this room today would like to share in the Commission's dream of providing every American in retirement 100% of pre-retirement disposable income. However, in the harsh light of reality, there is a marked difference between that for which we would dream and that which can be.

This Association considers the establishment of MUPs as not justified by the data developed and presented by the Commission. The report's method of presenting private pension coverage statistics is potentially misleading in that it takes the focus away from the nature and location of non-coverage. The report provides a static treatment of coverage and does not look forward to the increasing probabilities of coverage. Furthermore, the impact of inflation and the cost involved in the report's recommendations are treated inadequately. This is not to say, however, that the Association does not favor greater private pension plan coverage. We do. But private employers must be afforded adequate opportunity, through voluntary incentives, to expand coverage and benefits within the realities of the marketplace. To construct appropriate incentives, the current and future nature of the potentially uncovered population must be well understood. The private pension system, with appropriate incentives and less burdensome regulation, holds great potential for continuing increases in the benefits it provides and in the percentages of workers it covers. However, the system has its natural limitations--as would MUPS--which will leave a segment of the population uncovered. The Association would like to see voluntary incentives constructed that would reduce the uncovered segment. For that segment of the population which will remain beyond the natural reach of the private pension sytem, the Association endorses the appropriate role of government in providing a minimum floor of social income security for this segment. However, the private pension system should not be forced beyond its structural limits in an effort to do so by the imposition of federal mandatory standards.

MANDATORY UNIVERSAL PENSION SYSTEM

MUPS is, in part, a product of the Commission's conclusion that replacement of 100% of pre-retirement disposable income from all sources is a desirable retirement goal. The Commission, however, did not seek to support the feasibility of this position. The Commission's 100% income replacement goal should be examined critically for two reasons: First, it is generally true that the income level of a person just prior to retirement represents the highest lifetime earnings level. The Commission's desire to enable a worker to retire at a level commensurate with the highest level attained in a working career is laudable--but not realistic. Second, the Commission expressly acknowledged that consumption patterns of retirees are different than those for active workers, but it did not make any offsetting adjustments in its income replacement goal to account for such differences. It is generally recognized that retirees have lower income needs relative to younger workers. For example, two major expenses of family life -- child raising and home ownership -- are likely to be absent from the income needs of our retired population. Most retirees have adult children who are, financially independent of their parents. And, most retirees either own their own homes outright or have small mortgages with interest rates well below current market levels.

Our Association, therefore, does not agree with the Commission that a realistic retirement income goal for this country is to replace fully the pre-retirmeent disposable incomes for all retirees. The Commission's questionable income replacement goal is relevant in that the MUPS proposal is a necessary element to the fulfillment of this goal.

Simply stated, MUPS would require all employers to make a pension contribution equal to 3% of payroll for all employees over the age of 25 and with more than one year of service (1000 hours of employment) with their employer. MUPS would further require that: (1) the employee be fully vested in the employer contribution made on his behalf; (2) the plan not be integrated with the Social Security program and (3) the benefit be fully portable. In an effort to mitigate the cost of MUPS, the Commission recommends phasing it in over three years and giving small businesses, upon which MUPS would fall the hardest, a tax credit for MUPS contributions.

It is premature to address the specifics of MUPS because the basic assumptions which have been cited in support of MUPS are either flawed or not established by available data. Further, the Commission failed to investigate alternative solutions. The Commission recommended MUPS because it perceived that (1) voluntarily established private plans do not now, and will not in the future, cover a sufficient percentage of the Nation's workforce; (2) the level of Social Security benefits for employees not now covered by private plans is inadequate; and (3) the personal savings, which low and middle-income people can be expected to set aside for retirement years, will not be adequate to cover their needs. We disagree.

The Commission's assumption with respect to coverage is that "about half of the private work force" currently participates in a private pension plan and that this percentage is not expected to increase significantly in the future. These assumptions would lead one to infer that half of our Nation's workers are not covered by a private pension plan and will not be covered by one in the future. Upon closer inspection, however, it is clear that actual pension coverage in the private system is closer to 75% of the relevant workforce. In addition, the data shows that this figure is likely to expand as time goes on.

According to a recent study being conducted by the Employee Benefit Research Institute (EBRI), a non-profit educational organization, the total U.S. "workforce" is made up of 95.4 million workers. Of that number, 24.1 million are workers who are either under age 25 or over age 64. These are two groups which ERISA does not generally require to be covered by private pension plans. Another 13.5 million employees in the total workforce are either part-time employees or are employees who have not worked for their employers for more than one year. ERISA does not require coverage for this group. And finally, when agricultural workers and self-employeed individuals are considered, another 8.1 million workers can be eliminated from the total workforce. Thus, when the "total workforce" is adjusted to the "relevant workforce" which is more meaningful to the coverage issues, the starting figure of

95.4 million drops to 49.7 million.

The EBRI study goes on to show that of the relevant population of 49.7 million workers, 74% are currently covered by a private employer pension plan and that 56% of all such participants are entitled to receive a vested benefit at some future date. The study concludes that the percentage of employee coverage in the private employer pension system is "well above a majority" and that we are clearly moving towards a time when two-thirds of the relevant workforce will be entitled to receive vested benefits from a private employer retirement plan. The EBRI study, which was developed over a period of two years, will be completed and published formally in June of this year.

The Commission also assumed that employee coverage by the private pension system is not likely to expand in the futur. Statistics revealed in the EBRI study, however, point in a different direction. From 1950 to 1979, a period during which the total U.S. workforce increased by 90%, the EBRI study shows that participation in employer-sponsored plans increased by 253%. In addition, the study reveals that whereas the uncertain regulatory climate created by ERISA caused new plan formations to drop to a low of 3,494 plans in 1976, the 1980 figures are much more representative of the vigor of the private pension system. In 1980, 56,063 new plans were formed. That is more than 15 times the number of new plans formed in 1976. In our view, there will be even greater expansion of the private pension system if Congress creates the proper environment: ERISA needs to be scaled-down to more manageable proportions and tax incentives need to be improved. Legislative changes which encourage the voluntary establishment of new plans and the improvement of existing plans will have a dramatic and positive effect on coverage. <u>Our Association has just completed a two-year</u>

analysis of the amendments which we believe would be helpful to eliminate the ERISA created impediments to the adoption of new plans. We intend to submit this analysis to this Subcommittee for its study of the present private pension system.

The Commission also assumed, as another reason for MUPS, that the level of Social Security benefits for groups not covered by a private employer pension plan was inadequate. The Commission's own statistics however, disprove this assumption. According to the Commission's statistics, 85% of the non-covered population earns $15,000 or less in annual income. A statistical table which appeared in the Commission's second Interim Report, but not in the Final Report, showed that for a married couple, with one wage earner, Social Security benefits would replace 64% of the wage earner's pre-retirement gross pay. The Commission's table showed further that a benefit equal to 71% of the wage earner's pre-retirement gross pay would replace 100% of his disposable income. Thus, for people in the $15,000 and under group, the Social Security benefit falls only 7 percentage points short of the Commission's retirement benefit goal of 100% replacement of pre-retirement disposable income. Clearly, if MUPS were added to the present Social Security benefit, a large portion of the uncovered group might receive retirement benefits in excess of 100% of their pre-retirement disposable income. A mandatory system, such as MUPS, is not the appropriate mechanism for enabling certain segments of the population to receive more income in retirement than they did as wage earners.

The Commission's third assumption supporting MUPS is that personal savings for low and middle-income individuals are presently insubstantial and not likely to play a meaningful role in providing retirement income for such individuals in the future. The Commission, however, provided little data on the extent or form of personal savings for the low and middle-income groups. One glaring omission in the Commission's analysis is the extent to which home equity can be used in meeting retirement needs. As noted earlier, substantial home ownership exists among the elderly. However, the possibility for using "reverse annuity mortgages" or similar mechanisms was never evaluated by the Commission. Such techniques could permit retired indivuduals to retain their home ownership but at the same time utilize their accumulated home equity for their retirement needs.

The Commission also failed to identify any of the impediments to savings by these groups. The most obvious impediment, of course, is inflation. To the extent MUPS is offered as a response to inflation, it is a bad response. The best government response to inflation is to confront it directly, by striving to bring it under control through sound fiscal and monetary policies.

Personal savings have also been retarded by low interest rates paid on bank pass-book accounts and the taxation of that interest. Changes in either or both of these factors will encourage greater personal savings.

We submit that the Commission's examination of the personal savings issue is based upon the situation as it currently exists, rather than on the situation as it could be if inflation were under control, interest rates on passbook accounts were higher, and tax incentives for employer and employee savings were enacted by Congress.

Our Association strongly supports one of the tax incentives discussed in the Commission's report--the provision for a deduction of employee contributions under a qualified plan. We are pleased that a number of bills have been introduced in this Congress to provide for such a deduction, and we are hopeful that any tax legislation adopted this year will include a provision permitting employees to deduct their contributions under a qualified plan. A similar provision adopted in Canada several years ago has had the effect of creating substantial new savings among employees in all income ranges. If this provision were adopted and other impediments to personal savings were removed, we believe that personal savings would increase to more substantial levels, thereby eliminating another of the Commission's perceived justifications for MUPS.

In conclusion, I wish to say, on behalf of the Association, that the framework for dialogue that has been built by the Commission is of profound importance, and we would hope that the dialogue continues to be pursued with the greatest diligence. The Commission's final report however, is not a complete report. In our judgment the major issues deserve much more thorough analysis. More data needs to be developed and more alternatives must be evaluated. The Commission has not made a case for MUPS. The basic assumptions which it makes to support MUPS are either not valid or not proven. The Commission did not test the MUPS parameters to determine whether they would produce the level of benefits desired. Before a private employer adopts a pension plan, it is customary to have the actuary perform numerous calculations, taking into consideration variations in age of employees, turnover, mortality, compensation, inflation, etc. In this way, the employer determines before hand, to the extent possible, whether the pension contribution and level of benefit promised by the plan will meet the desired objectives. This type of fundamental testing was not done for the proposal to create MUPS.

The Commission's report represents a beginning in identifying the major pension issues which confront us today. Much more work needs to be done, however, before the difficult and delicate task of their resolution can be realized.

May 15, 1981

Statement of

The ERISA Industry Committee (ERIC)

to the

SENATE FINANCE COMMITTEE

SUBCOMMITTEE ON SAVINGS, PENSIONS & INVESTMENT POLICY

Regarding

PRESIDENT'S COMMISSION ON PENSION POLICY FINAL REPORT

My name is George J. Pantos and I am a partner in the law firm of Vedder, Price, Kaufman, Kammholz & Day, Washington, D.C.

I appear today on behalf of The ERISA Industry Committee (ERIC), an association of some 100 major corporations concerned with national retirement policy issues. ERIC's members include half of the nation's fifty largest industrial companies and represent a broad cross-section of the nation's largest retailers, utilities, bankers and insurers.

The hearing today is focused on the Final Report of the President's Commission on Pension Policy. ERIC followed the work of the Commission very closely and appeared before the Commission on numerous occasions during the past two years to present views on various issues pending before the Commission. We are happy to share our views with the Subcommittee today on certain aspects of the Final Report.

With your permission, Mr. Chairman, we would like to concentrate today on two issues in the Commission Report, namely, incentives for individual retirement savings and the mandatory pension proposal, and reserve the right to file a more detailed statement for the record.

We are pleased that the Commission has endorsed the present aggregate of means for providing retirement income security - the three-legged stool of Social Security, private pensions, and individual savings. Further, in seeking to increase retirement income, the Commission has confirmed the historic rationale of Social Security as a minimum floor of protection; it has endorsed the value of private pensions; and it has advocated several measures that could add greatly to the prospect of an important role for individual savings.

We are pleased that the Commission has not yielded to the expedient of expanding the role of Social Security, which even now has long-range problems that must be addressed and solved in this decade.

Incentives For Retirement Savings

In developing its principal recommendations, the Final Report is focused on means to increase pension coverage. The Commission advocates that gaps in coverage and pension adequacy can be addressed through a federal tax system which encourages personal retirement savings. We concur that much can be accomplished in expanding the role of private savings. Specifically, ERIC strongly endorses the Commission's view that reasonable amounts of employee contributions for retirement security should be deductible from income for federal income tax purposes, and taxed instead when withdrawn upon retirement. This would parallel the present treatment for employer contribution to qualified plans.

A change in the tax laws is needed to permit deductible employee contributions which would spur added pension coverage. In addition, this approach has the advantage of adding substantially to the nation's capital base. In the interest of time, I shall not comment further on this point since on February 24, ERIC submitted specific suggestions regarding certain savings incentive tax bills pending before this Subcommittee.

Mandatory Pensions

The centerpiece of the Final Report is the concept of mandatory pensions beyond the scope of the present Social Security system. The vehicle suggested for further consideration could be either a separate tier of the Social Security sysystem, with permission for employers to "contract out", or a mandatory program of "private" pensions with a central portability clearinghouse.

If such a program could create pensions for those who now are without them, and at no cost to anyone, who would not support it? But there is, of course, a price for every economic benefit, and it is naive to overlook it.

The Report appears to expect that the cost of mandated pensions would be borne by the employer. If so, payroll costs of business would rise, which would favor the use of machines over people. To the extent that employment could not be cut to offset its higher cost, a business would earn a lower economic return, and the equity capital supporting it would now have a new inducement to apply itself elsewhere, in a business that is less people-intensive. Hence, the economic burden of mandatory pensions would fall most heavily on employers most affected by payroll-related costs.

In other cases, the cost of mandatory pensions could be passed on to the consumer, thereby adding to inflation.

In still other cases, the cost of mandatory pensions would be borne by the employees, through wages that fail to rise, or rise more slowly, so as to offset the new payroll cost. It is questionable whether employees will appreciate a cut in current earnings so that a pension can be accumulated for them that they would not have chosen to fund voluntarily.

A mandatory pension program would have the same helpful economic effects as any rise in the minimum wage. Its administration, however, would bring wholly new difficulties; its reduction in disposable income would bring new pressure for evasion of reporting, and disrespect for legal process generally; and the financial burden would fall most heavily on those least able to cope with new administrative and financial burdens. In this regard, as has been already noted, many employers terminated their well-funded pension plans shortly after the enactment of ERISA rather than comply with the onerous administrative requirements of the Act.

More broadly, the proposal is objectionable becuase it goes too far in having the government determine the allocation of private objectives. American society had already established, through Social Security, an organized program of a minimum floor of protection to continue income after retirement, death or disability. If now the government is to require, not a minimum floor of protection but some higher goal, looking ultimately to full continuation of income after retirement, shall we expect similar proposals for mandatory purchase of "adequate" life insurance and disability income coverage? And what further diversions of current resources should be made, against the will of the producers of those resources, to accord with the better judgment of the government?

We are deeply concerned that the proposal is, in plain terms, a proposal for compulsory plan coverage. We oppose compulsion for benefits beyond the concept of a minimum floor of protection. We believe it would be a mistake to endorse a concept which diminishes the voluntary character of pension security above the mandated minimum level of Social Security.

A final comment relates to the central assumption of the Report that only 45% of the workforce is now covered by private retirement plans. The evidence is clear from studies presented to the Commission that coverage varies widely among different industries, and that differences in coverage can be explained by differences in size of the establishment and the level of wages. In effect, these studies conclude that the "uncovered sector" is largely made up of workers employed by small and marginal employers, and employees who are low paid and not represented by unions.

In this regard, the following comments taken from page 63 of the Final Report, Additional Views, which includes statements from seven of the eleven Commissioners, should be noted:

> "Unfortunately the President's Commission continues to use a figure of only 45% of the private sector workforce actually participating in a pension plan, thereby showing a large "gap" of uncovered people. But the "gap" is largely young or short service or

part timers or low paid workers in small establishments. Half of the non-covered workers are under age 25 or have less than one year of service. Twenty-nine percent are part time. Two thirds earn less than $10,000 a year. Seventy-nine percent are in firms with fewer than 100 employees.

The relevent figure to use is that nearly 70 percent of full-time American workers are already participating in private pension plans or will be when they reach age 25 and have one year of service. The majority of the remaining uncovered are part-time or low paid workers in smaller establishments for whom Social Security is the crucial coverage."

More can undoubtedly be done, and should be done, to encourage people to make their own provision for the economic needs of retirement. As noted, the Final Report makes valuable proposals for such encouragement, as discussed under the heading, "Tax Policy," and they should be given an appropriate opportunity for implementation before moving forward with further consideration of the concept of a mandatory program of benefits beyond the scope of the present Social Security system.

Impediments to Growth of Private Pension System

While the Commission acknowledges the important role of private pensions, we were disappointed with the Commission's overly pessimistic forecast that little future expansion in the private systems will occur voluntarily. We were also disappointed that the Commission failed to address certain impediments to growth of the private pension system which could be resolved by a simplification of present ERISA requirements. Complex and burdensome ERISA requirements, particularly in the reporting and disclosure area, have had an adverse impact on retirement plans and have precipitated plan termination, particularly by smaller employers.

Certain burdensome ERISA fiduciary and prohibited transaction provisions have also created a strong disincentive for many plan sponsors to continue their plans.

In addition, fundamental changes have taken place in the ERISA Title IV program in recent years which have signaled the need to overcome the deficiencies in the termination insurance program for single employer plans. Present law actually encourages certain financially-troubled plan sponsors who have extended basic pension promises beyond 30% of their net worth to terminate their plans and pay only a limited liability to the PBGC, which guarantees certain pension benefits under Title IV. Another deficiency in present law is that voluntary plan termination is now an event insurable by the PBGC. These Title IV problems (and others) were recently corrected by the Congress for multiemployer plans, and the relevant principles of that solution should be extended by the Congress to single employer plans.

These present disincentives to plan coverage, and others like them, must be corrected by Congress so that the voluntary growth of private plans can resume. We must face the fact that from a universe of about 100,000 defined benefit plans, terminations jumped from about 1,200 per year before ERISA was adopted in 1974 to as high as 7,200 per year in 1976, and are still running at 4,000 per year. These are mainly small plans, where preservation and expansion are most needed. They were also financially strong plans -- over 98% of plans terminated since 1974 have been sufficiently funded to cover their guaranteed benefits. Causing those plans to terminate was surely a major step backward in achieving a broader pension coverage. The country needs to reverse the conditions that causes so many small but strong plans to terminate.

There have been proposals to induce the formation of new plans, or the liberalization of existing plans, by temporary tax credits for employers. We doubt that such measures would have much effect, because pension benefits are a long-term undertaking for which short-term tax inducements are, or should be, irrelevant. Of course, the deductibility of employee contributions discussed earlier should be a most helpful tool in encouraging plan adoption and liberalization.

National Association of Manufacturers

STATEMENT OF

IRVINE H. DEARNLEY, VICE PRESIDENT, CITIBANK, N.A.

ON BEHALF OF

THE NATIONAL ASSOCIATION OF MANUFACTURERS

ON THE FINAL REPORT OF

THE PRESIDENT'S COMMISSION ON PENSION POLICY

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

COMMITTEE ON FINANCE

UNITED STATES SENATE

May 15, 1981

1776 F Street, N.W. • Washington, D.C. 20006 • (202) 626-3700

SUMMARY OF

STATEMENT OF

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Mr. Chairman and members of the Subcommittee, my name is Irvine H. Dearnley, and I am a vice president of Citibank, N.A. I am before you today representing the National Association of Manufacturers. The NAM is an organization of nearly 12,000 members covering every state. Our members employ a majority of the country's industrial labor force and produce over 75 percent of its manufactured goods.

Many of our members provide some form of retirement program for their employees, and have had a vital interest in the activities of the President's Commission. Over the past two years, the NAM has testified and submitted statements on several issues under review by the commission. They include disability retirement, universal Social Security coverage, ownership and control of pension fund assets, and the federal administration of pension programs.

In its final report, the President's Commission recommended that the federal government establish and administer a Minimum Universal Pension System (MUPS) for all workers.

The system would be funded by employer contributions of 3 percent of payroll as a minimum benefit standard. All employees more than 25 years of age, with one year of service and 1,000 hours of employment would be participants in the system. Benefits under the program would vest immediately.

The NAM is opposed to such a system.

Currently, the percentage of wages that is deferred until retirement to pension plans by employers varies from group to group. Each employer bases his decision on numerous factors that include external competitive forces, profitability, the absolute level of wages being paid out in cash, the age and size of the firm, the nature of its workforce, and the firm's capital investment needs. The commission's proposal would impose mandatory coverage on groups that have decided on the basis of their own pertinent demography that the maximum portion of their labor costs should be paid out in current wages or current benefits rather than deferring it to retirement income. The NAM believes that employers should have the right to make these decisions for themselves.

The commission's suggestions, designed to minimize the costs of MUPS, may still not suffice for a struggling young company with limited credit lines and a pressing need for capital in order to preserve the jobs of its present employees. Further, these attempts to minimize costs might not be enough for an older company, large or small, paying most of its employees wages at close to the minimum legal level. The cost may simply be too much to allow such a company to remain in business and thereby pay even this level of wages.

One of President Reagan's most important goals -- with the full support of the American people -- is to more clearly define, limit and ultimately reduce the scope of government regulation of the economy. The NAM believes the commission's proposal would inevitably lead to another unresponsive and unmanageable government bureaucracy with excessive regulation and red tape.

The NAM's material submitted for the record indicates there are some proposals in the commission's report believed worthy of support, but they can't be covered in the time available to us here. They include, with respect to Social Security, -- opposition to the use of general revenues, allowing interfund borrowing, covering all federal and state and local government employees, and raising the normal retirement age beyond 65.

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We thank the subcommittee for the opportunity to appear, and we hope our statement will be useful to the subcommittee in its examination of the commission's final report. I welcome your comments and will be happy to try to answer any questions you may have.

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BACKGROUND

In 1978, then President Carter appointed a Commission of 11 prominent citizens to review our national retirement policy. The Commission's final report has been released. In general, the Carter Commission has made some sensible suggestions regarding the strengthening of Social Security finances, the need for disability income coverage, and the simplification of integration rules and the tax structure. In a number of other important areas, such as the social investment of pension funds and the matter of inflation and its devastating effects on pension plans, the Commission has not set up any useful suggestions.

The Carter Commission's recommendations would include one extremely sharp change in federal policy -- the mandating of private pension coverage for all organizations. This is in sharp contrast to the approach taken by the 1965 Report of President Kennedy's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. The Kennedy Committee set out certain fundamental principles, one of which was that "wide latitude should be permitted in the establishment of private pension plans consistent with the concepts of the free economy and the divergent needs and circumstances of various firms and industries." Expanding on this point, President Kennedy's Committee observed that, "Private supplementary pension plans are voluntarily instituted, frequently by collective bargaining agreements, and their terms vary not only to meet the needs of particular groups of employees but in consideration of "ability to pay" factors fashioned by the economic circumstances of particular companies and industries." In contrast, the report of the Carter Commission may represent a high water mark in federal intrusion into private pension matters.

The report is grounded in the general principle that pension benefits should be measured against the needs or desires of the individual worker. To the extent that a pension is viewed as a right stemming from American citizenship, as opposed to a benefit that is earned through work, there could be little control exercised over an ever-increasing level of benefits. Indeed, the Carter Commission concludes that the most appropriate goal is to replace 100% of pre-retirement disposable income from all sources. With a goal so high, it is clear that much of the existing private system will fall short. Very few workers now receive this level of pension income because few employers can afford to set aside the required cost.

The process the Carter Commission followed in developing a need for mandatory pensions was one of first setting an essentially unrealistic goal -- continuation of full pre-retirement disposable income for all workers. In the process, the Commission ignored the variations in ability to pay by industry, by large or small companies, by profitable or unprofitable organizations, etc. The Commission also insisted on full immediate vesting.

Inflation is mentioned in the report and is, of course, deplored. But other than concluding that there should be no requirement for indexing all pensions at this time, there is little further reference to inflation in the report. Actually, from the establishment of the Commission in July, 1978, to the issuance of its final report in February, 1981, inflation eliminated about one-third of the purchasing power of accumulated pension plan benefits -- a loss that exceeds, by a factor of ten times, the total losses that have resulted from the termination of all U.S. pension plans that ever have been terminated.

The stated mandate of the Commission was to conduct a comprehensive review of retirement, survivor and disability programs in the United States, including private, federal, state and local programs, and to develop national policies for those programs. It is not expected, therefore, that the Carter Commission's report should emphasize the need of retirement income in lieu of alternative uses of such funds. While the Commission was established with reference to reviewing private, federal, state and local programs, the Carter Commission report is couched in terms of the "retirement income system," belying the fact that our "national system" is a collection of tens of thousands of individually designed arrangements. Indeed, when such programs are designed at the level closest to the individual worker, rather than on a national basis, they are more likely to reflect the demography pertinent to each employer group.

MINIMUM UNIVERSAL PENSION SYSTEM

The Carter Commission recommendation requires all employers to contribute 3% of all employee earnings into a defined contribution pension plan. A basic objection is levelled at this recommendation, namely, that the federal government, after having collected a share of workers' earnings in federal income taxes, would be telling the worker precisely how he could use a portion of his remaining income, i.e., the mandatory pension contribution made on the worker's behalf by the employer (if the commission intends for a 3% contribution to be deducted from the employees' payroll). If this direction by a federal commission should be accepted with regard to pensions, will the American worker next be required to set aside 5% of his income into personal savings accounts, or to allocate 10% for medical expenses? The ultimate end of this process of the federal government directing all expenditures would be a society with no personal incentives whatever.

There are objections to a mandatory pension system requiring a 3% of pay contribution into a defined contribution program (if the Commission intends for the 3% contribution to be an add-on cost to the employer as an equivalent to 3% of payroll and not actually deducted from the employees' payroll). First, the proposal simply would increase the cost of labor. In marginal areas, it would have precisely the same effect as an increase in the minimum wage, i.e., further unemployment and management decisions in favor of more automation versus human labor. In a broad sense, therefore, this sort of program may serve to reduce the work force which it is intended to protect. In so doing, work-related retirement benefits would become available to a decreasing number of individuals. Second, the imposition of a required pension contribution on all companies would have the greatest adverse effect on those which are not now making pension contributions. These companies include many small, marginal firms which are not making enough money to afford a pension contribution. These would be driven into bankruptcy by the added costs and, consequently, would cease to pay wages.

Businesses are much like individuals in the sense that their ability to pay varies over time. At the foundation of a new business, capital is scarce and wages are lower because of a lack of funds. To insist in such instances on setting aside 3% of wages for retirement income (if it is a deduction from existing compensation and not an employer equivalent), rather than permitting the organization to grow, expand, increase wages and then add pension benefits, is to overlook the real world limitations on savings. The setting aside of a specified annual sum to produce retirement income may not best match the pattern of available resources and required expenses in all instances. For example, young people who are trying to arrange for housing and are purchasing furniture and equipment for their future lifetime as a family cannot be expected to have precisely the same amount available for retirement savings as the individual who, at an older age, has already completed the purchase of his home and furniture and finished educating his children.

The precise details on how the mandatory universal pension system might work are not available in the Carter Commission report. This is perhaps to be expected because if many of the details were to be spelled out, it is probable that too many problems would arise. For example, it seems clear that the intention of the Carter Commission is that the 3% contribution should be superimposed as a broad general minimum on all organizations which already have pension plans. In these cases, a 3% contribution carried forward with interest obviously would have to be paid to employees terminating without vested rights to benefits under the existing retirement plan.

Finally, the burden of mandatory pensions would fall most heavily on those organizations in which management or labor has made a deliberate and reasoned decision not to offer private pensions. This group consists largely of small businesses, firns with high labor turnover, and organizations with minimal ability to maintain records and fill in government forms. While 3% of total payroll or something approaching that may be siphoned away from small businesses into a mandatory pension program, it is unlikely that any of the amount would be diverted back to the small business community in the form of capital. Pension funds generally are invested in the securities of larger firms or of government. The real burden would fall most heavily, therefore, on the small enterprise.

STRENGTHENING PRIVATE PENSIONS

The Carter Commission has come up with a number of recommendations which in its view would serve to strengthen private pensions. In this regard its point of view is clearly worthy of consideration by all pension practitioners. But if private pensions are to remain truly private, the goals and the needs perceived by Washington might not be truly representative of the goals and needs of any one particular group of employers.

The Carter Commission has recommended that private pension plans increase their normal retirement age from 65 to 68, along with Social Security. Similarly, the Carter Commission has recommended that spouses' benefits be automatically required (without saying who should pay the cost), has recommended prohibiting the cash-out of pension rights if they exceed $500, and has recommended that mandatory retirement at age 70 be eliminated. Administrators of public retirement plans may be upset by the Commission's recommendation that some version of ERISA be adopted to apply to public retirement plans. All of these things are already recommended in other proposed legislation.

STRENGTHENING SOCIAL SECURITY

The Carter Commission also has recommended a series of changes intended to strengthen the Social Security program. In a number of instances these recommendations conflict with the major recommendations of the National Commission on Social Security, whose report was issued in summary form on January 11, 1981. In other instances the recommendations generally coincide. For instance, the Carter Commission would favor inter-fund borrowing to alleviate the short run financing problem, and would also favor universal coverage for Social Security. Both of these recommendations are made by the National Commission on Social Security. The Carter Commission recommends an increase in the retirement age from 65 to 68 over a 12-year period starting in 1990. The National Commission would phase in this same change over a 12-year period starting in 2001. On the other hand, the Carter Commission recommends elimination of the retirement earnings test, the inclusion of Social Security benefits in taxable income for the recipients, and a deduction or tax credit for Social Security contributions among active workers. The National Commission on Social Security would retain the earnings test and lower the applicable age from 72 to 70. The Carter Commission recommends that the special minimum benefits be extended for longer service, but that it be offset by the amount of any private pension payable. The National Commission does not recommend any such offset.

The National Commission on Social Security's members were appointed by President Carter and Congress. Accordingly, its views were expected to differ somewhat from those of the Social Security Advisory Council's, the membership of which is selected by the Social Security Administration. It is no real source of embarrassment, therefore, that the National Commission's recommendations differ somewhat from those of the Social Security Advisory Council's. It is somewhat unusual, however, for a second Presidential Commission to come out with sharply differing recommendations in the area of Social Security.

STRENGTHENING INDIVIDUAL SAVINGS

The Carter Commission recommends a simplification of the tax structure and the allowance of employee contributions to pension plans as a deduction from taxable income. The Commission also recommends a uniform tax policy for savings that are specifically directed toward retirement. In part, the Commission's recommendations arise from its discovery that capital formation in America is falling sharply below that of other major industrial nations. Capital formation, however, depends not only on savings specifically earmarked for retirement, but on savings of all types. By recommending a special tax treatment for savings that are earmarked solely for retirement, we would again have the injection of the federal government into the manner in which savings accounts can be used. The Carter Commission did not recommend that we encourage savings in general, but rather that we encourage savings which must be locked up, used only for retirement income, and on which penalties must be imposed if they are used for other less worthy purposes, such as the expenses of one's own final illness, expenses in connection with disabled children, elderly parents or natural catastrophes such as fire and flood. A more simple approach under which investment earnings on savings would be taxed only upon withdrawal might be more understandable to the average worker and might actually encourage savings, despite inflation at so high a level that a dollar saved may be fifty cents lost.

MISCELLANEOUS

The Commission's study of disability problems did not result in a specific recommendation as to the types of programs to offer. In fact, the Commission recommends further exploration of a universal disability program, a ceiling and floor on replacement ratios for all disability benefits (suggesting the possibility of mandatory benefits), the use of rehabilitation, job redesign, and an occupational disability program for older workers. Individual industries and companies have already incorporated all of these items in one form or another in the design of their existing benefits programs.

The Commission recommends an increase in the level of Supplemental Security Income to the poverty line level and an elimination of the asset test. Clearly, this would add to total government expenditures, but the report does not give an estimate, and moreover incorporates a statement to the effect that federal welfare expenditures would be reduced substantially if the Commission's recommendations are enacted.

Finally, the Carter Commission appraised the effect of inflation on retirement benefits and recommended that the Bureau of Labor Statistics develop a separate cost-of-living index for the retired. Rather than mandating full inflation protection, however, the Commission felt that greater emphasis should be placed on the expansion of pension coverage to those not now receiving benefits rather than requiring an improvement in benefits for those now covered.

CONCLUSION

The recommendations of the Carter Commission seem to run sharply counter to the principles on which President Reagan was elected. Therefore, it is likely to be some years, if ever, before any of the specific recommendations of the Carter Commission are enacted by Congress. It is also likely that, after the formal, final report of the Carter Commission on Pension Policy has been fully analyzed and evaluated, it will be found that while the Commissioners devoted a considerable amount of time to the project, it is wanting in many respects.

Senator CHAFEE. The last panel consists of Mr. O'Hara and Mr. Klose.

Mr. O'Hara, please proceed.

PANEL CONSISTING OF JAMES O'HARA, ACTING CHAIRMAN FOR THE STANDING COMMITTEE ON RETIREMENT OF LAWYERS, AMERICAN BAR ASSOCIATION; AND EDWIN A. KLOSE, PRESIDENT AND SENIOR CONSULTANT, KLOSE ASSOCIATES, INC.

Mr. O'HARA. Thank you, Mr. Chairman. In the interest of time, I will briefly summarize my statement and ask that it be incorporated in record.

Senator CHAFEE. Without objection, so ordered.

Mr. O'HARA. I am here today on behalf of the American Bar Association, urging this subcommittee to eliminate the disparity that exists between qualified plans applicable to corporate employees and those applicable to employees of unincorporated businesses.

We believe that this objective would be consistent with the Commission's report which recommends a more consistent and equitable distribution of the benefits presently available under retirement plans.

This is an objective that the American Bar Association has been urging for several years. We have appeared before a number of congressional committees.

It is one of the highest priorities of the association in terms of legislative recommendations.

We believe that this discrimination between the two plans is very blatant and unjustifiable.

In discussing this matter with previous administrations, no policy explanation was given for this continuing discrimination. The only objection raised against our proposal was the revenue loss.

We have no present estimates as to what the revenue loss would be. We have requested that from Treasury and expect to receive it shortly, and if you like, we could furnish it to the subcommittee.

Senator CHAFEE. Are you talking about the Keogh plan, now?

Mr. O'HARA. That is correct, sir.

Senator CHAFEE. Would you still have a percentage of earnings.

Mr. O'HARA. Yes, what we recommend——

Senator CHAFEE. Is that 15 percent up to 7,500?

Mr. O'HARA. Yes, we recommend an elimination of any distinction between a Keogh plan and a qualified plan applicable to corporate employees.

Senator CHAFEE. So, you would have 41.5?

Mr. O'HARA. Yes, $41,500 is the maximum contribution now to a qualified defined contribution plan——

Senator CHAFEE. Would the man who had earnings from his law practice and $50,000 he had added with outside income, be permitted to put in $41,500?

Mr. O'HARA. Sir, we would——

Senator CHAFEE. You'd make it as a percentage of earnings?

Mr. O'HARA. Yes, we would still keep the percentage of earnings as a limitation, consistent with the present policy that there should not be excess contributions, but that the contributions be geared to some level of compensation.

But, right now, not only are we suffering from the gap between the base contributions allowed under the two plans, but also, the Keogh contribution is, of course, not indexed. The qualified plan, which originally had a base in 1974 of $25,000, is indexed and adjusted for the inflation that we have encountered in the past few years. The inflationary adjustment alone has accounted for $16,500—twice the Keogh limit.

We are simply urging that this discrimination between the two plans be eliminated—that every employee, whether employed by a corporate employer or an unincorporated business, be treated alike.

What has been happening recently is that there has been a widespread incorporation of businesses—large firms as well as small and medium sized businesses. This is putting a real cramp on a number of businesses that really are better operated as sole proprietorships. That is increasing the cost of doing business. It is putting these business men in an awkward position if they are not familiar with corporate arrangements. The reason they are entering into some of these cumbersome arrangements is because of the tax benefits that are available to corporations and which are otherwise unavailable to unincorporated businesses.

We think of the revenue loss issue as really illusory since we are not asking, as some of the other proposals do, for enactment of legislation to provide new benefits. Any increase in IRA, for example, would obviously require a change in the law, but the unincorporated businessmen under current law can get the benefits that we are urging by simply incorporating.

This discrimination forces him to choose his form of business based on tax considerations rather than business considerations. We believe this discrimination should be eliminated. I thank you for your time, Senator.

Mr. CHAFEE. Thank you, Mr. O'Hara, very much.

Mr. Klose, please proceed.

OPENING REMARKS OF EDWIN A. KLOSE, PRESIDENT AND SENIOR CONSULTANT, KLOSE ASSOCIATES, INC.

Mr. KLOSE. Thank you, Mr. Chairman. My name is Ed Klose and I'm president of an IRA consultant firm and I welcome this opportunity to share my views regarding the final report of the President's Commission on Pension Policy, and I point with enthusiasm to the bills, and in particular, S. 243, now under consideration by your committee which will enable the broad policy goals of that Commission to be achieved.

S. 243, the Savings and Retirement Income Incentive Act of 1981 will permit Americans to realistically strive for the goal of 100 percent replacement of preretirement disposable income when considering all probable sources. S. 243 and, moreover, over an extended period, S. 12 and similar bills are the most important and positive legislative steps which can be taken in support of thc goals recommended by the President's Commission on Pension Policy.

The President's Commission was established as I saw it to review the interrelationships developing among the three elements of retirement income and to provide policy recommendations to assure that American workers have the opportunity to provide a comfortable financial retirement for themselves.

I followed the activities of the Commission closely and noted that the social security and employer pension legs of the three-legged stool of retirement income received much study and I also noted that there was limited references to the IRA, the new kid on the block, as a personal savings tool.

Frankly, this didn't come as much of a shock to me after my experiences with the financial insitutions, pension consultants and other retirement income professionals because the IRA is not properly understood—in my book is not properly understood—in my judgment.

It must be understood or least better understood if it is to pull its weight in the retirement income tripod.

The IRA is the newest leg but as it matures or is allowed to mature I believe it will quickly become an equal policy partner with the other two legs of retirement income.

The IRA is a Federal program which encourages savings with a double built-in protection for the individual against inflation, because both the deposit and all earnings are shielded from current Federal taxes. There does not now exist a better tax-favored consumer program to stimulate individual savings, and it is based on one of the oldest economic ideas in the world—tax incentives. These savings, based on tax incentives, also mean that the consumer reduces or defers spending which is a bonus for our economy at this time.

The present and prospective IRA program is also equitable, efficient, its feasible and can be regulated within present structure. It does not result in a revenue loss to the U.S. Treasury, but rather is a deferred revenue source and, more importantly, represents an immediate savings investing in our economy.

An American knows that only he not his Government and not his employer, knows what the total financial requirements are to support his comfortable financial retirement. And, herein, is the problem to be solved.

The concept and structure of the retirement income tripod needs to be broadened and better communicated at the individual level. Financial institutions, pension consultants and other retirement income professionals and specialists need to devote more talent to the total education or awareness task and the Congress should lead in this effort with legislation such as S. 243.

The task now is for legislative action and the recent social security proposals of the administration reinforce the urgent call for support to expand the IRA personal savings leg of the three-legged stool for retirement income.

I support and encourage savings and retirement income incentives, a principal that was endorsed by President Reagan during the last session of Congress, which is endorsed by the President's Commission on Pension Policy and by every major financial association, by most economists and by both major political parties.

Let's give Americans an IRA personal savings tool to enable them to work toward the desired retirement income goals outlined in the report of the President's Commission on Pension Plans.

Thank you for this opportunity——

Senator CHAFEE. Would you permit the IRA to be used for withdrawals for a first purchase of a home and education of children?

Mr. KLOSE. Absolutely.

[The prepared statements of the preceding panel follow:]

AMERICAN BAR ASSOCIATION

STATEMENT OF

JAMES T. O'HARA, ACTING CHAIRMAN
STANDING COMMITTEE ON RETIREMENT OF LAWYERS

on behalf of the

AMERICAN BAR ASSOCIATION

before the

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

COMMITTEE ON FINANCE

UNITED STATES SENATE

concerning

THE REPORT OF THE PRESIDENT'S
COMMISSION ON PENSION POLICY

May 15, 1981

SUMMARY

Under existing law, there is a disparity in tax treatment with respect to contributions and benefits available to employees and self-employed persons under qualified retirement plans. Contributions to a defined contribution plan may be made for an employee up to $41,500, while a self-employed person may obtain equivalent tax benefits only to the extent of $7,500 per year. In addition, the employee limitation is adjusted for cost-of-living increases, while the $7,500 limitation is not. The American Bar Association urges that legislation be passed which eliminates this unsupportable discrimination against self-employed individuals by increasing the maximum limitation on deductible contributions that are permitted for self-employed plans, allowing adjustments for cost-of-living increases, and eliminating the duplicative set of special restrictions that apply only to self-employed plans.

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to present this testimony to you on behalf of the American Bar Association. I am James T. O'Hara, Acting Chairman of the Standing Committee on Retirement of Lawyers. I am here at the request of Reece Smith, President of the American Bar Association, to urge the elimination of the existing disparity in the levels of contribution to qualified retirement plans for employees and self-employed persons.

The views I am going to express also reflect those of John S. Nolan who, as then Chairman of the Standing Committee on Retirement of Lawyers, appeared before the House Committee on Ways and Means in March of 1978.[1/] As a member of the Standing Committee and Chairman-Elect of the Tax Section of the American Bar Association, Mr. Nolan continues to participate in the effort to pass legislation eliminating the discriminatory tax treatment of self-employed persons.

The President's Commission on Pension Policy recently recommended that "[c]ontributions and benefit limitations for individuals should be treated more consistently for all types of retirement savings."[2/] The Commission's recommendation

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1/ See Statement of John S. Nolan, Chairman, Special Committee on Retirement Benefits Legislation, American Bar Association, before the Committee on Ways and Means (March 7, 1978).

2/ The President's Commission on Pension Policy, Coming of Age: Toward a National Retirement Income Policy, 49 (February 26, 1981).

recognizes the need for a uniform tax policy toward retirement savings which would "distribute the tax benefits more equitably" and would be a more "rational approach to providing incentives for individual effort."[3/]

One of the most blatant examples of inequitable treatment among individuals is the severe discrimination that self-employed individuals suffer in comparison to corporate employees with respect to qualified retirement plan benefits under Federal and state income tax laws. This discrimination has increased substantially in recent years because of inflation, and has been one of the major causes of the widespread trend of incorporation of small businesses. The incorporation trend has, in turn, resulted in increases in the cost of doing business. Many small businesses which have been incorporated would actually be more appropriately conducted as sole proprietorships. Further, the discrimination against self-employed plans has created even stronger pressure to form professional corporations. The existing discriminatory tax treatment no longer has any tax policy or other justification, and the tax laws should be changed to eliminate it.

Background -- H.R. 10 and ERISA

The tax benefits from "qualified" (tax-favored) retirement plans are extraordinary. They represent by far the most valuable

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3/ Id.

tax benefit allowed by Congress to employees. Employer contributions for the benefit of employees are not taxable to the employees when made, even though the employees' rights are vested and the amounts are held in trust for them.4/ The investment earnings on such funds held for employees are entirely tax-exempt, regardless of how invested.5/ The employees are taxable on such amounts only when they draw out their benefits, usually after retirement.6/ Even then, if the amounts are drawn out as a "lump sum distribution," the income tax treatment is extremely favorable. The tax deferral effect, whereby no income tax is imposed on such funds or the investment earnings thereon for long periods of years, plus the taxation of such amounts after retirement, often in lower brackets or as lump sum distributions, provides major tax savings.

In addition, the accumulated funds for an employee, for the most part, are not subject to estate tax if the employee dies prior to the time they are fully withdrawn.7/ This provides extremely valuable estate planning benefits to persons with substantial estates. Finally, although such qualified plans must cover employees on a non-discriminatory basis that does not favor

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4/ IRC §402(a).

5/ IRC §501(a).

6/ IRC §§402(a) and 72.

7/ IRC §2039 (c), (f).

shareholder-employees, officers, or highly-paid employees, this does not significantly inhibit the benefits that are available to higher income persons from such plans.

Prior to 1962, self-employed persons could not participate in such qualified plans to any extent. In 1962, the H.R. 10 or Keogh provisions were adopted permitting annual deductible contributions by self-employed persons up to $2,500.[8/] Congress also imposed a complex structure of special requirements and restrictions in addition to those regularly imposed by the Internal Revenue Code on all qualified plans. There was some justification for these special limitations and restrictions on self-employed plans at that time because the tax law contained inadequate provisions to prevent skewing of benefits in favor of owner-employees.

In 1974, Congress adopted the Employee Retirement Income Security Act (ERISA), imposing a comprehensive set of restrictions and limitations on all qualified retirement plans, including self-employed plans. Contributions by an employer to a "defined contribution plan"[9/] on behalf of any employee were

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8/ The deduction, though not the contribution, was limited to $1,250 from 1962 to 1964.

9/ A "defined contribution plan" is a plan such as a money purchase pension plan, profit-sharing plan, or stock bonus plan under which amounts contributed for particular employees are accounted for in separate accounts for them. The amounts are held in trust, and investment earnings are credited to employees' separate accounts. The employee subsequently receives (usually after retirement) an annuity for himself, or himself and his spouse, or a lump sum payment, based on whatever his separate account will provide.

limited to $25,000 per year. This limit is adjusted annually for cost-of-living increases.10/ At present, the limit is $41,500.11/ Contributions to a "defined benefit plan"12/ were limited so that no employee could receive an annuity after retirement exceeding $75,000 per year, a limitation which was also to be adjusted for cost-of-living increases. At present, this limit is $124,500.13/

In contrast to this, ERISA increased the limit on deductible contributions by self-employed persons from $2,500 to only $7,500.14/ This $7,500 is not even adjusted annually for cost-of-living increases. Also, although an "owner-employee" may make additional non-deductible contributions, these additional contributions cannot exceed $2,500 per year.15/ Further, although

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10/ IRC §415(d).

11/ IRC §415(c).

12/ A "defined benefit plan" is an aggregate-funded pension plan under which separate accounts are not maintained for employees. Employees are provided pre-determined annuities or other benefits after retirement determined by their earnings level, years of service, age, or a combination of these factors. The employer must contribute whatever amount (determined actuarially) is required each year to fund these future pre-determined benefits. The essential difference from a defined contribution plan is that the employer takes the investment risk in a defined benefit plan while the employee does so in a defined contribution plan.

13/ IRC §415(b).

14/ IRC §404(e).

15/ IRC §4972(c).

ERISA imposes on all qualified plans a uniform and comprehensive set of restrictions governing employee participation, vesting, funding, insurance and benefits, prohibited transactions, and other matters, Congress failed to eliminate the duplicative and more severe set of restrictions covering these same subjects which already applied to self-employed plans.

The result is that, at the present time, contributions to a defined contribution plan may be made for an employee up to \$41,500, while a self-employed person may obtain equivalent tax benefits only to the extent of \$7,500 per year. Further, this disparity will continue to grow as inflation occurs, since the employee limitation is indexed while the \$7,500 limitation is not. This failure to provide adjustments for cost-of-living increases is an important omission. For example, in 1974 the ceiling on employee plans was only \$25,000, resulting in an inflationary adjustment of \$16,500 for the following seven-year period. This adjustment for inflation, even by itself, is more than double the maximum self-employed plan limit of \$7,500, which cannot be adjusted for inflation. Simply stated, this means that an employee in a corporation can make deductible contributions in amounts more than five times greater than his self-employed colleague.

An even greater disparity exists with respect to the benefits available under a defined benefit plan.[16/] In addition, self-employed plans are subject not only to all of the restrictions and limitations imposed by ERISA on all qualified plans, but also to the special H.R. 10 restrictions and limitations as well. The restrictions that are applicable to self-employed plans are excessively complex. They unduly complicate the administration of the national retirement system and are confusing to small businessmen and businesswomen assessing retirement plan alternatives. The President's Commission on Pension Policy has referred to the current tax treatment of retirement contributions and benefits as "needlessly complex and inconsistent."[17/]

American Bar Association Recommendations

There is no tax policy or other justification for this extraordinary difference in benefits available to employees

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16/ This occurs because an owner-employee of a corporation adopting a plan when the owner-employee is well along in the span of his working years, say age 50, who adopts a qualified plan for his corporation may fund an annuity for himself through the plan up to the general ERISA limit (presently $124,500) over the limited number of remaining years to his retirement. The H.R. 10 defined benefit plan limits have special rules to reduce the benefit that can be funded for a self-employed person (itself far lower in any case than the employee limit) if the funding does not begin until an age after 30.

17/ The President's Commission on Pension Policy, supra, note 2, at 8.

versus self-employed persons. It is the position of the American Bar Association that Congress should eliminate all the discriminatory limitations and conditions presently applicable to self-employed plans.

The American Bar Association is firmly committed to this objective which is embodied in the following outstanding resolution of the Association:

> BE IT RESOLVED, That the Internal Revenue Code of 1954 should be amended by eliminating all differences in treatment of self-employed persons with respect to qualified employee benefit plans and all other employee benefits; and
>
> BE IT FURTHER RESOLVED, That at the least, the limitations on contributions to, or benefits from, qualified employee benefit plans should be the same for both employees and self-employed persons and should provide for adjustments for increases in the cost of living as is presently provided with respect to plans for employees.

The American Bar Association testified before the House Ways and Means Committee in strong support of this action on March 7, 1978.[18/] The Carter Administration was opposed to any legislative change along this line, not on grounds of principle but solely because of revenue losses that would result. Any revenue loss estimate, however, is to some extent illusory as more and more self-employed persons organize themselves as corporations. The American Bar Association also

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18/ See note 1, *supra*.

submitted a statement to the House Ways and Means Committee on this same subject in February of 1980.[19]

This is a matter that vitally affects the financial interests of all professionals. There is a very high level of interest in the matter at the present time. The President of the American Bar Association believes this subject is sufficiently important to be one of the major priorities of the Association. The ABA Standing Committee on Retirement of Lawyers is currently working on the enactment of legislation to increase the benefits on pensions for the self-employed. Other professional associations are also becoming more interested. In addition, Mr. Rostenkowski, Chairman of the House Ways and Means Committee, has recently proposed that the deductible limits for self-employed individuals should be raised from $7,500 to $15,000. This is an important first step toward alleviating the inequitable treatment of self-employed individuals, but such inequities will not be eliminated until the benefits afforded the self-employed are equal to those available to corporate employees.

The current Administration is placing heavy emphasis on stimulating savings and investment, and thus capital formation, through the tax system. It is clearly evident that increasing the tax benefits available to self-employed persons through

19/ See Statement of E. Charles Eichenbaum and James T. O'Hara, Standing Committee on Retirement of Lawyers, American Bar Association, before the Committee on Ways and Means (February 7, 1980).

qualified retirement plans will induce a higher level of savings than would otherwise occur. Therefore, I now urge the Subcommittee to work toward enacting legislation which eliminates the unnecessary discrimination against self-employed individuals by increasing the maximum limitation on deductible contributions that are permitted for self-employed plans, allowing adjustments for cost-of-living increases, and eliminating the duplicative set of special H.R. 10 restrictions that apply only to self-employed plans. These changes are an important step toward achieving the goal of the President's Commission on Pension Policy to "provide all individuals greater incentives to save for retirement and help attain the goals of an adequate retirement income."[20/]

On behalf of the Association, I thank the Chairman and the committee for permitting me to present these views.

20/ The President's Commission on Pension Policy, *supra*, note 2, at 49.

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THE THREE-LEGGED STOOL

OF

RETIREMENT INCOME

IRA
PERSONAL SAVINGS

SOCIAL SECURITY EMPLOYER PENSIONS

STATEMENT PREPARED

FOR THE

COMMITTEE ON FINANCE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

MAY 15, 1981

Edwin A. Klose
President
Klose Associates, Inc.

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Suite 1012
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May 15, 1981

Mr. Chairman and Members of the Subcommittee,

My name is Ed Klose and my personal and professional interest is to help establish a valid retirement income system in our country that could eventually assure American workers real retirement income security. Over 25 years of experience has taught me and the statistics of the President's Commission on Pension Policy confirm that real retirement income security is attained when tax-incentive savings are included in an individuals retirement income program.

I am President of an IRA (Individual Retirement Account) consulting firm. I have had almost 25 years experience in executive, administrative and operational areas relating to pensions and since 1974 have been exclusively involved with the IRA, the tax-sheltered personal savings tool introduced by ERISA (Employee Retirement Income Security Act).

I welcome this opportunity to share my views regarding the final report of the President's Commission on Pension Policy and point with enthusiasm to the bills, and in particular S.243, now under consideration by your Committee which will enable the broad policy goals to be achieved.

The President's Commission stated that it "believes that the replacement of preretirement disposable income from all sources is a desirable retirement income goal." Not true. It is THE desired goal and policy considerations of the Congress should set no lower standard.

S. 243, the "Savings and Retirement Income Incentive Act of 1981" will permit Americans to realistically strive for the goal of 100% replacement of preretirement disposable income when considering all probable sources. S. 243 and, over a more extended period, S.12 and simular bills are the most important positive legislative steps which can be taken in support of the goals recommended by the President's Commission on Pension Policy.

What are the current problems in the U.S. with the basic relationships among public (Social Security) and private (employer) Pensions and IRA personal savings?

Until ERISA and the creation of the IRA, the basic problem was that a serious imbalance existed between these three areas because the personal savings segment enjoyed no favorable tax treatment and employer pensions were not assured.

I, personally, became very excited in the fall of 1974 when I first read in its entirety the ERISA legislation signed by President Ford. I even read ERISA twice because I found within it the two elements which would permit balance and therefore make possible a valid retirement income system which could eventually assure American workers real retirement income security.

These elements emerged and were institutionalized by ERISA as the second and third leg of the retirement income tripod. These elements were the guaranteed TAX-FAVORED employer pensions and TAX-FAVORED personal savings to go with the first leg, the TAX-FAVORED Social Security program.

Five years later the President's Commission on Pension Policy was established, as I saw it, to review the interrelationships developing in these three areas and to provide policy recommendations to assure that American workers have the opportunity to provide a comfortable financial retirement for themselves.

I followed the activities of that Commission closely and noted that the Social Security and employer pension legs of the three-legged stool of retirement income received much study and comment and I also noted that there had been limited references to the IRA, the new kid on the block, as a personal savings tool.

Frankly, this didn't come as much of a shock to me after my experiences with financial institutions, pension consultants and other retirement income professionals and specialists, but I do believe that the "current problems in the U.S. with the basic relationships among public (Social Security) and private (employer) pensions and personal savings" certainly includes the problem that the IRA is not properly understood. It must be understood or at least better understood if it is to pull its weight in the retirement income field.

The IRA is the Tax-Shelter Personal Savings leg to join the tax-sheltered employer pension leg and the tax-favored Social Security leg of the retirement income tripod.

The IRA is the newest leg but as it matures or is allowed to mature it will quickly become an equal policy partner. Let's take a look at where it is already.

The IRA is often thought of as a retirement program for persons who don't have a pension plan where they work. It is just not fair or accurate to describe and communicate the IRA in only this way.

In fact, the IRA has many forms and is probably the most important single tax-sheltered program available to consumers after the purchase of a home. Every IRA results in a current Federal tax deferral or savings to an individual and it is well known that the only thing better than a tax deferred is a tax avoided.

A financial institution can offer a variety of IRA forms for eligible contributions or deposits. I pioneered the concept of identifying these from the individual's point of view as:

1. SEP-IRA - For self-employed persons, persons with income from self-employment (whether or not self-employed full time, and even if an active participant in an employer sponsored retirement plan) or employers without a pension plan. <u>Maximum annual contribution - $7,500 or 15% of income, whichever is less.</u>

2. Transfer IRA — For a person to transfer an IRA from one financial institution to another. No maximum deposit limit.

3. Rollover IRA — For a person to receive tax free until distributed otherwise taxable lump sums of money received from a qualified employer sponsored retirement fund. No maximum deposit limit.

4. Accumulation IRA — For a person without a current employer sponsored retirement plan. Maximum annual contribution - $1,500 or 15% of income, whichever is less.

5. Spousal IRA — For a non-working spouse if the working spouse makes a current contribution to an Accumulation IRA. Maximum annual contribution - $875.

As you can see, by identifying five IRA forms the IRA takes on greater importance for an individual.

According to the latest IRS survey, at least 55,000,000 taxpayers are today eligible for one of the above IRA forms which probably means that more Americans are eligible for an IRA than are now included in all employer sponsored retirement plans. This will certainly be a fact if S.243 is enacted which would mean that every U.S. taxpayer would be eligible for one or more IRA's.

The IRA is a Federal Program which encourages savings with double built-in protection for the individual against inflation because both the deposit and all earnings are shielded from current Federal taxes. There does not now exist a better tax-favored consumer program to stimulate individual savings, and it is based on one of the oldest economic ideas in the world -- tax incentives. These savings, based on tax incentives, also mean that the consumer reduces or defers spending, a bonus for our economy at this time.

The present and prospective IRA Program is also equitable, efficient, and feasible, and can be regulated within existing structures. It does not result in a revenue loss to the U.S. Treasury, but rather is a deferred revenue source and, more importantly, represents an immediate savings investment in our economy.

With tax-sheltered personal savings and employer pensions now institutionalized by ERISA, millions of Americans became instant pension winners and can now look ahead with self-controlled assurances to a comfortable financial retirement. Certain of them now have the tools to permit them to coordinate their own retirement income. And all workers will have this opportunity if the policy goal of the Commission is accepted and implementation permitted by proper legislation.

Retirement, regardless of the age at which it occurs, is a very private and personal experience. The composite American worker has spent a working lifetime enjoying his own generally improving standard of living and looks forward to the rewards of a self-defined retirement.

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An American worker also knows that the personal savings source of retirement income which could not be developed rapidly or protected in the past because of the absence of a tax-favored program is now the equal of a corporate program.

And finally, the worker knows that only he — not his government and not his employer — knows what the total financial requirements are to support his comfortable retirement. He now has the structural tools necessary to do the job and he can be a pension winner.

The current problem with the three-legged stool of retirement income is not its concept. The concept, I believe, is sound as it now permits an adequate retirement income based on the individual having the opportunity to develop a retirement income stream from one or more of three sources — one involuntary, one voluntary, and one a mixture — all of which are now tax favored.

Adequate retirement income is now self-determined conceptually and has become an earned right, instead of a birth right.

Herein is the problem. The concept and structure of the retirement income tripod needs to be broadened and better communicated at the individual level. Financial institutions, pension consultants and other retirement income professionals and specialists need to devote more talent to the total education or awareness task and the Congress should lead this effort with legislation such as S. 243.

The structure exists for an enlarged population of pension winners, which can only come about if they are provided with sound policy reinforcement or support and guidance, which I am personally convinced the Commission provided with its broad view.

The task now if for legislated action and the recent Social Security proposals of the Administration reinforce the urgant call for support to expand the IRA Personal Savings leg of the three-legged stool for retirement income.

We have some problems in our economy today but we also have 92.2% of our labor force working and this tremendous and vital resource could help solve current and longer term retirement income problems if economic attention is focused through the responsible use of tax incentives which are anti-inflationary and not a "quick fix".

I support and encourage Savings and Retirement Income Incentives, a principal that was endorsed by President Reagan during the last session of the Congress, which is endorsed by the President's Commission on Pension Policy and by every major financial association, by most economists and by both major political parties.

Let's give Americans the IRA Personal Savings tool to enable them to work toward the desired retirement income goals outlined in the Report of the President's Commission on Pension Policy.

Thank you for this opportunity to share my views with you.

Senator CHAFEE. Thank you very much, Mr. Klose and Mr. O'Hara. I appreciate your both coming here. That completes the hearing this morning.

[Hearing adjourned at 12:08.]

[By direction of the chairman the following communications were made a part of the hearing record:]

Unionmutual

Portland, Maine 04122
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May 27, 1981

Mr. Robert E. Lighthizer, Chief Counsel
Committee on Finance
Room 2227, Dirksen Senate Office Bldg.
Washington, D.C. 20510

Re: Report of President's Commission on
Pension Policy Hearing on May 15, 1981

Dear Mr. Lighthizer,

I am writing to you in behalf of Union Mutual Life Insurance Company, Unionmutual Pension and Insurance Corporation, and Unionmutual Stock Life Insurance Company of America (collectively "Unionmutual"). Unionmutual is the tenth largest writer of insured pensions in the United States.

On February 26, 1981, the President's Commission on Pension Policy delivered its final report to the President and the Congress. The Commission's mandate had been to study the nation's retirement, survivor, and disability systems and to recommend specific reforms and organizational changes in all the present systems including Social Security and private plans that would be required to meet the goals the Commission perceived.

Because of the limited behavioral analysis and almost non-existent cost benefit analysis, we believe the work of the Commission is not finished and should be carried on by either a reconstituted Commission or a new group appointed by the new Administration and Congress. However, we believe that some of the specific recommendations are valid. Indeed we support the recommendations for raising the Social Security normal retirement age from 65 to 68, the recommendation for universal coverage under Social Security, the recommendation for deductible employee contributions and various other parts of the report. Even in those areas the cost to the employer, the employee and the nation have not been fully explored, and our support for them is based on work done by other groups.

It should be pointed out, however, that the work of the commission had enormous breadth and scope, and represented a monumental effort. Even if the Commission's work is incomplete, it should be supported for having undertaken and at least laid the ground work for this enormous project.

Historically, the Federal government has maintained a substantial ongoing interest in the retirement income area. The Employee Retirement Income Security Act of 1974 brought Federal regulation to all private pension and welfare benefit programs. Major amendments to the Social Security Act were passed in 1977. These amendments were to have solved the financial problems of the system well into the next century. Regrettably, they helped to solve the problems for less than a four-year period. This failure was recognized by mid-1978 when President Carter moved to form the President's Commission on Pension Policy.

At that time, the President stressed the tremendous size and scope of retirement programs, the current level of public plan unfunded liabilities, and the need for reforms aimed at the control of costs. During its lifetime, the Commission's chairman repeatedly stressed the need for assessing potential social and economic implications of recommendations that might be made by the Commission. Assessing affordability was spoken of frequently.

The Commission issued its final report on February 26, 1981. The transmittal letter from Chairman McColough to President Reagan capsulized conclusions of the Commission: "A crisis exists in our retirement income programs. The nation's retirement programs are dangerously dependent on pay-as-you-go systems, such as Social Security. Large tax-supported programs have created an imbalance in the overall system which has serious implications for the future. The lack of private pension plan coverage for many retirees and inadequate savings for most older Americans places an enormous burden on programs."

The Commission reached the following conclusions with regard to the dimensions of the retirement income problem:

(1) The most pressing problem facing the Social Security System is its inability to meet future commitments.

(2) The most serious problem facing the retirement system is the lack of pension coverage among private sector workers. By "retirement system" is meant the entire complex of systems that provide income to older Americans.

(3) The biggest issue facing public employee pension plans is the cost associated with early retirement ages.

(4) Employee pension plans can result in seriously inadequate retirement benefits for spouses of deceased or divorced workers.

(5) A number of problems are caused by the lack of coordination between disability and retirement programs.

Having identified the principal problems the Commission saw facing our retirement programs, it moved to recommendations. The Commission stated the following goal as underlying the entire report: The Commission believed that the replacement of pre-retirement disposable income <u>from all sources</u> is a desirable income goal. In other words, post-retirement income should equal 100% of disposable pre-retirement income. The Commission, however, was not saying that pension plans and Social Security should make up 100% of a worker's pre-retirement gross income. The replacement goal was 100% of income after taxes and working expenses. On the average, most pension plans provide this level of income, so that the goal is not as idealistic or as unattainable as it might first appear to be. Unfortunately, the report provided no information on the potential cost of accomplishing this goal. There have been some studies to indicate that achieving this objective for individuals currently well into their careers could add tens of billions of dollars per year to the cost of doing business. There is a tremendous amount of research that would need to be done before actually moving towards such a national policy. The question of the social and economic costs and consequences was not addressed by the Commission.

In addition, the Commission stated that in considering income replacement, income from all sources, namely Social Security, private pension plans, and personal savings should be considered. Having stated this, however, the Commission went on to almost completely ignore the "third leg of the stool", personal savings, in reaching their conclusions. That is to say, methods of increasing personal savings, which are at an all time low in the United States, were not addressed at all.

The same lack of careful analysis can be shown in the principal recommendation of the Commission; namely, that a minimum universal system of pensions be established for all workers, which together with Social Security would provide the 100% goal. The use of the word "universal" and the stress on "all workers" would indicate that the entire working population would be included in this proposed program. Such is not the case. Rather than all 95.4 million workers between the ages of 16 and 64 being included, the Commission chose to qualify the recommendation as follows: all employees over the age of 25 with one year of service and 1,000 hours of employment with their employer would be participants in the system. Thus, assuming this to be the non-agricultural work force, the proposed "universal" system would apply to 49.7 million workers. The difference is significant for many reasons. Foremost is the fact that in establishing the need for the minimum pensions system (MUPS) the Commission repeatedly stressed that lack of private pension coverage was the most serious problem facing the retirement system. The Commission said that only 45% of the work force was currently participating in private pension programs. Yet, rather than proposing a truly universal program, they proposed one that even under the most optimal circumstances would increase participation to 52% of the work force.

This approach brings a number of questions into focus. First, is coverage of private pensions really the major problem described by the Commission? Second, is the use of the word "universal" honest or appropriate? Third, should the Commission have made it clear that even if MUPS was enacted, total participation of the work force would rise from 45% to only 52%? Fourth, when looked at in this way, would the MUPS be worth the disruptions and costs it might carry with it? Fifth, are MUPS a solution in search of a problem, or are they not a solution at all? It can be fairly suggested that an examination of these questions could lead one to different conclusions than those reached by the Commission. This indicates that additional research and analysis would be appropriate in order to allow decision-makers to reach their own judgments on the correctness of what the Commission has recommended.

Another example of the lack of careful analysis might be the recommendation of a tax credit of 46% of small business contributions to a qualified plan. The Commission argued that this should mitigate any adverse cost consequences for small businesses. It should be noted, however, that over 200,000 small businesses paid no taxes against which a credit could be applied in 1978 and this number is estimated to be higher in both 1979 and 1980. This implies a gap in the research undertaken by the Commission. The report provides no insights into the competitive implications of this proposal, into potential effects on new business creation, into the potential effects on business terminations, and no insights into potential implications for the competitiveness of small businesses versus large businesses. These gaps have been justified, based on a lack of data which would make such research possible. The social and economic consequences may be too great to justify policy changes without that research. The Commission concluded that tax incentives, even those proposed by their report, would not significantly increase the pension plan participation of low and moderate income workers, and workers employed by small businesses. Rather than this statement being viewed as a conclusion, it must more honestly be viewed as a hypothesis. Like any hypothesis, it deserves to be fully researched and tested before it is used as the basis for justifying major policy changes. This is particularly true when one focuses on the voluntary nature of tax incentives versus the compulsory or mandatory nature of alternative policy proposals.

Overall, those sections of the Commission's report dealing with today's structured retirement income programs tend to leave the reader with more questions than answers. The report represents a statement of goals that is generally unsupported by detailed analysis. In addition, the report sets out its most far-reaching recommendation based on a presentation that is exceptionally misleading - - the mandatory program proposed would not apply to all workers. Moreover, it is appropriate to judge the effectiveness of current retirement income programs against the same population that would be covered. Such an analysis might well move on toward very different conclusions than those reached by the Commission.

The final section of the Commission report focuses on financing and phasing in the recommended retirement income programs. The Commission states that it feels that our nation's retirement income programs are dangerously dependent on pay-as-you-go systems, such as Social Security, Supplemental Security Income, and in-kind benefit programs, and that such programs produced a large tax burden which should be reduced. It appears inconsistent that the Commission ignores the fact that the 3% levy on employers to finance the MUPS will be viewed by many as nothing more than a tax. As a result, one must question the Commission's statement that "the only new expense that the Commission recommends is an increase in SSI benefit levels to the poverty line." Contrary to this statement, a quick review of the full set of recommendations made by the Commission would indicate that many of them would include additional expenses. The following examples might be included:

(1) Minimum Universal Pension System

(2) Integration changes

(3) Spouse benefit changes

(4) Universal Social Security

(5) Tax treatment and earnings test

(6) Individual savings

(7) Employment of older workers

The Commission further states that Federal expenditures for such programs as food stamps, Medicaid and housing assistance could also be expected to decline as the recommendations take full effect. An analysis of age and wage demographics of the work force might indicate that such an assessment is, indeed, optimistic. Further, there is no analysis provided in the Commission report that would allow one to assess the validity of the conclusion. Such an analysis would, of course, be necessary before elected officials could be expected to reach conclusions on the recommendations proposed. A fair and balanced assessment of the report must include an analysis of added policy costs in the absence of changes in tax treatment, as well as net policy cost if tax incentives are adopted. Even in that case, however, it must be recognized that using tax reduction capacity to finance retirement income rather than other aspects of our nation's needs has both implicit and explicit costs. This is another area that would have to be explored by political officials in reaching conclusions which was not explored in the Commission's report.

Even the specific recommendations we support have not been adequately analyzed by the Commission, but rather by other bodies with specific responsibility for them. In other words, our support for these three recommendations would not be forthcoming, were we dependent only on the analysis provided in the Commission report. The recommendations we support and the reasons for support are as follows:

(1) Raising the Social Security normal retirement age from 65 to

68. One of the reasons for the continued perilous financial condition of the Social Security system is the fact that people are living longer and collecting benefits for a longer period of time. Raising the normal retirement age to 68 would overcome the effects of the improved mortality tables. Since mortality improves very slowly, raising the age would be of long-term benefit to the system. Secondly, workers are healthier and many jobs are less strenuous today for 65 to 68 year olds than in the past. This recommendation has been examined closely and approved by the National Commission on Social Security, and a bill embodying it has been reported out by the Social Security Committee of the House Ways and Means Committee.

(2) Universal Social Security Coverage. We agree with the recommendation that Social Security be extended to presently non-covered workers. Most of these noncovered workers are federal, state, and local government employees and employees in nonprofit organizations. Universal coverage would tend to eliminate benefit problems for workers who move between covered and noncovered employment, and would eliminate inequities in the distribution of Social Security benefits. It is, also, worthy of note that increasing the base of contributions to Social Security cannot help but improve the financial condition of the system. This recommendation has also been approved by the National Commission on Social Security.

(3) We also approve the recommendation for deductible employee

contributions. A limited employee contribution to qualified plans would have a number of advantages, including reducing the pressures on Social Security, increasing capital formation, providing a non-inflationary tax cut and encouraging new plan formation. A number of bills have been introduced into the 97th Congress that would provide for such contributions.

We believe these three recommendations to be sound and politically attainable in the very near future.

The Commission's work represents, as we have admitted, a monumental effort. However, not enough was accomplished in many areas so that one could reasonably base decisions affecting the entire American population. There is still much to be explored. There was limited behavioral analysis and very limited analysis to assess overall economic and political implications. The tax analysis was limited at best as it related to many of the recommendations. Rather than being an objective presentation of facts, the report in many places takes on the tone of a highly political document. The foremost example of this political tone is the presentation on coverage and its identification as <u>the</u> greatest problem facing the retirement system. As presented, the coverage figures are misleading and do not lead the reader to a greater understanding of the American retirement income system.

The overall recommendations of the Commission, were they adopted, would have significant implications for the public and private sectors in (1) the cost of doing business, (2) the level of employment and new job creation, (3) the pattern of new business creation, (4) the scope of government regulation, (5) future prospects for government mandating of programs, (6) levels of overall Federal taxation, (7) distribution of tax incentives amongst and between government programs, (8) the proportion of gross national product dedicated to retirement income programs.

The recommendations set out a framework that has not been analyzed or conceptually tested. Before the nation moves to a major re-structuring of present programs, more must be known. We are dealing, after all, with the future of every American. Therefore, it is our recommendation that further study and analysis be made into the implications, factors, results of each of the recommendations made by the Commission. The most direct way in which this can be done is through the establishment of a reconstituted Commission or a new group appointed by the new Administration and Congress composed of experts with the knowledge of the statistical methods necessary to test each of these conclusions.

Ruth Sky
Governmental Affairs Associate

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June 15, 1981

The Honorable John H. Chafee
Chairman, Subcommittee on Savings,
Pensions and Investment Policy of
the Senate Finance Committee
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Chafee:

On May 15, 1981, in testimony before the Subcommittee on Savings, Pensions and Investment Policy of the Senate Finance Committee during hearings on the President's Commission on Pension Policy, the American Bankers Association (the ABA) requested legislation exempting bank-sponsored pooled investment funds for Keogh plans and Individual Retirement Accounts from regulation under the federal securities laws. The Investment Company Institute* respectfully submits the attached memorandum in opposition to the legislative proposal put forth by the ABA.

The Institute and its members have extensive experience and expertise relating to Keogh plans and IRAs. We actively participated in the legislative process which led to the enactment of the 1962 federal tax legislation which first permitted self-employed persons to establish Keogh plans, and in the enactment of the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) relating to Keogh plans and IRAs. The Institute and its members also participated in the legislative process which resulted in the 1970 amendments to the federal securities laws relating to pooled investment funds sold to retirement plans.

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* The Investment Company Institute is the national association to the American mutual fund industry. Its membership includes 574 open-end investment companies ("mutual funds"), their investment advisers and principal underwriters. Its mutual fund members have assets of about $180 billion, and have approximately 12 million shareholders.

Adoption of the ABA's proposal would give rise to the very abuses which Congress has sought to prevent -- the mass-marketing of interests in bank-sponsored pooled investment funds to hundreds of thousands of Keogh plans, IRAs and their individual participants without the protections afforded by the federal securities laws. Congressional hearings in the last Congress demonstrated that serious abuses currently are taking place with respect to bank collective investment funds sold to Keogh plans, and other retirement plans due to present exemptions from the federal securities laws. During those hearings, both the Securities and Exchange Commission and the Department of Labor testified in opposition to the ABA's proposal. Indeed, Congress repeatedly has declined to further exempt bank pooled investment funds from the federal securities laws.

The ABA's proposal must be viewed in light of a complete understanding of Keogh plans and IRAs. Most Keogh plans and IRAs tend to be very small and have very few participants: a recent Institute study indicates that the average Keogh plan has only 1.4 participants, and IRAs typically have only one participant. Many Keogh plans and all IRAs permit each participant, and not the employer, to select his or her own investments from among various alternative funding media. Many, if not most, Keogh plans and almost all IRAs are not covered by ERISA. More importantly, ERISA only seeks to protect a participant with respect to his or her plan; ERISA does not purport to protect Keogh plans, IRAs and their individual participants when they invest in pooled investment funds.

If the ABA's proposal is adopted, banks would be free to run aggressive advertising campaigns, using the types of advertisements attached as Exhibit A, advertisements which led a recent Chairman of the Senate Banking Committee to express "astonishment" over the present lack of SEC jurisdiction with respect to bank pooled investment funds sold to corporate retirement plans. Additionally, hard factual evidence (a study of the sales literature used by 17 banks pooled funds) indicates that the ABA proposal will have the affect of denying Keogh plans, IRAs and the participants in such plans adequate information on which to base their investment decisions. Finally, adoption of the ABA's proposal will deny participants in IRAs the substantive protections provided by the Investment Company Act of 1940.

For the reasons set forth above and in the attached memorandum, we strongly urge that the Subcommittee reject this latest attempt by the ABA to achieve repeal of the federal securities laws as they relate to bank-sponsored pooled investment funds sold to Keogh plans and IRAs.

We respectfully request that this letter and the attached memorandum be included in the hearing record.

We would be pleased to furnish any additional information which the Subcommittee or its staff may request.

Sincerely,

Will M. Tartikoff

William M. Tartikoff
Assistant Counsel

Attachments

MEMORANDUM OF THE
INVESTMENT COMPANY INSTITUTE
IN RESPONSE TO THE
AMERICAN BANKERS ASSOCIATION'S
PROPOSAL TO AMEND THE
SECURITIES ACT OF 1933 AND
THE INVESTMENT COMPANY ACT OF 1940
BEFORE THE SUBCOMMITTEE ON SAVINGS,
PENSIONS AND INVESTMENT POLICY
OF THE SENATE COMMITTEE ON FINANCE
JUNE 12, 1981

In testimony before the Subcommittee on Savings, Pensions and Investment Policy on May 15, 1981, the American Bankers Association (the ABA), in the guise of pension reform, requested legislation exempting bank-sponsored pooled investment funds sold to Keogh plans and Individual Retirement Accounts (IRAs) from regulation under the federal securities laws. For the reasons stated below, the Investment Company Institute* opposes the ABA's proposal.

In order to assess the ABA's proposed legislation, it is necessary to consider the legislative history of the securities laws as they relate to pooled investment funds sold to retirement plans; recent Congressional concerns regarding bank pooled investment funds sold to retirement plans; the nature of Keogh plans and IRAs and; the likely consequences of the adoption of the ABA proposal on Keogh plans, IRAs and the millions of individual participants in such plans.

The following discussion of each of these matters demonstrates that:

1. Congress amended Section 3(a)(2) of the Securities Act of 1933 (the 1933 Act) in 1970 in order to assure that participants in Keogh plans investing in pooled investment funds receive the disclosure protection of the 1933 Act.

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* The Investment Company Institute is the national association of the American mutual fund industry. Its membership includes 574 open-end investment companies ("mutual funds"), their investment advisers and principal underwriters. Its mutual fund members have assets of about $180 billion and have approximately 12 million shareholders.

2. When Congress enacted the Employee Retirement Income Security Act of 1974 (ERISA) permitting the creation of IRAs, it sought to provide IRA participants with both the disclosure protection of the 1933 Act and the substantive protections afforded by the Investment Company Act of 1940 (the 1940 Act).

3. Subsequent Congressional hearings have demonstrated that serious abuses are currently taking place with respect to bank pooled investment funds sold to corporate retirement plans due to the present exemptions for such funds from the federal secruities laws.

4. Congress repeatedly has declined to further exempt bank pooled investment funds for retirement plans from federal securities regulation.

5. Keogh plans, IRAs and their participants need the protections afforded by the federal securities laws since Keogh plans and IRAs tend to be small; many Keogh plans and all IRAs permit each participant to select his or her own investments; many, if not most, Keogh plans and IRAs are not covered by ERISA; and, in any event ERISA does not purport to provide the protections afforded by the federal securities laws.

6. Adoption of the ABA proposal would permit commercial banks to mass-merchandise interests in their pooled investment funds to Keogh plans, IRAs and individual participants in such plans through aggressive advertising campaigns without providing adequate disclosures on which the plans and their participants could base their investment decisions, and would deprive IRA participants of the substantive protections of the 1940 Act.

Legislative History of the 1970 Amendements to Section 3(a)(2) of the 1933 Act.

In 1955, the Federal Reserve Board first authorized national banks to form collective investment funds for the commingling of assets of corporate retirement plans managed by a bank. * Jurisdiction over these funds was transferred to the Comptroller of the Currency in 1962. The Comptroller's regulations prohibited the merchandising and advertising of interests in these funds to corporate plans.** Therefore, the Securities and Exchange Commission (the SEC) took the position that interests in these pooled funds were exempt from registration under the 1933 Act based on the private offering exemption.***

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 appeal to the Keogh market using interests in their pooled investment funds on an

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* 30 Fed. Reg. 3305 (1955).

** 28 Fed. Reg. 3312(1963); 12 C.F.R. §9.18(b)(5)(iv) (1964).

*** See SEC Memorandum 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 cited as 1963 Hearings): "The Commission has consistently take 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."

**** Pub. L. No. 87-792, 76 Stat. 809.

"assembly-line approach." * Since banks openly sought to mass-merchandise shares of their pooled investment funds to Keogh plans, the SEC naturally took the position that the shares had to be registered 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 bank pooled investment funds for corporate plans from registration. However, he opposed legislation which would have removed the SEC's disclosure jurisdiction over bank pooled investment funds for Keogh plans: "[Keogh] plans involve a complex

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* 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 involved 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 regualtion as the mutual fund itself?" Address of Chairman Ray Garrett, Jr., Before 55th National Trust Conferences, 15-16 (February 4, 1974).

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 Admendments of 1970, which adopted the pattern which the SEC had applied. Bank and insurance company pooled investment funds for corporate plans and Keogh plans were exempted from registration as investment companies (Investment Company Act of 1940, Section 3(c)(11)). Interests in pooled investment funds sold to corporate plans were exempted from registration under the Securities Act of 1933 (Section 3(a)(2)). But interests in pooled investment 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)):

> "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, 1960).**

<u>Legislative History of ERISA</u>

In 1974, Congress enacted ERISA which, <u>inter alia</u>, expanded Keogh plan contribution limits up to $7,500 a year. ERISA also expanded Keogh plans by permitting low-income

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* Statement of SEC Chairman Manual F. Cohen at Hearings Before the Senate Committee on Banking and Currency on Amendment No. 438 to S. 1659, 90th Cong. 1st Sess., at 1328 (1968).

** Other provisions in the 1970 legislation reflected special Congressional concern with pooled investment funds sold to 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.

self-employed persons to contribute 100% of earned income up to $750 to a "mini Keogh" plan. When it enacted these provisions expanding the use of and contributions to Keogh plans, Congress did not change the application of the 1933 Act to bank pooled investment funds sold to Keogh plans.

In addition, ERISA, for the first time, permitted individuals who are not covered by corporate plans or Keogh plans to establish and make tax-deductible contributions to IRAs. Congress made it clear that IRA participants need the full investor protections provided by the federal securities laws. Page 338 of the ERISA Conference Report stated: "The conferees intend that this legislation with respect to individual retirement accounts is not to limit in any way 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 bank pooled investment funds offered to IRAs (like interests in bank pooled investment funds for Keogh plans) must be registered under the 1933 Act and prospectuses must be given to prospective investors. In addition, bank pooled investment funds for IRAs are subject to the Investment Company Act of 1940.

It should be emphasized that ERISA was enacted to protect participants in employee benefits plans. However, ERISA does <u>not</u> attempt to regulate the matters covered by the federal securities laws. For example, ERISA seeks to provide a participant in a plan with <u>information concerning the plan itself</u>, by requiring that the participant receive a summary plan description and an annual plan report. However, when an employee benefit plan (or a participant in a plan) purchases shares in a pooled investment fund, be it a bank pooled investment fund, an insurance company pooled 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, IRAs and their participants with prospectuses describing the pooled fund. It is the federal securities laws, not ERISA, which limit the types of advertisements which

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* H.R. Rep. No. 93-1280, 93d Cong., 1st Sess. at p. 338.

sponsors of pooled investment funds can direct at Keogh plans, IRAs and their participants. It is the federal securities laws, not ERISA, which provide Keogh plans, IRAs and their participants with the right to sue sponsors of pooled funds for fraud and misrepresentations in connection with the purchase of shares of the pooled fund.

Subsequent Congressional Concerns With Bank Pooled Investment Funds for Retirement Plans

Since the enactment of the 1970 legislation which subjected bank pooled investment funds for Keogh plans to the 1933 Act registration requirements and the enactment of ERISA which subjected bank pooled investment funds for IRAs to the 1933 and 1940 Act, the ABA repeatedly has sought legislation which would remove these requirements. As the following chronology demonstrates, Congress not only repeatedly has declined to enact such legislation, but has reaffirmed SEC jurisdiction over bank pooled investment funds sold to Keogh plans and IRAs.

First, 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 IRAs from the federal securities laws. * The Subcommittee did not report out the legislation requested by the ABA.

Second, in 1978, the ABA testified before the Subcommittee on Oversight of the House Ways and Means Committee urging legislation exempting bank pooled investment funds for IRAs from the federal securities laws.** The Committee did not report out the legislation requested by the ABA.

Third, in 1978, major pension reform legislation, S. 3017, the ERISA Improvements Act of 1978, was introduced by the then Chairman, Senator Williams, of the Senate Committee on Human Resources and the ranking minority member Senator Javits. Section 274 of the bill contained a provision, suggested by

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* See Hearings on S. 249 Before the Senate Subcomm. on Securities, 94th Cong., 1st Sess. (1975), at 463-75.

** See Hearings on Individual Retirement Accounts and IRS Plan Termination Survey Before the Subcomm. on Oversight of the House Ways and Means Comm., 95th Cong., 2d Sess. (1978), at 191-93.

the ABA, which would have removed SEC jurisdiction over bank pooled investment funds sold to Keogh plans and IRAs. The provision was vigorously opposed by both the SEC and the Department of Labor. SEC Chairman Williams stated: "... 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 self-employed individual who wishes to establish an IRA."* Chairman Williams also added his support for continuing the protections afforded IRA participants by the 1940 Act.** Secretary of Labor Marshall stated:

> "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, <u>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 commingled funds."</u> (Emphasis added).***

The Investment Company Institute presented graphic evidence of the actual abuses which would take place if SEC jurisdiction over bank pooled investment funds for Keogh plans and IRAs was removed.****

First, we discussed abuses in <u>advertising.</u> As noted above, the SEC administratively had exempted interests in bank pooled investment funds sold to corporate plans from registration under the 1933 Act based on the private offering exemption (a position codified by Congress in 1970) at a time

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* Statement of SEC Chairman Williams, Joint Hearings on S. 3017 Before the Subcomm. on Labor of the Senate Comm. on Human Resources and the Subcomm. on Private Pension Plans and Employee Fringe Benefits of the Senate Comm. on Finance, 95th Cong., 2d Sess., at 347 (1978). (Hereinafter cited as 1978 Hearings).

** H.R. Rep. No. 93-1280, 93rd Cong., 1st Sess. at p. 354.

*** Submission of Secretary of Labor Ray Marshall to Honorable Harrison A. Williams, Jr., Chairman, Senate Committee on Human Resources, September 8, 1978, at 9.

**** Statement of the Investment Company Institute, 1978 Hearings, at 798.

when regulations of the Comptroller of the Currency prohibited merchandising and advertising of these pooled funds to corporate plans. However, after the SEC and Congress acted to exempt these interests from the 1933 Act, the Comptroller suddenly amended his regulations so as to permit national banks to advertise and publicize their pooled investment funds sold to corporate retirement plans.* We attached to our testimony representative advertisements being run by banks aimed at corporate retirement plans (similar advertisements are attached to this memorandum as Exhibit A), and stated that if bank pooled investment funds for Keogh plans and IRAs were exempted from the 1933 Act. "...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 out-performing the Dow Jones.'"**

Second, we discussed abuses in the area of disclosure. We stated that if bank pooled investment funds for Keogh plans and IRAs were exempted from the 1933 Act, banks would not be required by ERISA or the federal banking laws to provide Keogh plans and IRAs and their participants with prospectuses, but would be free to utilize any sort of sales material they desire. In order to demonstrate exactly what would occur if bank pooled investment funds for Keogh plans were exempted from the 1933 Act, we examined material which 17 banks provide to prospective Keogh plan investors concerning the banks' pooled investment funds (which take advantage of present exemptions from the 1933 Act since they allegedly are only offered to Keogh plans in one state).*** Our examination of

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* 37 Fed. Reg. 24161, at 24162 (1972).

** Statement of the Investment Company Institute, 1978 Hearings at 836.

*** These banks, which we selected on a randon basis, were: Bank of 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 & Trust Co. (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).

these documents was to determine whether Keogh plans and Keogh plan participants investing in these pooled 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 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, <u>every</u> mutual fund registered under the Investment Company Act must continuously provide all of this information to all prospective investors, including Keogh plans, and IRAs and their participants. Thus, this study of 17 bank pooled investment funds which are exempt from the 1933 Act demonstrated the point made by SEC Chairman Williams and Secretary of Labor Marshall--it is the federal securities laws, and not ERISA, which require sponsors of pooled investment funds to make disclosures to Keogh plans and plan participants concerning their pooled funds. We noted that the Federal Trade Commission's Bureau of Consumer Protection recently had issued a lengthy report critizing the inadequate disclosure provided to IRA participants who invest in product which presently are <u>not</u> subject to the federal securities laws (e.g., bank savings accounts and certificates of deposit).* We noted that exempting bank pooled investment funds for Keogh plans, and IRAs would place these Keogh plans, and IRAs and their participants in exactly the same position as the unprotected IRAs discussed in the FTC report.**

Third, following our testimony, we retained outside counsel to study the impact of the 1970 amendments which exempted bank pooled investment funds for Keogh plans from <u>substantive regulation</u> under the Investment Company Act. Counsel reviewed the operations of six bank-sponsored pooled investment funds for Keogh plans based on prospectuses on file with the SEC. The law firm's report (a copy of which is attached as Exhibit B) stated:

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* 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.

** Statement of the Investment Company Institute, 1978 Hearings, at 837-38.

"The study demonstrates that in many instances in the bank managers of these unregulated funds arrogate to themselves completely unfettered discretion to change investment policies and advisory fees without the consent of investors. The banks are also able to obscure their advisory fees by excluding them from disclosed expense ratios. The absence of 1940 Act regulation also allows the banks to delay honoring investor redemption requests, to avoid reporting to shareholders, and to use the fund's brokerage commissions without regulatory restrictions."

"Most important of all, the regulatory vacuum created by the exemption from 1940 Act regulation allows the banks to profit from self-dealing tranactions with their funds. Thus, banks can maximize the funds' interest-free deposits with the banks by delaying investments of new deposits and by keeping the funds' portfolios in a 'liquid position.' They also invest fund assets in certificates of deposit issued by their own banks. Such self-dealing would be illegal if the funds were registered under the 1940 Act. Thus, the study makes clear, notwithstanding registration under the Securities Act of 1933, disclosure by itself, even disclosure administered by the SEC, is not sufficient. It is the strongest evidence that protection of participants in managed investment funds requires 1940 Act regulation."

We believe that this study raises serious questions about the continued wisdom of exempting bank pooled investment funds for Keogh plans from the type of substantive regulation contained in the Investment Company Act of 1940.*

The testimony of the SEC and the Department of Labor and the evidence submitted by the Institute at the hearings on the 1978 bill evidently convinced the Chairman and the ranking minority member of the Senate Committee to conclude that, rather than decreasing federal regulation over bank pooled investment funds sold to employee benefit plans, legislation should be enacted <u>increasing</u> federal regulation in this area. In 1979, they reintroduced their bill as S. 209, the ERISA Improvements Act of 1979, and included a provision, Section 154, providing that, while the SEC was to lose its limited jurisdiction with respect to bank pooled investment funds sold to retirement

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* This problem is not limited to bank pooled investment funds sold to Keogh plans, but involves tens of thousands of <u>corporate</u> plans and billions of dollars. The American Bankers Association recently reported that bank pooled investment funds for corporate retirement plans had assets of $47.5 billion at year-end 1978. American Bankers Association 1980 "Collective Investment Funds Survey Report", at 7.

plans, the Secretary of Labor was to be mandated to prescribe regulations relating to advertising, disclosure and "such other standards as the Secretary may specify to protect plan participants and beneficiaries." Thus, bank pooled investment funds sold to corporate plans would, for the first time, have been subject to federal regulation in the areas of advertising, disclosure and substantive requirements. Federal regulation over bank pooled investment funds for Keogh plans would have been <u>expanded</u> to include substantive regulation.

SEC Chairman Williams testified that these provisions represented an improvement over the 1978 bill, but questioned the fragmentation of securities regulation between the Commission and the Department of Labor.* Secretary of Labor Marshall stated that, since the Department lacked expertise in this area and the SEC possessed such expertise, more study was needed in this area.** The Institute stated that, while the provision was a substantial improvement over the 1978 bill, securities type jurisdiction should be vested in the SEC, the agency expressly created by Congress to regulate securities matters.*** Following the hearings, the Senate Committee on Labor and Human Resources reported out the bill, deleting Section 154.

While the Committee did not report out a bill including provisions relating to bank pooled investment funds sold to Keogh plans, IRAs and other retirement plans, the legislative history of S. 3017 and S. 209 demonstrates that serious abuses are occurring in this area and that leading members of the Labor Committee were concerned with <u>increasing</u> federal regulation over these pooled funds, not with decreasing existing regulation.

This view is shared by other members of Congress and by two recent SEC Commissioners.

In 1978, the Institute testified 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. Our testimony called the Committee's attention to representative advertisements being run by banks for their pooled investment funds for corporate retirment plans. The following exchange took place between then Chairman Proxmire and the president of the Institute:

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* Statement of the Securities and Exchange Commission, Hearings on S. 209 Before the Senate Comm. on Labor & Human Resources, 96th Cong., 1st Sess. (1979), 657 at 658. (Hereinafter cited as 1979 Hearings).

** Statement of Secretary of Labor Marshall, 1979 Hearings, 124 at 199.

*** Statement of the Investment Company Institute, 1979 Hearings, 711, at 719-20.

"The Chairman. Has the SEC indicated any interest in this because they seem to be so blatant and so conspicuous, as you say: 'entering our second decade to outperforming the Dow Jones, 'Your fixed-income fund has got to deliver superior results, 'Its about time investment managers were judged on their success instead of their addresses,' in the Birmingham bank with a crow sitting on a directions sign, New York to Dallas, Atlanta and Birmingham, which is a great place. 'Your company's employee benefit plan can't profit from a bad fit.'

"These are all banks that have fine conservative reputations. Its astonishing that they can do this and the SEC has no authority, no jurisdiction, and they can do that in competition of course with your industry. It just doesn't seem to be logical at all. Either what the SEC is doing in restraining the [mutual fund] industry is wrong, which I think it is not--I think it's right--or the banks should be restrained on the same basis."

"Mr. Silver. I fully agree, Mr. Chairman."

"The Chairman. When you talk about competition, that obviously isn't fair competition."*

In 1979, the Chairman and other members of the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Banking Committee introduced legislation, H.R. 2747, which would have ended these abuses by prohibiting national banks from advertising and merchandising interests in their pooled investment funds to corporate retirement plans. In his testimony, SEC Chairman Williams called attention to the fact that Congress had exempted bank pooled investment funds for corporate retirement plans at a time when regulations of the Comptroller of the Currency prohibited merchandising and advertising, but that:

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* Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs on S. 72, 95th Cong., 2d Sess. (1978), at 348.

"In a sharp departure from this historical setting, however, regulations of the Comptroller of the Currency were recently amended to provide that general advertising prohibitions--which embodied the policies underlying the exemption provided in the Securities Act--are no longer applicable to collective investment trust funds maintained by banks for corporate pension funds. As a result, many banks have begun to market interests in those trust funds aggressively through general advertising about the investment performance of those corporate pension trusts. Although these bank trust funds compete with other collective investment media such as investment companies and insurance company separate accounts, which generally are subject to the registration provisions of the Securities Act, individual plan participants in the corporate pension plans purchasing interests in bank trust funds may be denied the protection afforded under the Securities Act to which they would be entitled if their corporate pension plan administrators had chosen to invest in these competing media."*

Chairman Williams also stated that:

"It would would be anomalous if all financial institutions offering investment advice to the general public, whether directly through publicly-solicited individual advisory relationships or indirectly through publicly-solicited collective investment management arrangements like investment companies, were not subject to the same regulatory requirements, the same fiduciary responsibilities, and the same degree of enforcement presence."**

Subsequently SEC Commissioner Friedman also indicated the bank pooled investment funds for retirement plans should be subject to <u>full</u> SEC regulation:

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* Statement of SEC Chairman Harold M. Williams Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs. Regarding H.R. 1539, H.R. 2747 and H.R. 2856, October 17, 1979, at 17.

** <u>Ibid</u> at 15-16.

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"In general, the Investment Company Act and the Investment Advisers Act should apply to bank investment management. Why should an independent investment manager who manages funds for pension funds and other institutions be regulated by the SEC as an investment adviser while a bank is not? Why should they be subject to different rules regarding their ability to advertise or their fiduciary obligations?

"If banks are managing an entity that is the functional equivalent of a mutual fund or a closed-end investment company there is no reason to have different rules regarding self-dealing, pricing, approval of investment management fees, and the like. The need for independent directors is as great as in a mutual fund complex. This is not simply a matter of competitive equity. The regulatory pattern for investment management is essentially sound. It responds to real problems that were rife in the investment company industry in the 1920's and were replicated in the REIT experience of the 1970s. Its logic and benefits are no less applicable to banks than to other investment managers.

"Moreover, it is not clear to me that all of the past regulatory compromises regarding the Securities Act of 1933 continue to make a lot of sense. In those plans in which the employee has an investment decision to make, the result looks very much like an investment company. Whether or not any of the employee's money is invested in the employer's securities would seem to have little to do with what ought to be the result in terms of disclosure."*

In summary, Congressional hearings since the enactment of the 1970 Amendments to Section 3(a)(2) of the 1933 Act and the enactment of ERISA in 1974 demonstrate that there now exists inadequate regulation with respect to bank pooled investment funds sold to Keogh plans and other retirement plans due to present exemptions from the federal securities laws.

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* Investment Management and the Glass-Steagall Act-the Emperor's New Clothes, Remarks to the Association of Bank Holding Companies, November 13, 1980, at 12-13.

Therefore Congress has repeatedly refused to enact legislation which would further reduce existing regulation in this area. We submit that the Congress should be extremely wary of enacting exemptive laws which decrease existing regulation, thereby opening the way to even greater abuses than presently exist.

In order to understand the impact of the ABA's proposed legislation on Keogh plans, IRAs and their millions of individual participants, it is necessary to understand some basic facts regarding Keogh plans and IRAs.

Nature of Keogh Plans and IRAs

(a) Keogh plans and IRAs tend to be very small and cover very few participants. In 1978, the Institute conducted a study of Keogh plans funded with mutual fund shares (which accounted for over 30% of all Keogh plans assets). We found that at year-end 1977, the average Keogh plan funded with mutual fund shares had assets of only $8,106 and only 1.4 participants. (In contrast, at year-end 1975, the average corporate plan had assets of $425,000 and 60 participants).* IRAs typically cover only one individual, and at year-end 1979, IRAs funded with mutual fund shares had, on the average, only $5,223 per account.

(b) Many Keogh plans and all IRAs, permit each participant (rather than the employer) to select his or her own investments from among various alternative funding media. Thus, in these cases, it is each participant, and not the employer, who selects the particular funding media for his or her own account.

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* Statement of the Investment Company Institute, 1978 Hearings, at 845. More recent information confirms the findings of our 1978 study. At mid-year 1980, the average Keogh plan funded with mutual fund shares has assets of only $16,013 and only 1.4 participants, with an average individual account size of $11,477. At mid-year 1980, the average individual Keogh account at mutual savings banks was even smaller, with assets of only $6,496. See Table 4, Analysis of Monthly Savings Bank Trends, National Association of Mutual Savings Banks, September 25, 1980.

(c) Many, if not most, Keogh plans and IRAs are not covered by Title I of ERISA.* ERISA, Title I, only applies to plans which cover employees.** Thus almost all IRAs are exempt from ERISA. Further, a Keogh plan which only covers a sole proprietor is not covered by Title I, and regulations also exempt a Keogh plan which only covers a sole proprietor and his or her spouse.*** In addition, regulations exempt a Keogh plan which only covers partners and not employees.****. Thus, given the small size of the average Keogh plan (1.4 participants), it is likely that many, if not most, Keogh plans are not covered by Title I of ERISA.

These basic facts concerning Keogh plans and IRAs--the small size of most Keogh plans and IRAs; the fact that many Keogh plans and all IRAs allow each participant to select his or her own investments; and the fact that all IRAS and many, if not most, Keogh plans, are not covered by ERISA--have an important bearing on the ABA's legislative proposal to exempt interests in bank pooled investment funds sold to Keogh plans, IRAs and their participants from the federal securities laws.

Consequences of Adopting the Proposed Legislation

If the proposal is adopted, commercial banks would be free to mass-merchandise interests in their pooled investment funds to thousands of Keogh plans, IRAs and individual participants in such plans without any restraints whatever imposed by ERISA, the federal banking laws or the federal securities laws.

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* Title I of ERISA contains the fiduciary, reporting and enforcement provisions of the law.

** ERISA §3(2)(A)

*** ERISA Reg. §2510. 3-3(c)(1)

**** ERISA Reg. §2510. 303(b). See, e.g., Securities Act Release No. 5989, an application filed by a Keogh plan employer for a Commission order exempting interests in its Keogh plan: "The Plan [only] covers the Applicant's partners... Applicant states that because the Plan covers persons, all of whom are employees [e.g. partners] within the meaning of Section 401(c)(1) of the Code, the Plan is not an "employee pension plan' under Title I of ERISA".

Banks would be free to run aggressive advertising campaigns using ads of the type attached hereto as Exhibit A. Thus, United Jersey Bank could run ads aimed at Keogh plans, IRAs and their participants stating "We're #1 nationally in investment performance"; Hibernia National Bank could advertise that it is "#1"; and The First National Bank and Trust Company of Tulsa could advertise that it has "First Place in the Pension Fund Playoffs."

Further, if the proposal is adopted, banks would be free to sell interests in their pooled investment funds to Keogh plans and IRAs without providing prospectuses and using any type of sales literature they desire. Our study of 17 bank-sponsored pooled Keogh funds (which take advantage of the intrastate exemption from the 1933 Act) demonstrates the disclosures (or rather the lack of disclosures) which will take place, Keogh plans, IRAs and their participants will not be provided with even the most basic information on which to base their investment decisions. They will not receive information concerning the fund's investment restrictions; the bank operating the fund; the officers and directors of the bank; the fees paid to the bank; the fund's policy with respect to buying and selling portfolio securities; and the amounts of brokerage commissions paid by the fund or to whom. In most cases, they will not receive any information regarding the fund's current financial statements or its current portfolio.

Finally, banks would be free to operate pooled investment funds for IRAs, in complete disregard of numerous provisions of the 1940 Act designed to prevent self-dealing transactions between the sponsoring banks and the pooled funds.

Conclusion

From the time that Congress first permitted self-employed individuals to establish Keogh plans covering themselves and their employees, through the enactment of ERISA, and as recently as 1980, Congress has been concerned that Keogh plans, IRAs and their individual participants receive the important investor protection provided by the federal securities laws. To achieve this result, Congress determined that interest in bank pooled investment funds sold to Keogh plans, IRAs and participants in such plans should be subject to the disclosure requirements of the Securities Act of 1933 and, in the case of IRAs, the substantive requirements of the Investment Company Act of 1940.

The evidence supports the determination made by Congress. Most Keogh plans and IRAs are small and have few participants. Many Keogh plans and all IRAs permit each participant, rather than the employer, to select his or her own investments from alternative funding media. All IRAs and many Keogh plans are not subject to Title I of ERISA, and, in any event, ERISA does not purport to protect Keogh plans, IRAs and their participants when they invest in pooled investment funds. The evidence also demonstrates that bank pooled investment funds which currently are exempt from the federal securities laws do not provide investors with adequate disclosures and are involved in serious self-dealing transactions.

This evidence explains why Congress repeatedly has declined, and continues to decline, to enact legislation exempting bank pooled investment funds for Keogh plans and IRAs from the protections afforded by the federal securities laws.

Exhibits A + B are in Finance Committee official files

SUPPLEMENTAL TESTIMONY OF HEARING HELD BY THE
HONORABLE JOHN H. CHAFEE, UNITED STATES SENATOR,
SUBCOMMITTEE CHAIRMAN, SENATE FINANCE COMMITTEE, ON MAY 15, 1981

TYPE OF INVESTMENT SAVINGS TO BE MADE ELIGIBLE
FOR INDIVIDUAL RETIREMENT ACCOUNTS ALLOWING AN INCOME TAX CREDIT

Submitted by: Emmett C. MacCubbin
Chairman of the Board
Home Mutual Life Insurance Company

Supplemental testimony of hearing held by the Honorable John H. Chafee, United States Senator, Subcommittee Chairman, Senate Finance Committee, on May 15, 1981.

TYPE OF INVESTMENT SAVINGS TO BE MADE ELIGIBLE
FOR INDIVIDUAL RETIREMENT ACCOUNTS ALLOWING AN INCOME TAX CREDIT

We heartily endorse the bill that you have introduced that would allow every worker with earned income to open an Individual Retirement Account and make tax deductible contributions up to $2,000 a year.

It is recommended that a tax credit be provided up to 15% of earned income or $2,000 a year, whichever is smaller, each and every year that earnings qualify. Also, it is desirable that there be some form of penalty for withdrawal prior to age 59½ and a requirement that funds must be withdrawn by age 70½.

Fixed payment retirement income endowments and annuities should be included among the vehicles eligible for this contribution toward pensions similar to what is now being eligible in HR10s.

Saving for retirement is a long-term endeavor and needs a systematic monitored method of saving rather than a hit-or-miss occasional deposit. Fixed payment retirement income endowments and annuities are ideallv suited for this purpose. The endowments provide full retirement benefits if they live to see the plan completed. The plan is automatically completed if the future retiree becomes disabled before age 65 or the beneficiary would receive cash or income in the event death occured prematurely. The future retiree can set up any frequency of payment that he or she desires, and receive a very important service of notification in advance of each payment and if a payment is missed. There are approximately 485,000 qualified life insurance agents to help provide continuity and assistance.

As you can see from the enclosed chart, of the 45.4% people who are eligible, earning between $15,000 and $20,000, only 5.5% have availed themselves to the opportunity to participate in an IRA. Fixed payment endowments or annuity plans can help alleviate this neglect.

There is also attached an Individual Retirement Account prospectus illustrating in detail the results if the worker lives or if he should die prematurely. There is also a detailed policy schedule to illustrate all aspects of this vehicle supplementing Social Security and/or other pension benefits.

The loss of tax revenue should be more than off-set by the reduction in the supplemental Social Security payments, welfare payments and the like.

I appreciate your including this as testimony in your hearing of May 15.

TABLE VII

PERCENTAGE OF PEOPLE WHO ARE ELIGIBLE WHO HAVE IRA'S BY INCOME CLASS, 1977

FAMILY ADJUSTED GROSS INCOME (IN DOLLARS)	PERCENTAGE OF PEOPLE WHO ARE ELIGIBLE	PERCENTAGE OF ELIGIBLE PEOPLE WHO HAVE IRA'S
0 - 5,000	85.0	.2
5,000 - 10,000	70.0	1.3
10,000 - 15,000	60.0	3.3
15,000 - 20,000	45.4	5.5
20,000 - 50,000	24.9	21.7
OVER 50,000	28.6	52.4

Source: President's Commission on Pension Policy

If You Live
... money for you!

CASH for you at age 65 of . . . $ 91,623.69

Your total contribution to age 65 . . $ 60,000

less total TAX SAVINGS to age 65 $ 19,952 †

NET contribution . . . . $ 40,048.00

DIFFERENCE to age 65 of . . . . $ 51,575.69

or **INCOME** every month for Life of . . . . $ 592.65

+ Will be increased by higher tax rates
' Will be decreased by non-deductible risk cost.

If You Die
... money for them!

CASH for your family of not less than . . . . $ 59,265.00

or **INCOME** every month of . . . . . . $ 568.91

for a period of . . 10 Years

which makes a total of . . . . . $ 68,269.20

1. P O L I C Y   S C H E D U L E

*******POLICY INFORMATION SECTION*******

POLICY ISSUED AT MALE AGE 25 NEAREST BIRTHDAY.

POLICY CLASS IS STANDARD.

POLICY OWNER IS INSURED.

PREMIUM PAYMENT MODE IS ANNUAL.

P R E M I U M   E F F E C T I V E   D A T E S

BEGINNING ON	TOTAL ANNUAL PREMIUM
NOV 05, 1980	$1,500.00

POLICY MATURES ON NOV 05, 2020

POLICY LOAN INTEREST RATE IS 5.00% PAYABLE IN ADVANCE

POLICY PAGES: 02135.1, 02001.1, 02002.1, 02003.1, 02304.1, 02218.1, 02248.1, APP.

AGENT

POLICY NUMBER	INSURED
8888888	
DATE OF ISSUE	AMOUNT OF INSURANCE
NOV 05, 1980	$59,265

2. P O L I C Y S C H E D U L E

* * * * * * * * * * * * B E N E F I T S E C T I O N * * * * * * * * * * * *

POLICY NUMBER 8888888
MALE AGE 25

	INITIAL DEATH PROCEEDS*	ANNUAL PREMIUM	PAYABLE FOR
PARTICIPATING ENDOWMENT INSURANCE POLICY FOR 40 YEARS	$59,265	$1,500.00	40 YRS

RETIREMENT INCOME AT AGE 65 IS $592.

*SEE PROCEEDS AND GUARANTEED VALUES SECTION FOR SUBSEQUENT YEARS PROCEEDS.

3\. POLICY SCHEDULE

PROCEEDS AND GUARANTEED VALUES SECTION

PARTICIPATING ENDOWMENT INSURANCE POLICY FOR 40 YEARS

POLICY NUMBER B888888
MALE AGE 25

IF ALL PREMIUMS DUE HAVE BEEN PAID ---
THE GUARANTEED POLICY VALUES WILL BE ---

AT THE BEGINNING OF POLICY YEAR	THE TOTAL PROCEEDS WILL BE	ON NOV. 05	CASH VALUE	PAID-UP INSURANCE	$59,265** EXTENDED TERM INSURANCE TO
1	$59,265	1981	-0-		
2	$59,265	1982	$410.11	$1,126	JUN 27, 1985
3	$59,265	1983	$1,712.76	$4,622	DEC 08, 1994
4	$59,265	1984	$3,055.11	$7,941	JAN 06, 2002
5	$59,265	1985	$4,437.76	$11,260	FEB 08, 2007
6	$59,265	1986	$5,861.90	$14,460	JAN 21, 2011
7	$59,265	1987	$7,329.30	$17,601	APR 29, 2014
8	$59,265	1988	$8,840.56	$20,683	FEB 18, 2017
9	$59,265	1989	$10,397.45	$23,706	AUG 18, 2019
10	$59,265	1990	$12,001.16	$26,609	$2,548*
11	$59,265	1991	$13,651.69	$29,454	$7,704*
12	$59,265	1992	$15,350.23	$32,299	$12,683*
13	$59,265	1993	$17,097.36	$34,966	$17,483*
14	$59,265	1994	$18,894.27	$37,633	$22,165*
15	$59,265	1995	$20,740.38	$40,240	$26,729*
16	$59,265	1996	$22,638.64	$42,789	$31,055*
17	$59,265	1997	$24,589.64	$45,278	$35,322*
18	$59,265	1998	$26,595.76	$47,708	$39,411*
19	$59,265	1999	$28,659.96	$50,078	$43,382*
20	$59,265	2000	$30,785.20	$52,390	$47,175*
21	$59,265	2001	$32,972.68	$54,642	$50,849*
22	$59,265	2002	$35,227.12	$56,894	$54,405*
23	$59,265	2003	$37,550.30	$59,087	$57,843*
24	$59,265	2004	$39,947.57	$61,280	$61,102*
25	$59,265	2005	$42,423.07	$63,413	$64,303*
26	$59,265	2006	$44,982.14	$65,547	$67,325*
27	$59,265	2007	$47,630.69	$67,621	$70,229*
28	$59,265	2008	$50,375.84	$69,695	$73,014*
29	$59,265	2009	$53,226.49	$71,769	$75,622*
30	$59,265	2010	$56,191.52	$73,844	$78,171*

(CONTINUED ON NEXT PAGE)

3. P O L I C Y   S C H E D U L E

P R O C E E D S   A N D   G U A R A N T E E D   V A L U E S   S E C T I O N

PARTICIPATING ENDOWMENT INSURANCE POLICY FOR 40 YEARS — POLICY NUMBER B888888, MALE AGE 25

IF ALL PREMIUMS DUE HAVE BEEN PAID ---

AT THE BEGINNING OF POLICY YEAR	THE TOTAL PROCEEDS WILL BE	THE GUARANTEED POLICY VALUES WILL BE --- ON NOV. 05	CASH VALUE	PAID-UP INSURANCE	$59,265** EXTENDED TERM INSURANCE TO
31	$59,283	2011	$59,282.19	$75,918	$80,541*
32	$62,466	2012	$62,465.90	$77,933	$81,845*
33	$65,746	2013	$65,745.04	$79,889	$83,090*
34	$69,122	2014	$69,121.95	$81,785	$84,275*
35	$72,601	2015	$72,600.81	$83,622	$85,460*
36	$76,184	2016	$76,183.97	$85,400	$86,705*
37	$79,875	2017	$79,874.40	$87,119	$87,890*
38	$83,676	2018	$83,675.66	$88,719	$89,075*
39	$87,591	2019	$87,590.71	$90,260	$90,379*
40	$91,624	2020	$91,623.69	$91,623	$91,624*

NON-FORFEITURE FACTOR 1364.077613

INTEREST RATE FOR RESERVES AND VALUES IS 3.00%

*EXTENDED TERM INSURANCE TO NOV 05, 2020 PLUS PURE ENDOWMENT IN THE AMOUNT SHOWN PAYABLE ON THE SAME DATE.

NONE OF THE ABOVE FIGURES INCLUDE ANY DIVIDENDS LEFT AT INTEREST, ANY PAID-UP ADDITIONS, OR ANY DIVIDENDS DUE AND UNPAID.
ANY LOAN OUTSTANDING WILL DECREASE THE AMOUNTS SHOWN.

**IF CASH VALUE IS LARGER, AMOUNT OF EXTENDED TERM INSURANCE WILL BE THE CASH VALUE.

STATEMENT OF POLICY COST AND BENEFIT INFORMATION

HOME MUTUAL LIFE INSURANCE COMPANY
CENTRE STREET AT PARK AVENUE, BALTIMORE, MARYLAND 21201
TELEPHONE (301) 685-7111

POLICY NUMBER: B888888 DATE PREPARED: NOV 12, 1980

AGENT NAME: --

DISTRICT ADDRESS: --

INSURED'S AGE AND SEX: 25 MALE

BASE POLICY: PARTICIPATING ENDOWMENT AT AGE 65 POLICY WITH ADDITIONAL CASH VALUES PAYABLE FOR AGE 65.

* * * * * * * * SCHEDULE OF ANNUAL PREMIUMS * * * * * * * *

TYPE OF COVERAGE	BEGINNING OF POLICY YEARS 1 THRU 5	10	20	AGE 65
BASE POLICY	1,500.00	1,500.00	1,500.00	CEASED
TOTAL	1,500.00	1,500.00	1,500.00	0.00

* * * * * * * * SCHEDULE OF DEATH BENEFITS * * * * * * * *

BEGINNING OF POLICY YEAR	BASE POLICY
1	59,265
2	59,265
3	59,265
4	59,265
5	59,265
10	59,265
20	59,265
AGE 65	MATURED

POLICY NUMBER: 8888888

* * * * SCHEDULE OF CASH SURRENDER VALUES AND DIVIDENDS * * * *

END OF POLICY YEAR	CASH SURRENDER VALUE	CASH DIVIDENDS*
1	0.00	0.00
2	410.11	48.00
3	1,712.76	51.56
4	3,055.11	56.30
5	4,437.76	60.45
10	12,001.16	84.16
20	30,785.20	152.31
AGE 65	91,623.69	423.15

* DIVIDENDS ARE BASED ON THE CURRENT DIVIDEND SCALE OF THE COMPANY AND ARE NOT GUARANTEED.

POLICY LOANS UP TO THE AMOUNT OF CASH SURRENDER VALUE ARE AVAILABLE. INTEREST ON THE LOAN AMOUNT IS 5.00% ANNUAL, PAYABLE IN ADVANCE.

* * * * * * COST COMPARISON DISCLOSURE INFORMATION * * * * * *

	END OF 10 YEARS	20 YEARS
LIFE INSURANCE SURRENDER COST INDEX	9.08	9.08
LIFE INSURANCE NET PAYMENT COST INDEX	24.41	24.04
EQUIVALENT LEVEL ANNUAL DIVIDEND	0.90	1.27

AN EXPLANATION OF THE INTENDED USE OF THE COST INDEXES AND THE EQUIVALENT LEVEL ANNUAL DIVIDEND IS INCLUDED IN THE LIFE INSURANCE BUYER'S GUIDE.

UNCONDITIONAL REFUND

THIS POLICY, IF NOT SATISFACTORY, MAY BE RETURNED TO THE COMPANY OR ITS AGENT WITHIN TWO WEEKS AFTER RECEIPT BY THE OWNER. ALL PREMIUMS PAID WILL BE REFUNDED.

ORDINARY ISSUE PREMIUM HISTORY CARD PRINTOUT

NAME | ADDRESS | FOLIO | AGT NO

MD

00000

POLICY NO. AGE INSURED

MODE PAY

8888888 25

ANNUAL (1)

DATE OF POLICY DATE OF BIRTH

11/05/1980 04/23/1956

PLAN RIDERS

SI65

NUMBER OF UNITS

FPB ADB

AMOUNT OF INS. SEX

59,265 M

AMOUNT OF INS. CR.

46,500

MODE PREMIUMS

LIFE	1,500.00
FPB	.00
WP/PB-LIFE	.00
WP-FPB	.00
ADB	.00
IO	.00
IO-WP	.00
TOTAL	1,500.00

RATINGS

TABLE FLAT
IO WP/PB .
ADB

DIV. OPT. NONF. OPT.

ACCM (4) APL (1)

AGENT NAME

OWNER NAME SEX

COMMISSIONS

%	.00	1ST
%		REN
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%		BRKR

OFF DATES

LIFE-PREM 2020
LIFE-BEN 2020
TERM CONV
FPB-BEN
FPB-PREM
WP/PB-LIFE
WP-FPB
ADB-PREM
ADB-BEN
IO-PREM
IO-BEN
IO-WP
TAB RATE
FLAT RATE

ANNUAL PREMIUM

1,500.00

EXTRA PREMIUM

.00

Supplementary Statement

of

The ERISA Industry Committee (ERIC)

to the

Subcommittee on Savings, Pensions and Investment Policy

of the

Senate Finance Committee

on the

President's Commission on Pension Policy

FINAL REPORT

June 19, 1981

ERISA Industry Committee (ERIC)

SUITE 500 □ 1919 PENNSYLVANIA AVENUE, N.W. □ WASHINGTON, D.C. 20006 □ (202) 833-2800

Supplementary Statement Of

The ERISA Industry Committee (ERIC)

on the

President's Commission on Pension Policy

FINAL REPORT

The ERISA Industry Committee (ERIC) is an association of some 100 major employers concerned with employee benefit issues. Its 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.

On May 15, 1981, ERIC presented testimony to the Subcommittee on two issues in the Final Report of the President's Commission on Pension Policy, namely, incentives for individual retirement savings and the mandatory pension proposal. In that statement ERIC also addressed certain impediments to growth of the private pension system which could be resolved by a simplification of present ERISA requirements. On February 24, 1981, ERIC also presented testimony to the Subcommittee concerning incentives for individual retirement savings.

This statement supplements ERIC's prior testimony with comments on other subjects contained in the Final Report, including retirement income goals, spousal benefits, ownership and control of pension fund assets, retirement policy administration and inflation.

Retirement Income Goals

The Commission has recommended that replacement of pre-retirement disposable income from all sources is a desirable retirement income goal.

The replacement rates that are illustrated in the Final Report require further analysis, even though the recognition of pre- and post-retirement taxes, reduced work-related expenses, and reduced need for retirement income saving is appropriate. For example, more than 70% of those beyond age 65 live in their own homes, and 80% of those homes require no additional mortgage payments. Home ownership is a form of retirement income saving that should be recognized.

We regret the Commissioners did not recognize the need to analyze the cost implications of this recommendation. A fundamental economic question is whether our country can afford to allocate the resources necessary to meet the standards recommended.

The long-term rises in the proportion of our country's population that is at the older ages will require an ever expanding share of our resources to be allocated to retirement income.

In the case of the pay-as-you-go Social Security program, existing benefit promises alone will require substantially increasing payroll tax rates. As an indication of the level of resources that will need to be allocated, the office of the Actuary recently determined that, if Social Security were required to meet the minimum funding standards applied by ERISA to private plans, the required contribution would be more than 24% of taxable payroll for the cash benefit portion of Social Security alone. Additional taxes would be required to finance the hospital insurance portion.

In essence, we concur with the Additional Views of Commissioner William C. Greenough in the Final Report:

> "The Commission believes that the replacement of preretirement disposable income from all sources is a desirable retirement income goal. A pleasant goal to contemplate - yes; a realistic one - no. If accomplished, it would mean that a large number of people would live in retirement better than they ever had before except just prior to retirement. Fairness in our society means balancing fairness to young families at lower early earnings who are buying homes and educating their children while paying for Social Security, as well as fairness to the retired."

Spousal Benefits

The Final Report includes recommendations on spousal benefits, with emphasis on issues relating to divorced spouses of employees. Changes in the law surrounding postretirement survivor protection under pension plans are proposed. The Final Report states that in cases of separation or divorce, the pension "entitlement" earned during marriage should be divisible. The Commission leaves to courts to decide how to divide such pensions "entitlements" upon divorce.

Historically, pensions have been considered a private right and spousal rights in marital dissolutions have been left to the parties to resolve in the context of state law. Federal courts have repeatedly declined jurisdiction over divorces that did not raise a Federal question. Under present law, state courts have discretion to review the special circumstances of each divorce case and to render decisions in the light of all the facts surrounding such cases. Any change in this policy would infringe on an area that we believe is correctly reserved first to private decision and then to the state courts to decide in case of dispute.

The Final Report proposes that survivors of employees who die before retirement with a vested benefit receive survivor benefits, either under the pension plan or through life insurance. The choice of vehicle recognizes that, in general, pension plans are designed to provide pensions, that life insurance plans are designed to provide death benefits, and that survivor benefits are in essence death benefits, not pensions. However, care must be taken not to create a federal requirement that all employers who provide pensions provide death benefits, whether or not through life insurance. Even in enacting ERISA, the federal government was careful not to require employers to provide any type of benefit. Government should not interject itself into the dynamics of employee relations and labor-management collective bargaining by mandating specific benefits.

Ownership and Control of Pension Fund Assets

The Final Report recommends that issues related to the ownership, control, and investment of pension fund assets, including questions of non-traditional investment criteria, should be further investigated by a new Presidential Commission and by Congress. We believe that the primary objective of pension plan funding and asset investment is to ensure that workers will have financial security in retirement. This is itself a social objective of the highest importance, and the achievement of this objective should not be compromised or diluted by the introduction of other and conflicting objectives requiring that plan assets be applied to promote other interests.

The effect of investment returns of plan assets is distinctly different for the two major types of plans. In defined contribution plans, investment results directly affect plan benefits, and the affect upon plan participants is direct and visible. In defined benefit plans, investment results flow directly to the plan sponsor's obligation to make sufficient contributions to the plan to pay the promised benefits. The effects upon plan participants is therefore less direct and less visible, but nonetheless real in determining how well the plan sponsor can continue the plan, pay promised benefits, and improve the plan in the future.

Those who advocate control of plan assets by plan participants (or their representatives) typically assert that other substantial benefits can be obtained, whether for participants, other employees, or industry, with little or no sacrifice of investment return on the assets. This is highly improbable. Pursuit of such objectives abuses the fiduciary principle of undivided loyalty to the interests of all participants in a plan, and will generally impact investment return adversely. Dictating investments for the purpose of increasing employment opportunities for active participants can prove to be costly to the interests of retired participants if investment results are adverse. Similarly, exclusionary investment rules can result in quantifiably lower-than-average investment returns, thereby undermining the productivity of plan assets needed to secure benefits, improve benefits, and facilitate inflation adjustments.

Those who seek to control plan assets would be on firmer ethical and legal ground if the purpose were to improve investment returns, particularly if such control were to be exercised by well-qualified and competent investment managers. Even so, satisfactory investment returns cannot be assured, and it should be recognized that control of pension plan assets by other than qualified investment managers must be expected to result in inferior investment results, thereby reducing benefits for defined contribution plans, or reducing the plan sponsor's willingness to increase benefits for defined benefit plans.

· Moreover, whatever the type of plan, the ones who make the basic investment decisions are the ones best qualified to vote the proxies of common stocks, and all other investment-oriented subjects.

Administration

We concur with the Commission on the effectiveness of recent efforts to improve the Executive Branch administration of ERISA.

During the past three years, various proposals have been advanced to alter the regulation of the private employee beenfit system. Suggestions have been offered to reduce delays in issuing regulations, opinions, and exemptions as well as to eliminate excessive paperwork burdens on plan administrators. Hearings have been held in the House and Senate, a variety of legislative proposals have been introduced, and a comprehensive study was undertaken by the Carter Administration. At the heart of these proposals have been recommendations to consolidate within a single agency the responsibility for certain regulatory functions which are now carried out by several agencies.

The principal problems of multiple jurisdiction arose immediately after passage of ERISA, and in large part were associated with the creation of new offices within the Labor and Treasury Departments and the implementation of entirely new legislation. Many of these problems, particularly the paperwork burdens, have been reduced significantly by the elimination of duplicative filings as well as by improved coordination between the agencies. Moreover, DOL, Treasury, and the PBGC have developed greater expertise in their respective areas, and this has resulted in more effective and efficient administration of the ERISA program.

More specifically, Reorganization Plan No. 4 of 1978 more clearly divided certain ERISA regulatory responsibilities between the Labor and Treasury Departments. Generally, the Plan gives to Labor rulemaking responsibility for fiduciary matters, and to Treasury responsibility for participation, vesting and funding standards.

This realignment of responsibilities has clearly helped to moderate overlapping jurisdiction and to simplify the implementation of ERISA. Generally, substantial progress has been made to reduce delays in issuing regulations and in processing application for prohibited transaction exemptions. President Carter's January 1980 Report to the Congress */ concluded that:

> The Reorganization Plan has significantly alleviated the problems in ERISA administration to which it was addressed: the processing of applications for exemptions from prohibited transaction provisions and the issuing of regulations. In addition, there have been substantial further reductions in the paperwork burden associated with the Act, and the Department of Labor and Department of the Treasury have begun cooperative agreements to improve the coordination of their field enforcement activities.

The improved coordination resulting from Reorganization Plan No. 4 created a greater certainty among plan sponsors concerned with ERISA compliance, and the problems attributed initially to multiple jurisdiction have, in the main, been resolved and are no longer of major concern to plan sponsors.

In addition, we believe the creation of a new "super" agency would not eliminate the role of Treasury and Labor in employee benefit administration. It would require a further difficult realignment of responsibility and would add yet another

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*/ Study of the Administration of ERISA, Report to the Congress, OMB, Executive Office of the President, January 1980.

agency which would have the counterproductive effect of resurrecting many of the startup and transfer of responsibility problems that generated the single agency proposal.

Inflation

This is the most important subject facing the nation as well as the private retirement system. The Interim Report correctly stated that "Effective national economic policy provides the only true protection for retirees against prolonged high rates of inflation," but it is disappointing that the Final Report does not develop this subject.

It is a fundamental obligation of the federal government to provide a stable currency which will make it possible for individuals to plan and provide for their own financial future. Curing inflation would eliminate the subject of indexing pension benefits, and would eliminate the escalation of pension costs caused by inflation's erosion of plan assets.

National action to bring inflation under control is essential, not only to all participants in private retirement plans but to all who save and invest. Retirement income goals will never be met if our entire economic system must continue to be based on a dollar that declines in value by 50% in five years, and by almost 90% over the fifteen-year life expectancy of the average retiree.

Federal Pensions

The Commission has recommended that federal pensions be adjusted on the basis of the lesser of average federal wage increases or increases in the CPI. We concur with this recommendation and further recommend that this type of approach be adopted for Social Security. If the 1977 Amendments to the Social Security Act had provided that benefits be increased by the lower of wage or price increases, cash flow problems would not have developed under the program. If future benefit increases were so limited, we believe this would provide the program with substantial protection from adverse economic conditions.

* * *

POSITION STATEMENT

OF

THE ELECTRONIC INDUSTRIES ASSOCIATION

ON THE

MINIMUM UNIVERSAL PENSION SYSTEM

AS RECOMMENDED BY THE

PRESIDENT'S COMMISSION ON PENSION POLICY

The EIA, representing 350 companies that employ more than 1½ million workers, voices its strong opposition to the recommendations by the Commission on Pension Policy that the federal government establish and administer a Minimum Universal Pension System for all workers.

EIA believes that the establishment of a universal pension system would seriously affect or destroy the wide range of private retirement and pension plans that have been voluntarily established by employers, employees, financial institutions, and insurance companies. It would establish unreasonable eligibility and benefit levels on an employer without regard to an individual employer's profitability, the age and size of the company and its workforce, the firm's capital investment needs, and the degree of competition that the firm faces.

Our member companies believe that each individual firm makes its own decision to establish and manage a private pension or retirement program using appropriate funding and actuarial services in the best interest of its employees under existing laws.

Employers are already excessively burdened with government regulation, and to further impose another governmental pension system on the private sector would be a backward step. We of EIA believe that government's role is to encourage employers in the private sector to voluntarily establish pension or retirement programs by providing tax incentives or credits. Where an employer is not able to establish a pension program for its employees, then a tax deduction or tax credit should be provided to individual employees who voluntarily elect to establish Individual Retirement Accounts for their own future retirement income security.

ELECTRONIC INDUSTRIES ASSOCIATION • 2001 EYE STREET, N.W. WASHINGTON, D.C. 20006 • (202) 457-4900
TWX: 710-822-0148

May 13, 1981

MEMORANDUM

TO: EIA Executive Staff

FROM: Tom Patton T.P.

SUBJECT: EIA Position, Pension Policy

The subject position statement, prepared by the Industrial Relations Council, was submitted to the Senate Finance Committee for the record of that committee's hearings on the report by the President's Commission on Pension Policy. The report calls for a mandated minimum universal pension system for all workers. EIA is opposed.

ELECTRONIC INDUSTRIES ASSOCIATION • 2001 EYE STREET, N.W. WASHINGTON, D.C. 20006 • (202) 457-4900
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PROFIT Sharing Council

May 27, 1981

Honorable John H. Chafee
Chairman, Subcommittee on Savings,
Pensions and Investment Policy
Committee on Finance
United States Senate
2227 Dirksen Senate Office Bldg.
Washington D.C.

Dear Senator Chafee:

Pursuant to your notice of April 30, 1981, the following comments on the President's Commission on Pension Policy Report entitled "Coming of Age: Toward a National Retirement Income Policy" are filed for incorporation in the record of your Subcommittee hearing which was held on May 15, 1981.

The Profit Sharing Council of America (hereinafter referred to as the "Council") is a non-profit association of approximately 1,400 employers who have established and maintain profit sharing plans covering some 1,750,000 employees. Council members are located throughout the United States, and are engaged in practically all areas of economic activity. The Council's functions include the promotion of the concept of profit sharing and the development of communication materials/technical information to help companies obtain maximum benefits from profit sharing for employees and employers alike.

General Comments

Before setting forth the specific objections of the Council to the Report of the President's Commission on Pension Policy, the Council wishes to offer a comment on the apparent failure of the Commission to recognize deferred profit sharing plans as an important source of retirement income to a substantial segment of the working population.*/ Approximately 14 million employees are participants in qualified deferred profit sharing plans and more than $50 billion is held in trust for these participating employees.

The Council is concerned that the Commission may have overlooked this large source of retirement income. Seemingly, they also overlooked thrift and savings plans, stock bonus plans, ESOPs and TRASOPs.

*/ "Deferred" profit sharing plans are to be distinguished from "cash" profit sharing plans. Under a cash plan distributions are made currently to the participating employees and, except for whatever retirement savings the individual may make, have no bearing on the subject of a national retirement income policy.

The amounts contributed annually to profit sharing trusts are allocated to the employees on a nondiscriminatory basis. These contributions, together with the investment earnings and gains, are distributed to the employee participants at retirement, death or disability -- events which were of concern to the Commission in its study.

Representatives of the Council appeared before the Commission on several occasions. In addition, the Council filed several papers with the Commission prepared jointly by the Council and the Profit Sharing Research Foundation. Copies of two of these statements are enclosed with the request that they be made part of the record of the hearings of your Subcommittee.

Specific Objections

In addition to the foregoing general observations, the Council is particularly opposed to two of the recommendations of the Commission. Briefly, the objections are these:

(1) Minimum Universal Pension System. -- The Council is opposed to the recommendation that a Minimum Universal Pension System (MUPS) be established for all workers and funded by employer contributions equal to 3% of payroll. It must be a defined contribution plan and must have full and immediate vesting. There are several reasons why the Council is opposed to MUPS.

(a) The establishment of MUPS would unduly complicate the retirement framework. Retirement income security is now provided by the Federal Social Security program and by private plans established by employers, either unilaterally or through collective bargaining. The Social Security System is in financial difficulty at this point and it appears that substantial readjustments will be required to put the program back on a sound financial footing. So far as private plans are concerned the complicated requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA) are still a source of confusion even though the statute has been in effect for over six years. The addition of a new type of retirement program such as MUPS, which differs in material respects from both the Social Security System and the pattern of private plans, will unduly complicate matters for both the Government and private employers. Features of the proposed MUPS allow for administration through the Social Security Administration at the employer's election. In view of the existing strain on Social Security, such an added responsibility is not warranted.

(b) The imposition of a mandatory pension plan on employers will discourage the development of new private plans and the improvement of existing plans. If employers are compelled by law to establish a retirement system with a prescribed fixed minimum contribution, they will tend to create plans providing no more than such a prescribed minimum. The level of contributions required by MUPS (3% of compensation) is far below the level of most deferred profit sharing plans according to the Council's 1980 annual survey of its members. The 1980 survey (based on 1979 experience) shows that the average contribution for all types of deferred profit sharing plans was 9.84% of compensation. It is interesting to note that the small companies (with under 100 employees) contributed 10.58% of compensation, on average, compared to 6.66% for companies with 5,000 or more employees. The somewhat smaller contribution by large employers is probably accounted for by the fact that such employers are apt to have pension plans as well as deferred profit sharing plans. It is quite obvious that the encouragement of new profit sharing plans will result in more liberal retirement benefits than MUPS would provide.

(c) There is no reason to legislate a mandatory retirement income program because the private system is expanding and can be expected to continue to cover new participants each year. A voluntary expansion of pension coverage is far preferable to one imposed by law.

The growth of private retirement plans in the United States has been nothing short of spectacular. According to the Report of the Senate Committee on Labor and Public Welfare accompanying S.4 (Sen. Rep. No. 93-127, 93rd Cong., 2nd Sess.), an estimated 4,000,000 employees were covered by private pension plans in 1940. By 1950 the figure had more than doubled; in 1960 over 21,000,000 employees were covered, and in 1973 approximately 30,000,000 workers participated. Indeed, the rapid growth in the pension area was the very basis for Congress to exert regulatory control over the plans.

With the enactment of ERISA there was understandably a slow-down in the growth of plans in the private sector, due undoubtedly to the complexities imposed by that law. However, the figures issued by the Internal Revenue Service on the number of plans of all types approved over the years show that the number of new plans being created has again picked up and, in fact, exceeds the pre-ERISA rate. Those figures show that for the calendar year 1978 there were 64,439 new profit sharing and pension plans approved covering 2,418,427 employees; for the year 1979, 55,963 new plans covering 1,487,212 employees; and for the year 1980, 68,806 new plans covering 2,739,454 employees. The figures demonstrate that there are a sizeable number of plans being created and a sizeable number of employees are being covered each year.

The Commission's conclusions on coverage and growth of plans are open to question. The interim report of the Commission issued in November 1980 stated that 58% of the private sector work force meeting the minimum age and service requirements of ERISA was participating in a pension plan. The report went on to state that pension plan coverage has remained static and that preliminary forecasting predicts very slow growth in coverage over the decade until 1990. It is submitted that the Internal Revenue Service figures do not bear out the conclusions of the Commission.

It is also relevant in this connection to note the remarks of Mr. Dallas Salisbury, Executive Director of the Employee Benefit Research Institute, before the Subcommittee on May 15, 1981. Mr Salisbury's testimony was directed in part to the conclusions of the Commission with respect to coverage and growth of plans. He pointed out that, after excluding employees not normally expected to be in employer-sponsored plans, 74% of the relevant work force is currently covered by retirement programs. The testimony also points out some shortcomings in the Commission's research and that, on the basis of the study done by the Employee Benefit Research Institute, the coverage of employees in the private sector may be expected to reach 83% by 1995, a sizeable increase over that predicted by the Commission.

It is quite obvious that the question of growth of coverage in the private sector is a key question in considering a mandatory pension system. It is equally obvious that the Subcommittee should not accept the conclusions reached by the Commission without further investigation.

(2) Prohibition on Lump Sum Distributions. __ The Council objects to the Commission's recommendation that all cash-outs of pension benefits over $500 be prohibited unless transferred to an IRA or to the plan of a subsequent employer.

It is submitted that the Commission's recommendation would operate to the detriment of the employee by restricting the ability of the employee to plan for retirement in the best financial way. The employee should not be denied the opportunity to receive a lump sum distribution if that best suits his financial situation at retirement. It is submitted that the employee, not the Government, is the only one in a position to make such a determination.

There are valid reasons for distributing an employee's account at retirement in one lump sum. Some time ago the Council had occasion to survey its membership on the frequency of lump sum distributions from deferred profit sharing plans and the reasons why such distributions are desired by employees. That survey showed that approximately 70% of payments from deferred profit sharing plans at retirement or other termination of service were in the form of a lump sum distribution. The figure would undoubtedly hold true today. There were several reasons given by the employees for taking their account balances in one sum. The predominant reason for taking a lump sum distribution was the desire of the individual to control his benefit. The ability to make a tax-free rollover to an IRA is even more advantageous to the employee. Undoubtedly, the Commission had this in mind in making its recommendation that the use of IRAs should be encouraged. However, it should not be mandated by the Government.

Conclusion

In summary, the Council is opposed to the establishment of the Minimum Universal Pension System recommended by the President's Commission on Pension Policy and is opposed to the recommendation that lump sum distributions from pension and profit sharing plans be restricted.

The Council believes that encouragement of participation in plans will do much to provide retirement security for employees. The Council has gone on record in support of deductible employee contributions for retirement purposes and is glad to see that the President's Commission also endorses this general proposal.

Respectfully submitted,

PROFIT SHARING COUNCIL OF AMERICA

Walter Holan
President

mc/
encl. (2)

Board of Global Ministries
The United Methodist Church
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Statement for the Record
on pensions
submitted to the
Subcommittee on Savings, Pensions and Investment Policy
Committee on Finance
U.S. Senate
May 29, 1981

The Women's Division, General Board of Global Ministries of the United Methodist Church welcomes the opportunity to submit for the record the portion of a Resolution titled Economic Justice for Women: Retirement Income dealing with pensions passed at the Women's Division Board meeting on April 5, 1981.

"More than 5 million women over the age of 65 live alone, and half that number are living their last years below the official poverty level. Most of these women have not always been poor. What happened to them is not inevitable but is rather the result of discrimination throughout their lives which strikes the cruelest blow at the end."

-- Representative Patricia Schroeder

WHEREAS, under private pension plans, women workers, more often than men, do not qualify for benefits because either their occupation is one traditionally not covered by pension plans or credits toward vesting* are forfeited due to greater job mobility;

WHEREAS, the average yearly private pension benefit for a woman worker is $970 compared to $2080 for her male counterpart;

THEREFORE, BE IT RESOLVED that the Women's Division:

2) Support private pension reform which would

   a) follow the recommendations of the President's Commission for Pension Policy for a Minimum Universal Pension System;

   b) provide for earlier vesting*;

   c) provide for portability+;

   d) provide for mandatory survivor's benefits for widowed spouses and for divorced spouses on a pro rata basis;

e) support the concept of pensions as part of joint property to be divided in case of divorce.

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*vesting - the right of an employee to receive accrued pension benefits after working a specified time period.

+portability - the carrying of pension investments from one job to another.

American Federation of Labor and
Congress of Industrial Organizations

815 Sixteenth Street, N W
Washington, D C 20006
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May 28, 1981

Honorable John Chafee, Chairman
Subcommittee on Savings, Pensions
and Investment Policy
Senate Finance Committee
2227 Dirksen Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for the opportunity to present the views of the AFL-CIO on the report of the President's Commission on Pension Policy.

Attached are the views of John Lyons, President of the Iron, Bridge and Structural Workers Union and a Vice-President of the AFL-CIO. Mr. Lyons was a member of the Commission and represented the AFL-CIO in that capacity. As you may know, the dissents of members were limited to 750 words in the Commission's report. For that reason, I am sending you Mr. Lyon's full views on the report and respectfully request that it be included in the record of hearings.

Sincerely yours,

Ray Denison

Ray Denison, Director
DEPARTMENT OF LEGISLATION

Attachment

A Century of Achievement
A Challenge for the Future

Following are the dissenting views of Commission Member John H. Lyons, President, International Association of Bridge, Structural and Ornamental Iron Workers and Vice-President AFL-CIO, to the report of the President's Commission on Pension Policy. These dissenting views follow the chronological order of the "Summary of Recommendations" of the Commission and use the same titles and subtitles without restating the Commission recommendation.

Retirement Ages:

1. Social Security. This Commission proposal would break faith with younger workers who would be the ones affected by the future increases in the age of eligibility and be required to pay larger social security contributions over their working lifetime since they would, in effect, receive reduced benefits at the time of retirement if they retired at the ages now recognized in the law. This would undermine confidence in the system for workers who will begin to feel that they cannot count on promised benefits which they have paid for. Such proposals would also be at the expense of some of the poorest and most deprived of our older citizens--those forced out of the labor market because of health conditions or unemployment. Though it is true that, on the average, older people may be able to work longer in the future, there would be many, probably most as is now the case, who would have to give up their jobs well before they are eligible for full benefits. The Commission proposal puts the cart before the horse by denying benefits without guaranteeing jobs or providing benefits in the event of ill health. The solution is not to raise the retirement age but to implement effective economic policies that enable people to work. This would result in voluntary decisions to work by those who can without taking benefits from those who can't.

3. State and Local Government Plans. The Commission recommends that state and local retirement systems should increase their normal retirement age in tandem with social security. The Trade Union movement has sought improved and more secure retirement systems for its members over the last several decades. Our objective has been to gain these systems for all workers throughout the American economy. Trade unionists stand together in rejecting recommendations that will result in the destruction of retirement systems that have already achieved a high level of coverage and protection for their employees. Most state and local employees do not enjoy collective bargaining rights which cover pay and all fringe benefits. Therefore, this Commission recommendation would produce, in most cases, unilateral actions without the consent of the employees which would substantially diminish and downgrade their current retirement system. This proposal would break faith with all employees currently active in the workforce who have not yet retired. A great number of employees affected have work schedules generally demanding long hours and shifts of duty at all hours of the day and night, on holidays and in all weathers, normal personal and family life for these professionals is out of the question. Therefore, it follows that their retirement should be allowed to recognize that and not be placed in tandem with sectors of the economy that have a different lifetime work schedule.

4. Federal Plans. The points made in the Commission recommendation on state and local government plans are equally applicable to federal plans. The only justification for a recommendation such as this would be if the working wages and

benefits of any of these groups of employees were vastly in excess of their private sector counterparts and, therefore, could be construed to be an inappropriate burden on the American taxpayer. However, after carefully studying this matter and consulting with the most recent Congressional reports, I must reject this as not the case. To clarify the issues requires consideration of both the pay increases and total compensation received by these general schedule federal employee workers. Federal employees have a "meet and confer" right in the process of setting wages. Since the Pay Comparability Act was adopted back in 1970, federal general schedule employees have seen their pay rates increased by only 88.6% while their private sector counterparts (as surveyed by the Bureau of Labor Statistics) have received average pay increases totaling 109.7%. Incidentally, inflation during this time advance by 125.1%. The point to be made here is that without full collective bargaining rights, these employees are constantly subject to unilateral actions taken by management or imposed through pay caps. Furthermore, I found the Congressional Budget Office (CBO) report, "Compensation Reform for Federal White Collar Employees", showing very close alignment between the total compensation paid to federal general schedule employees with that for their private sector counterparts throughout the American economy most convincing. The CBO found that if President Carter's proposed Total Compensation Bill were adopted without change, the impact on these federal workers would be to lower their next wage increase by 4.7%. However, after careful study the CBO outlined six areas entitled, "Potential Impact of Congressional Guidance", each of which would result in an increase in total pay to federal workers. These items included consideration of:

—Christmas bonuses regularly paid to private sector workers along with vacation bonuses provided to many of these workers;

—The private sector advantage of tax free social security;

—Changing the basis for costing social security to reflect the portion not paid by the employee;

—Adopting different actuarial methods for costing the retirement system and;

—Measuring the paid time off on the basis of leave used by federal workers rather than leave earned by federal workers.

The CBO concluded that federal pay for general schedule workers could easily be advanced by 4.7% if such a total compensation comparability method were adopted. This document to me is most persuasive--that the total pay and fringe benefits being received by federal sector workers is in line with their private sector counterparts.

5. Hazardous Occupations. The recommendation on hazardous occupations suffers from too narrow a focus in the context of retirement plans in the private sector. Before expanding the focus it should be noted that one of the underlying and primary reasons for the historical development of all employee retirement plans has been their value as recruitment, retention, and separation vehicles. While it has not occurred as the result of conscious policy decisions, the hazardous duty/public safety retirement plans have of necessity and fairness developed beyond the traditional concept of "retirement." This is in recognition of the special circumstances surrounding the public

safety forces. The fact that they are called retirement plans does not mean that they cannot be used administratively to meet special needs. Early retirement has appropriately been provided for these occupations in recognition of the fact that, they require strenuous physical exertion and frequent exposure to danger. Beyond the inherent physical risks and dangers, the more normal demands of these occupations are extremely strenuous in and of themselves. With schedules generally demanding long hours and shifts of duty at all hours of the day and night, on holidays and in all months, normal personal and family life for these professionals are out of the question. It is not strictly the hazardous and arduous nature of the work which leads to lower "retirement" ages. There are other workers whose work is as arduous but whose plans have more traditional retirement provisions. It is the public safety characteristic of this workforce that makes it desirable to have a comparatively young group. Hazardous duty occupations, by their very nature, demand a total team effort. Any one member of the team who is not performing at the most optimal levels, endangers his own life, the lives of his team members, and the lives and property of the public at large. There must be some way to maintain the high efficiency of the public safety group. If members of the public safety forces could not "retire" until their 50's, they are much more likely to "hang around" until their 60's, even though they were no longer fully effective contributors to the organization. There is no reason why administrative needs should not be met through the "retirement" plan. In fact, where there are Police and Fire plans that have relatively high and/or service requirements, there tends to be a higher incidence of disability retirements. This is administrative practicality as much as it is employee utilization. Absorption of administrative retirements by the disability programs is not only inefficient, it is more expensive because of higher benefit levels and more favorable tax treatment of disability benefits as compared to retirement benefits. The Commission should recognize the special circumstances of the expanded concept of "retirement" plans in this context. Therefore, it should encourage the articulation of specific policy by local governments along these lines. Early retirement provisions provide vital protections to the employee himself. Early retirement provisions also work to minimize costs to the public by working to decrease the number of personnel that might become eligible for disability retirement. My point here is, as the employee ages, his or her risk of suffering a disabling injury increases. If early retirement provisions were to be dispensed with, there is little doubt that disability retirements would increase tremendously. The costs associated with disability retirements are generally higher than those associated with early retirement. In this sense, early retirement works to minimize costs to the community. Early retirement provisions for hazardous duty occupations are the most efficient means to achieve the absolute necessity for maximizing the public safety, for the renewal of personnel and for their health and well-being.

Universal Social Security Coverage:

A most important part of the Commission recommendation states: "Social security should not replace an existing pension system for noncovered workers. Rather, an existing system should be modified to take into account benefits available under social security." While dissenting overall from the recommendation, I feel this statement deserves amplification to avoid misdirection of the Commission recommendation. It can best be emphasized by the following four points.

1. "The level of pension benefits now available to government workers and their beneficiaries is not reduced.

2. No additional financial burden is imposed on public employees without a commensurate adjustment in benefits.

3. The identity for government workers' retirement plans is not lost.

4. The opportunity for those employees to improve their retirement systems in the future is not diminished."

Furthermore, in arriving at its recommendation for Universal Social Security coverage, it has made three errors in analysis:

1. Many of its comparisons and conclusions have resulted from inadequate data and from analysis based upon inconsistent assumptions and faulty methodologies. (See Commission Staff Hearing records at AFL-CIO Headquarters--June 2, 1980.) In addition, I found most persuasive the paper presented to the Commission on January 23, 1981 criticizing the PCOPP study paper "Federal Pension Programs".

2. Government workers are employees and have the same retirement needs as those in other sectors of the economy. These needs are already met for most federal civilian sector employees by a retirement system which is rational, soundly financed, and a cost-effective retirement program.

3. By focusing solely on the impact of Social Security receipts and expenditures in the Unified Budget, the report fails to recognize that universal coverage would impose increased costs on taxpayers as the ultimate employer of public employees.

An example of the first flaw is represented by a January, 1981 Commission working paper on "Federal Pension Programs" which maintains that "income replacement rates are generally higher" in the federal sector than in the private sector and that such programs are "significantly more expensive than those in the private sector". To support the first contention, numbers are quoted out of context from the 1980 Bankers' Trust survey. A proper comparison shows that federal civil service replacement rates (even including some social security benefits from outside covered employment) are nearly equal to the private sector coverage replacement rate from the Bankers' Trust survey. For example, a 30-year private sector employee with final year's compensation of $25,000 receives 62 percent replacement from the average plan and the social security primary insurance amount. A similar federal employee would receive 63 percent replacement; assuming that he had 10 years of covered employment under social security (many federal retirees have not had such coverage); and taking into account the higher income tax burden borne by the federal retiree because civil service retirement benefits are fully taxable while social security benefits are tax free. The second contention of significantly more expensive benefits disintegrates when a comparison is made after eliminating the use of inconsistent assumptions and mixed methodologies. The working paper quotes 13 percent of payroll costs for private sector retirement plans from one context and compares it to 30.8 percent and 79.8 percent for federal civil service retirement benefits from a totally different context. A recent Congressional Budget Office study used comparable assumptions and a single methodology, to compare the cost of providing retirement and disability benefits using current federal practices on the one hand and representative private practices on the other. The result was 20.2 percent and 18.3 percent of federal payroll, respectively. This does not even consider the fact that federal pay levels have been capped for the last few years. The Universal Social Security Coverage Study Group report, upon which the Commission heavily relied, exhibits the same flaws in analysis demonstrated above; proposes integration formulas which reduce benefits to higher paid individuals whose pay is already limited by pay caps; and fails to take an integrated view of the true cost and impact of Universal coverage. We can understand the need to re-examine the Social Security benefit formula which provides a so-called windfall benefit, but we cannot condone any remedy which would single out public employees for exclusion.

Inflation Protection for Retirement Income:

3. Semi-annual cost-of-living increases are legitimate and desirable: they were, in fact, recommended for social security by the 1979 Advisory Council on Social Security. The objective of inflation adjustments is to protect the buying power of the original annuity. The GAO has concluded that semi-annual adjustments do not over-compensate retirees beyond the increase in the CPI. The formula itself wipes out the possibility of compounding. Furthermore, this Commission itself has previously held that ideally, annuities should be adjusted to inflation as it occurs. Certainly, semi-annual adjustments are a practical and realistic approach to this goal.

4. The recommendation to adjust federal pensions on the basis of the lower of average federal wage increases or the Consumer Price Index places budgetary concern above sound retirement policy. The Commission decided that such an approach was inappropriate and unfair for social security. Is it any less unfair to federal retirees who have the same needs as other retirees? This "lower of" approach would not only deny to federal retirees the real increases in standards of living from productivity and economic growth, it also would deny them standard of living protection (i. e., maintaining purchasing power of the original benefit dollars) from inflation.

Social Security Financing:

1. General Revenue. I regret no recommendation was made for general revenue financing for the social security program. The Commission's recommendation to use interfund borrowing and to speed up the 1985 scheduled increase is superior to many proposals now being urged on Congress to deal with the program's short-term financing problem. It is preferable to cutting benefits, using regressive forms of taxation such as the Value Added Tax (VAT), or postponing adequate financing in a manner that would undermine public confidence in the program. But the introduction of general revenue financing is the best way to deal with the program's funding problem. The United States is one of the few advanced industrial nations in the world in which the social security system is financed almost entirely from payroll taxes. In a country committed to progressive taxation based on ability to pay, it is strange that social security financing remains regressive, that is, low and middle income workers pay a higher proportion of their income to the program than do higher income families. This regressive effect is offset to some degree by a benefit formula which is weighted in favor of those with

lower earnings. But the payroll tax has reached a level where it is a significant burden on low and middle income workers during their working lives and relief is needed. In addition, unlike the payroll tax, general revenues do not directly increase employer costs and, therefore, are more likely to have a favorable effect on employment and inflation. I believe the Congress should turn to general revenues based on the progressive income tax to help finance the system and avoid future increases in the payroll tax. The best first step toward achieving this objective would be to partially finance Medicare in this manner since many individuals who oppose general revenue financing of the cash benefit program do not oppose such financing in Medicare.

2. Student Benefit. Fortunately, the Commission did delete its interim recommendation to terminate the social security student benefit -- although many on the Commission would still like to do so. But even the final recommendation that the student benefit be re-examined and put on a more rational basis clearly indicates dissatisfaction with the program. In my opinion, the value and purpose of the program is not generally understood or appreciated. The social security student benefit is not peculiar to the United States. Most industrial countries cover student benefits in their social security programs, often with more generous age criteria. The purpose is to encourage and enable the completion of a child's education by insuring against the loss of family earnings caused by death, disability or retirement. The data show, because of low family income, most students receiving social security student benefits can expect little, if any, parental aid in meeting educational costs. These students must supplement social security benefits with work and means-tested educational grants, loans and work-study programs. Federally-financed educational grant, loan and work-study programs are complimentary to the social security student benefit, not conflicting or competing. These federal programs, generally means tested, count all family income, including social security benefits, to determine eligibility and amount of aid. The social security benefit is an insurance program so that all workers covered and taxed by social security can provide predictable benefits for their children to continue their education in the event of the worker's death, disability or retirement. The elimination of this benefit would greatly increase the demand on and costs for federal educational assistance programs. Yet, there is every indication the Administration intends to cut the funding levels of these programs, not increase them. Without the social security student benefit, tens of thousands of children would not be able to complete their education and parents would see destroyed the insurance protection for which they had been working and paying taxes for a good part of their working lives.

Tax Policy:

The Commission makes a number of recommendations for national tax policy relating to retirement. Of particular concern are those relating to the taxation of social security benefits and to the more favorable tax treatment accorded savings for retirement. Taxation of social security benefits would represent a radical change in the treatment of these benefits. The majority recommendation may have merit, but I could support it only as part of or after achievement of genuine tax justice and overall tax reform eliminating the many loopholes now enjoyed by the wealthy and large corporations. It is unfair to place an additional tax burden on the disabled, retirees and survivors while Congress ignores the extreme inequities in the existing tax system. Phasing out the earnings test is largely meaningless as a compensating feature since only an extremely small number of social security beneficiaries are affected by it—only those who are working and earning significant wages. The proposals to provide more favorable tax treatment for retirement savings primarily benefit higher income workers and high paid professionals such as doctors, lawyers and corporate executives. The higher the individual's tax bracket, the greater the benefit. Such proposals would help very few low or middle income workers who live so close to the margin that they are unable to save anything or very little out of their income for this purpose. The recommendation for a refundable tax credit for low and moderate income workers, though helpful, could hardly be expected to be effective in securing significant additional savings by them. In short, it is extremely difficult, if not impossible, to accomplish major retirement protection through tax incentives in a nondiscriminatory manner. In addition, taken together, the proposals would result in substantial revenue loss running into tens of billions of dollars. These proposals shouldn't even be considered until proponents can demonstrate that the loss in revenue will not come at the expense of other more important programs or increased taxes for low and middle income workers.

Mandatory Universal Pension System (MUPS):

Considering all approaches to cover workers as a universal group, social security is the most feasible and fairest way. It can best provide for unmet retirement needs of those, predominantly low-wage workers, not now covered by private pensions. Benefits are kept up-to-date with rising wages during a workers' working life and increased automatically after retirement to reflect increases in the cost-of-living. The MUPS proposal has no such features and benefits would be diminished by inflation before and after retirement. Nor does MUPS provide for past service credits for older workers and, therefore, would not begin to adequately meet the income retirement needs of the uncovered until the turn of the century. Social security improvements automatically result in past service credit for covered workers. All of these advantages could be provided through social security at less cost. Unfortunately, political realities make the prospects of dealing with the problem through the social security system virtually nil. This being the case, the MUPS proposal may be the next best alternative. But the economic impact of a mandated private pension plan can vary greatly between employers. The MUPS proposal could result in unintended consequences, particularly for small employers and their employees, since they are the groups most affected by the proposal. For example, the report makes the assumption that after the three-year phase-in, the costs of the MUPS program will be borne by employees in the form of lower wages and fringe benefits. But these employees are the poorest of all workers and most in need of higher, not lower, wages. At the same time, small employers are to be given a business tax credit to ease their burden. In other words, the report recommends a tax subsidy for small employers though it assumes that the costs will be borne by the nation's lowest paid workers in the form of even lower wage and fringe benefits increases. Cost data are provided in the report but I don't feel they are sufficient in view of the complex economic variables involved and the importance of what is being recommended. For this reason, I cannot support the proposal until more specifics are known about it and its possible economic effects more carefully analyzed, particularly its effect on low paid workers.

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June 15, 1981

The Honorable John H. Chafee
Chairman, Subcommittee on Savings, Pensions and Investment Policy of the Senate Finance Committee
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Chafee:

On May 15, 1981, in testimony before the Subcommittee on Savings, Pensions and Investment Policy of the Senate Finance Committee during hearings on the President's Commission on Pension Policy, the American Bankers Association (the ABA) requested legislation exempting bank-sponsored pooled investment funds for Keogh plans and Individual Retirement Accounts from regulation under the federal securities laws. The Investment Company Institute* respectfully submits the attached memorandum in opposition to the legislative proposal put forth by the ABA.

The Institute and its members have extensive experience and expertise relating to Keogh plans and IRAs. We actively participated in the legislative process which led to the enactment of the 1962 federal tax legislation which first permitted self-employed persons to establish Keogh plans, and in the enactment of the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) relating to Keogh plans and IRAs. The Institute and its members also participated in the legislative process which resulted in the 1970 amendments to the federal securities laws relating to pooled investment funds sold to retirement plans.

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* The Investment Company Institute is the national association to the American mutual fund industry. Its membership includes 574 open-end investment companies ("mutual funds"), their investment advisers and principal underwriters. Its mutual fund members have assets of about $180 billion, and have approximately 12 million shareholders.

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Adoption of the ABA's proposal would give rise to the very abuses which Congress has sought to prevent -- the mass-marketing of interests in bank-sponsored pooled investment funds to hundreds of thousands of Keogh plans, IRAs and their individual participants without the protections afforded by the federal securities laws. Congressional hearings in the last Congress demonstrated that serious abuses currently are taking place with respect to bank collective investment funds sold to Keogh plans, and other retirement plans due to present exemptions from the federal securities laws. During those hearings, both the Securities and Exchange Commission and the Department of Labor testified in opposition to the ABA's proposal. Indeed, Congress repeatedly has declined to further exempt bank pooled investment funds from the federal securities laws.

The ABA's proposal must be viewed in light of a complete understanding of Keogh plans and IRAs. Most Keogh plans and IRAs tend to be very small and have very few participants: a recent Institute study indicates that the average Keogh plan has only 1.4 participants, and IRAs typically have only one participant. Many Keogh plans and all IRAs permit each participant, and not the employer, to select his or her own investments from among various alternative funding media. Many, if not most, Keogh plans and almost all IRAs are not covered by ERISA. More importantly, ERISA only seeks to protect a participant with respect to his or her plan; ERISA does not purport to protect Keogh plans, IRAs and their individual participants when they invest in pooled investment funds.

If the ABA's proposal is adopted, banks would be free to run aggressive advertising campaigns, using the types of advertisements attached as Exhibit A, advertisements which led a recent Chairman of the Senate Banking Committee to express "astonishment" over the present lack of SEC jurisdiction with respect to bank pooled investment funds sold to corporate retirement plans. Additionally, hard factual evidence (a study of the sales literature used by 17 banks pooled funds) indicates that the ABA proposal will have the affect of denying Keogh plans, IRAs and the participants in such plans adequate information on which to base their investment decisions. Finally, adoption of the ABA's proposal will deny participants in IRAs the substantive protections provided by the Investment Company Act of 1940.

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For the reasons set forth above and in the attached memorandum, we strongly urge that the Subcommittee reject this latest attempt by the ABA to achieve repeal of the federal securities laws as they relate to bank-sponsored pooled investment funds sold to Keogh plans and IRAs.

We respectfully request that this letter and the attached memorandum be included in the hearing record.

We would be pleased to furnish any additional information which the Subcommittee or its staff may request.

Sincerely,

William M. Tartikoff

William M. Tartikoff
Assistant Counsel

Attachments

MEMORANDUM OF THE
INVESTMENT COMPANY INSTITUTE
IN RESPONSE TO THE
AMERICAN BANKERS ASSOCIATION'S
PROPOSAL TO AMEND THE
SECURITIES ACT OF 1933 AND
THE INVESTMENT COMPANY ACT OF 1940
BEFORE THE SUBCOMMITTEE ON SAVINGS,
PENSIONS AND INVESTMENT POLICY
OF THE SENATE COMMITTEE ON FINANCE
JUNE 12, 1981

In testimony before the Subcommittee on Savings, Pensions and Investment Policy on May 15, 1981, the American Bankers Association (the ABA), in the guise of pension reform, requested legislation exempting bank-sponsored pooled investment funds sold to Keogh plans and Individual Retirement Accounts (IRAs) from regulation under the federal securities laws. For the reasons stated below, the Investment Company Institute* opposes the ABA's proposal.

In order to assess the ABA's proposed legislation, it is necessary to consider the legislative history of the securities laws as they relate to pooled investment funds sold to retirement plans; recent Congressional concerns regarding bank pooled investment funds sold to retirement plans; the nature of Keogh plans and IRAs and; the likely consequences of the adoption of the ABA proposal on Keogh plans, IRAs and the millions of individual participants in such plans.

The following discussion of each of these matters demonstrates that:

1. Congress amended Section 3(a)(2) of the Securities Act of 1933 (the 1933 Act) in 1970 in order to assure that participants in Keogh plans investing in pooled investment funds receive the disclosure protection of the 1933 Act.

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* The Investment Company Institute is the national association of the American mutual fund industry. Its membership includes 574 open-end investment companies ("mutual funds"), their investment advisers and principal underwriters. Its mutual fund members have assets of about $180 billion and have approximately 12 million shareholders.

2. When Congress enacted the Employee Retirement Income Security Act of 1974 (ERISA) permitting the creation of IRAs, it sought to provide IRA participants with both the disclosure protection of the 1933 Act and the substantive protections afforded by the Investment Company Act of 1940 (the 1940 Act).

3. Subsequent Congressional hearings have demonstrated that serious abuses are currently taking place with respect to bank pooled investment funds sold to corporate retirement plans due to the present exemptions for such funds from the federal secruities laws.

4. Congress repeatedly has declined to further exempt bank pooled investment funds for retirement plans from federal securities regulation.

5. Keogh plans, IRAs and their participants need the protections afforded by the federal securities laws since Keogh plans and IRAs tend to be small; many Keogh plans and all IRAs permit each participant to select his or her own investments; many, if not most, Keogh plans and IRAs are not covered by ERISA; and, in any event ERISA does not purport to provide the protections afforded by the federal securities laws.

6. Adoption of the ABA proposal would permit commercial banks to mass-merchandise interests in their pooled investment funds to Keogh plans, IRAs and individual participants in such plans through aggressive advertising campaigns without providing adequate disclosures on which the plans and their participants could base their investment decisions, and would deprive IRA participants of the substantive protections of the 1940 Act.

Legislative History of the 1970 Amendements to Section 3(a)(2) of the 1933 Act.

In 1955, the Federal Reserve Board first authorized national banks to form collective investment funds for the commingling of assets of corporate retirement plans managed by a bank. * Jurisdiction over these funds was transferred to the Comptroller of the Currency in 1962. The Comptroller's regulations prohibited the merchandising and advertising of interests in these funds to corporate plans.** Therefore, the Securities and Exchange Commission (the SEC) took the position that interests in these pooled funds were exempt from registration under the 1933 Act based on the private offering exemption.***

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 appeal to the Keogh market using interests in their pooled investment funds on an

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* 30 Fed. Reg. 3305 (1955).

** 28 Fed. Reg. 3312(1963); 12 C.F.R. §9.18(b)(5)(iv) (1964).

*** See SEC Memorandum 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 cited as 1963 Hearings): "The Commission has consistently take 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."

**** Pub. L. No. 87-792, 76 Stat. 809.

"assembly-line approach." * Since banks openly sought to mass-merchandise shares of their pooled investment funds to Keogh plans, the SEC naturally took the position that the shares had to be registered 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 bank pooled investment funds for corporate plans from registration. However, he opposed legislation which would have removed the SEC's disclosure jurisdiction over bank pooled investment funds for Keogh plans: "[Keogh] plans involve a complex

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* 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 involved 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 regualtion as the mutual fund itself?" Address of Chairman Ray Garrett, Jr., Before 55th National Trust Conferences, 15-16 (February 4, 1974).

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 Admendments of 1970, which adopted the pattern which the SEC had applied. Bank and insurance company pooled investment funds for corporate plans and Keogh plans were exempted from registration as investment companies (Investment Company Act of 1940, Section 3(c)(11)). Interests in pooled investment funds sold to corporate plans were exempted from registration under the Securities Act of 1933 (Section 3(a)(2)). But interests in pooled investment 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)):

> "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, 1960).**

Legislative History of ERISA

In 1974, Congress enacted ERISA which, inter alia, expanded Keogh plan contribution limits up to $7,500 a year. ERISA also expanded Keogh plans by permitting low-income

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* Statement of SEC Chairman Manual F. Cohen at Hearings Before the Senate Committee on Banking and Currency on Amendment No. 438 to S. 1659, 90th Cong. 1st Sess., at 1328 (1968).

** Other provisions in the 1970 legislation reflected special Congressional concern with pooled investment funds sold to 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.

self-employed persons to contribute 100% of earned income up to $750 to a "mini Keogh" plan. When it enacted these provisions expanding the use of and contributions to Keogh plans, Congress did not change the application of the 1933 Act to bank pooled investment funds sold to Keogh plans.

In addition, ERISA, for the first time, permitted individuals who are not covered by corporate plans or Keogh plans to establish and make tax-deductible contributions to IRAs. Congress made it clear that IRA participants need the full investor protections provided by the federal securities laws. Page 338 of the ERISA Conference Report stated: "The conferees intend that this legislation with respect to individual retirement accounts is not to limit in any way 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 bank pooled investment funds offered to IRAs (like interests in bank pooled investment funds for Keogh plans) must be registered under the 1933 Act and prospectuses must be given to prospective investors. In addition, bank pooled investment funds for IRAs are subject to the Investment Company Act of 1940.

It should be emphasized that ERISA was enacted to protect participants in employee benefits plans. However, ERISA does <u>not</u> attempt to regulate the matters covered by the federal securities laws. For example, ERISA seeks to provide a participant in a plan with <u>information concerning the plan itself</u>, by requiring that the participant receive a summary plan description and an annual plan report. However, when an employee benefit plan (or a participant in a plan) purchases shares in a pooled investment fund, be it a bank pooled investment fund, an insurance company pooled 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, IRAs and their participants with prospectuses describing the pooled fund. It is the federal securities laws, not ERISA, which limit the types of advertisements which

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* H.R. Rep. No. 93-1280, 93d Cong., 1st Sess. at p. 338.

sponsors of pooled investment funds can direct at Keogh plans, IRAs and their participants. It is the federal securities laws, not ERISA, which provide Keogh plans, IRAs and their participants with the right to sue sponsors of pooled funds for fraud and misrepresentations in connection with the purchase of shares of the pooled fund.

Subsequent Congressional Concerns With Bank Pooled Investment Funds for Retirement Plans

Since the enactment of the 1970 legislation which subjected bank pooled investment funds for Keogh plans to the 1933 Act registration requirements and the enactment of ERISA which subjected bank pooled investment funds for IRAs to the 1933 and 1940 Act, the ABA repeatedly has sought legislation which would remove these requirements. As the following chronology demonstrates, Congress not only repeatedly has declined to enact such legislation, but has reaffirmed SEC jurisdiction over bank pooled investment funds sold to Keogh plans and IRAs.

First, 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 IRAs from the federal securities laws. * The Subcommittee did not report out the legislation requested by the ABA.

Second, in 1978, the ABA testified before the Subcommittee on Oversight of the House Ways and Means Committee urging legislation exempting bank pooled investment funds for IRAs from the federal securities laws.** The Committee did not report out the legislation requested by the ABA.

Third, in 1978, major pension reform legislation, S. 3017, the ERISA Improvements Act of 1978, was introduced by the then Chairman, Senator Williams, of the Senate Committee on Human Resources and the ranking minority member Senator Javits. Section 274 of the bill contained a provision, suggested by

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* See Hearings on S. 249 Before the Senate Subcomm. on Securities, 94th Cong., 1st Sess. (1975), at 463-75.

** See Hearings on Individual Retirement Accounts and IRS Plan Termination Survey Before the Subcomm. on Oversight of the House Ways and Means Comm., 95th Cong., 2d Sess. (1978), at 191-93.

the ABA, which would have removed SEC jurisdiction over bank pooled investment funds sold to Keogh plans and IRAs. The provision was vigorously opposed by both the SEC and the Department of Labor. SEC Chairman Williams stated: "... 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 self-employed individual who wishes to establish an IRA."* Chairman Williams also added his support for continuing the protections afforded IRA participants by the 1940 Act.** Secretary of Labor Marshall stated:

> "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 commingled funds." (Emphasis added).***

The Investment Company Institute presented graphic evidence of the actual abuses which would take place if SEC jurisdiction over bank pooled investment funds for Keogh plans and IRAs was removed.****

First, we discussed abuses in advertising. As noted above, the SEC administratively had exempted interests in bank pooled investment funds sold to corporate plans from registration under the 1933 Act based on the private offering exemption (a position codified by Congress in 1970) at a time

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* Statement of SEC Chairman Williams, Joint Hearings on S. 3017 Before the Subcomm. on Labor of the Senate Comm. on Human Resources and the Subcomm. on Private Pension Plans and Employee Fringe Benefits of the Senate Comm. on Finance, 95th Cong., 2d Sess., at 347 (1978). (Hereinafter cited as 1978 Hearings).

** H.R. Rep. No. 93-1280, 93rd Cong., 1st Sess. at p. 354.

*** Submission of Secretary of Labor Ray Marshall to Honorable Harrison A. Williams, Jr., Chairman, Senate Committee on Human Resources, September 8, 1978, at 9.

**** Statement of the Investment Company Institute, 1978 Hearings, at 798.

when regulations of the Comptroller of the Currency prohibited merchandising and advertising of these pooled funds to corporate plans. However, after the SEC and Congress acted to exempt these interests from the 1933 Act, the Comptroller suddenly amended his regulations so as to permit national banks to advertise and publicize their pooled investment funds sold to corporate retirement plans.* We attached to our testimony representative advertisements being run by banks aimed at corporate retirement plans (similar advertisements are attached to this memorandum as Exhibit A), and stated that if bank pooled investment funds for Keogh plans and IRAs were exempted from the 1933 Act. "...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.'"**

Second, we discussed abuses in the area of disclosure. We stated that if bank pooled investment funds for Keogh plans and IRAs were exempted from the 1933 Act, banks would not be required by ERISA or the federal banking laws to provide Keogh plans and IRAs and their participants with prospectuses, but would be free to utilize any sort of sales material they desire. In order to demonstrate exactly what would occur if bank pooled investment funds for Keogh plans were exempted from the 1933 Act, we examined material which 17 banks provide to prospective Keogh plan investors concerning the banks' pooled investment funds (which take advantage of present exemptions from the 1933 Act since they allegedly are only offered to Keogh plans in one state).*** Our examination of

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* 37 Fed. Reg. 24161, at 24162 (1972).

** Statement of the Investment Company Institute, 1978 Hearings at 836.

*** These banks, which we selected on a randon basis, were: Bank of 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 & Trust Co. (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).

these documents was to determine whether Keogh plans and Keogh plan participants investing in these pooled 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 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 mutual fund registered under the Investment Company Act must continuously provide all of this information to all prospective investors, including Keogh plans, and IRAs and their participants. Thus, this study of 17 bank pooled investment funds which are exempt from the 1933 Act demonstrated the point made by SEC Chairman Williams and Secretary of Labor Marshall--it is the federal securities laws, and not ERISA, which require sponsors of pooled investment funds to make disclosures to Keogh plans and plan participants concerning their pooled funds. We noted that the Federal Trade Commission's Bureau of Consumer Protection recently had issued a lengthy report critizing the inadequate disclosure provided to IRA participants who invest in product which presently are not subject to the federal securities laws (e.g., bank savings accounts and certificates of deposit).* We noted that exempting bank pooled investment funds for Keogh plans, and IRAs would place these Keogh plans, and IRAs and their participants in exactly the same position as the unprotected IRAs discussed in the FTC report.**

Third, following our testimony, we retained outside counsel to study the impact of the 1970 amendments which exempted bank pooled investment funds for Keogh plans from substantive regulation under the Investment Company Act. Counsel reviewed the operations of six bank-sponsored pooled investment funds for Keogh plans based on prospectuses on file with the SEC. The law firm's report (a copy of which is attached as Exhibit B) stated:

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* 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.

** Statement of the Investment Company Institute, 1978 Hearings, at 837-38.

"The study demonstrates that in many instances in the bank managers of these unregulated funds arrogate to themselves completely unfettered discretion to change investment policies and advisory fees without the consent of investors. The banks are also able to obscure their advisory fees by excluding them from disclosed expense ratios. The absence of 1940 Act regulation also allows the banks to delay honoring investor redemption requests, to avoid reporting to shareholders, and to use the fund's brokerage commissions without regulatory restrictions."

"Most important of all, the regulatory vacuum created by the exemption from 1940 Act regulation allows the banks to profit from self-dealing tranactions with their funds. Thus, banks can maximize the funds' interest-free deposits with the banks by delaying investments of new deposits and by keeping the funds' portfolios in a 'liquid position.' They also invest fund assets in certificates of deposit issued by their own banks. Such self-dealing would be illegal if the funds were registered under the 1940 Act. Thus, the study makes clear, notwithstanding registration under the Securities Act of 1933, disclosure by itself, even disclosure administered by the SEC, is not sufficient. It is the strongest evidence that protection of participants in managed investment funds requires 1940 Act regulation."

We believe that this study raises serious questions about the continued wisdom of exempting bank pooled investment funds for Keogh plans from the type of substantive regulation contained in the Investment Company Act of 1940.*

The testimony of the SEC and the Department of Labor and the evidence submitted by the Institute at the hearings on the 1978 bill evidently convinced the Chairman and the ranking minority member of the Senate Committee to conclude that, rather than decreasing federal regulation over bank pooled investment funds sold to employee benefit plans, legislation should be enacted <u>increasing</u> federal regulation in this area. In 1979, they reintroduced their bill as S. 209, the ERISA Improvements Act of 1979, and included a provision, Section 154, providing that, while the SEC was to lose its limited jurisdiction with respect to bank pooled investment funds sold to retirement

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* This problem is not limited to bank pooled investment funds sold to Keogh plans, but involves tens of thousands of <u>corporate</u> plans and billions of dollars. The American Bankers Association recently reported that bank pooled investment funds for corporate retirement plans had assets of $47.5 billion at year-end 1978. American Bankers Association 1980 "Collective Investment Funds Survey Report", at 7.

plans, the Secretary of Labor was to be mandated to prescribe regulations relating to advertising, disclosure and "such other standards as the Secretary may specify to protect plan participants and beneficiaries." Thus, bank pooled investment funds sold to corporate plans would, for the first time, have been subject to federal regulation in the areas of advertising, disclosure and substantive requirements. Federal regulation over bank pooled investment funds for Keogh plans would have been <u>expanded</u> to include substantive regulation.

SEC Chairman Williams testified that these provisions represented an improvement over the 1978 bill, but questioned the fragmentation of securities regulation between the Commission and the Department of Labor.* Secretary of Labor Marshall stated that, since the Department lacked expertise in this area and the SEC possessed such expertise, more study was needed in this area.** The Institute stated that, while the provision was a substantial improvement over the 1978 bill, securities type jurisdiction should be vested in the SEC, the agency expressly created by Congress to regulate securities matters.*** Following the hearings, the Senate Committee on Labor and Human Resources reported out the bill, deleting Section 154.

While the Committee did not report out a bill including provisions relating to bank pooled investment funds sold to Keogh plans, IRAs and other retirement plans, the legislative history of S. 3017 and S. 209 demonstrates that serious abuses are occurring in this area and that leading members of the Labor Committee were concerned with <u>increasing</u> federal regulation over these pooled funds, not <u>with decreasing</u> existing regulation.

This view is shared by other members of Congress and by two recent SEC Commissioners.

In 1978, the Institute testified 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. Our testimony called the Committee's attention to representative advertisements being run by banks for their pooled investment funds for corporate retirment plans. The following exchange took place between then Chairman Proxmire and the president of the Institute:

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* Statement of the Securities and Exchange Commission, Hearings on S. 209 Before the Senate Comm. on Labor & Human Resources, 96th Cong., 1st Sess. (1979), 657 at 658. (Hereinafter cited as 1979 Hearings).

** Statement of Secretary of Labor Marshall, 1979 Hearings, 124 at 199.

*** Statement of the Investment Company Institute, 1979 Hearings, 711, at 719-20.

"The Chairman. Has the SEC indicated any interest in this because they seem to be so blatant and so conspicuous, as you say: 'entering our second decade to outperforming the Dow Jones, 'Your fixed-income fund has got to deliver superior results, 'Its about time investment managers were judged on their success instead of their addresses,' in the Birmingham bank with a crow sitting on a directions sign, New York to Dallas, Atlanta and Birmingham, which is a great place. 'Your company's employee benefit plan can't profit from a bad fit.'

"These are all banks that have fine conservative reputations. Its astonishing that they can do this and the SEC has no authority, no jurisdiction, and they can do that in competition of course with your industry. It just doesn't seem to be logical at all. Either what the SEC is doing in restraining the [mutual fund] industry is wrong, which I think it is not--I think it's right--or the banks should be restrained on the same basis."

"Mr. Silver. I fully agree, Mr. Chairman."

"The Chairman. When you talk about competition, that obviously isn't fair competition."*

In 1979, the Chairman and other members of the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Banking Committee introduced legislation, H.R. 2747, which would have ended these abuses by prohibiting national banks from advertising and merchandising interests in their pooled investment funds to corporate retirement plans. In his testimony, SEC Chairman Williams called attention to the fact that Congress had exempted bank pooled investment funds for corporate retirement plans at a time when regulations of the Comptroller of the Currency prohibited merchandising and advertising, but that:

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* Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs on S. 72, 95th Cong., 2d Sess. (1978), at 348.

"In a sharp departure from this historical setting, however, regulations of the Comptroller of the Currency were recently amended to provide that general advertising prohibitions--which embodied the policies underlying the exemption provided in the Securities Act--are no longer applicable to collective investment trust funds maintained by banks for corporate pension funds. As a result, many banks have begun to market interests in those trust funds aggressively through general advertising about the investment performance of those corporate pension trusts. Although these bank trust funds compete with other collective investment media such as investment companies and insurance company separate accounts, which generally are subject to the registration provisions of the Securities Act, individual plan participants in the corporate pension plans purchasing interests in bank trust funds may be denied the protection afforded under the Securities Act to which they would be entitled if their corporate pension plan administrators had chosen to invest in these competing media."*

hairman Williams also stated that:

"It would would be anomalous if all financial institutions offering investment advice to the general public, whether directly through publicly-solicited individual advisory relationships or indirectly through publicly-solicited collective investment management arrangements like investment companies, were not subject to the same regulatory requirements, the same fiduciary responsibilities, and the same degree of enforcement presence."**

Subsequently SEC Commissioner Friedman also indicated the bank pooled investment funds for retirement plans should be subject to <u>full</u> SEC regulation:

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* Statement of SEC Chairman Harold M. Williams Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs, Regarding H.R. 1539, H.R. 2747 and H.R. 2856, October 17, 1979, at 17.

** *Ibid* at 15-16.

"In general, the Investment Company Act and the Investment Advisers Act should apply to bank investment management. Why should an independent investment manager who manages funds for pension funds and other institutions be regulated by the SEC as an investment adviser while a bank is not? Why should they be subject to different rules regarding their ability to advertise or their fiduciary obligations?

"If banks are managing an entity that is the functional equivalent of a mutual fund or a closed-end investment company there is no reason to have different rules regarding self-dealing, pricing, approval of investment management fees, and the like. The need for independent directors is as great as in a mutual fund complex. This is not simply a matter of competitive equity. The regulatory pattern for investment management is essentially sound. It responds to real problems that were rife in the investment company industry in the 1920's and were replicated in the REIT experience of the 1970s. Its logic and benefits are no less applicable to banks than to other investment managers.

"Moreover, it is not clear to me that all of the past regulatory compromises regarding the Securities Act of 1933 continue to make a lot of sense. In those plans in which the employee has an investment decision to make, the result looks very much like an investment company. Whether or not any of the employee's money is invested in the employer's securities would seem to have little to do with what ought to be the result in terms of disclosure."*

In summary, Congressional hearings since the enactment of the 1970 Amendments to Section 3(a)(2) of the 1933 Act and the enactment of ERISA in 1974 demonstrate that there now exists inadequate regulation with respect to bank pooled investment funds sold to Keogh plans and other retirement plans due to present exemptions from the federal securities laws.

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* Investment Management and the Glass-Steagall Act-the Emperor's New Clothes, Remarks to the Association of Bank Holding Companies, November 13, 1980, at 12-13.

Therefore Congress has repeatedly refused to enact legislation which would further reduce existing regulation in this area. We submit that the Congress should be extremely wary of enacting exemptive laws which decrease existing regulation, thereby opening the way to even greater abuses than presently exist.

In order to understand the impact of the ABA's proposed legislation on Keogh plans, IRAs and their millions of individual participants, it is necessary to understand some basic facts regarding Keogh plans and IRAs.

Nature of Keogh Plans and IRAs

(a) Keogh plans and IRAs tend to be very small and cover very few participants. In 1978, the Institute conducted a study of Keogh plans funded with mutual fund shares (which accounted for over 30% of all Keogh plans assets). We found that at year-end 1977, the average Keogh plan funded with mutual fund shares had assets of only $8,106 and only 1.4 participants. (In contrast, at year-end 1975, the average corporate plan had assets of $425,000 and 60 participants).* IRAs typically cover only one individual, and at year-end 1979, IRAs funded with mutual fund shares had, on the average, only $5,223 per account.

(b) Many Keogh plans and all IRAs, permit each participant (rather than the employer) to select his or her own investments from among various alternative funding media. Thus, in these cases, it is each participant, and not the employer, who selects the particular funding media for his or her own account.

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* Statement of the Investment Company Institute, 1978 Hearings, at 845. More recent information confirms the findings of our 1978 study. At mid-year 1980, the average Keogh plan funded with mutual fund shares has assets of only $16,013 and only 1.4 participants, with an average individual account size of $11,477. At mid-year 1980, the average individual Keogh account at mutual savings banks was even smaller, with assets of only $6,496. See Table 4, Analysis of Monthly Savings Bank Trends, National Association of Mutual Savings Banks, September 25, 1980.

(c) Many, if not most, Keogh plans and IRAs are not covered by Title I of ERISA.* ERISA, Title I, only applies to plans which cover employees.** Thus almost all IRAs are exempt from ERISA. Further, a Keogh plan which only covers a sole proprietor is not covered by Title I, and regulations also exempt a Keogh plan which only covers a sole proprietor and his or her spouse.*** In addition, regulations exempt a Keogh plan which only covers partners and not employees.****. Thus, given the small size of the average Keogh plan (1.4 participants), it is likely that many, if not most, Keogh plans are not covered by Title I of ERISA.

These basic facts concerning Keogh plans and IRAs--the small size of most Keogh plans and IRAs; the fact that many Keogh plans and all IRAs allow each participant to select his or her own investments; and the fact that all IRAS and many, if not most, Keogh plans, are not covered by ERISA--have an important bearing on the ABA's legislative proposal to exempt interests in bank pooled investment funds sold to Keogh plans, IRAs and their participants from the federal securities laws.

Consequences of Adopting the Proposed Legislation

If the proposal is adopted, commercial banks would be free to mass-merchandise interests in their pooled investment funds to thousands of Keogh plans, IRAs and individual participants in such plans without any restraints whatever imposed by ERISA, the federal banking laws or the federal securities laws.

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* Title I of ERISA contains the fiduciary, reporting and enforcement provisions of the law.

** ERISA §3(2)(A)

*** ERISA Reg. §2510. 3-3(c)(1)

**** ERISA Reg. §2510. 303(b). See, e.g., Securities Act Release No. 5989, an application filed by a Keogh plan employer for a Commission order exempting interests in its Keogh plan: "The Plan [only] covers the Applicant's partners... Applicant states that because the Plan covers persons, all of whom are employees [e.g. partners] within the meaning of Section 401(c)(1) of the Code, the Plan is not an "employee pension plan" under Title I of ERISA".

Banks would be free to run aggressive advertising campaigns using ads of the type attached hereto as Exhibit A. Thus, United Jersey Bank could run ads aimed at Keogh plans, IRAs and their participants stating "We're #1 nationally in investment performance"; Hibernia National Bank could advertise that it is "#1"; and The First National Bank and Trust Company of Tulsa could advertise that it has "First Place in the Pension Fund Playoffs."

Further, if the proposal is adopted, banks would be free to sell interests in their pooled investment funds to Keogh plans and IRAs without providing prospectuses and using any type of sales literature they desire. Our study of 17 bank-sponsored pooled Keogh funds (which take advantage of the intrastate exemption from the 1933 Act) demonstrates the disclosures (or rather the lack of disclosures) which will take place. Keogh plans, IRAs and their participants will not be provided with even the most basic information on which to base their investment decisions. They will not receive information concerning the fund's investment restrictions; the bank operating the fund; the officers and directors of the bank; the fees paid to the bank; the fund's policy with respect to buying and selling portfolio securities; and the amounts of brokerage commissions paid by the fund or to whom. In most cases, they will not receive any information regarding the fund's current financial statements or its current portfolio.

Finally, banks would be free to operate pooled investment funds for IRAs, in complete disregard of numerous provisions of the 1940 Act designed to prevent self-dealing transactions between the sponsoring banks and the pooled funds.

Conclusion

From the time that Congress first permitted self-employed individuals to establish Keogh plans covering themselves and their employees, through the enactment of ERISA, and as recently as 1980, Congress has been concerned that Keogh plans, IRAs and their individual participants receive the important investor protection provided by the federal securities laws. To achieve this result, Congress determined that interest in bank pooled investment funds sold to Keogh plans, IRAs and participants in such plans should be subject to the disclosure requirements of the Securities Act of 1933 and, in the case of IRAs, the substantive requirements of the Investment Company Act of 1940.

The evidence supports the determination made by Congress. Most Keogh plans and IRAs are small and have few participants. Many Keogh plans and all IRAs permit each participant, rather than the employer, to select his or her own investments from alternative funding media. All IRAs and many Keogh plans are not subject to Title I of ERISA, and, in any event, ERISA does not purport to protect Keogh plans, IRAs and their participants when they invest in pooled investment funds. The evidence also demonstrates that bank pooled investment funds which currently are exempt from the federal securities laws do not provide investors with adequate disclosures and are involved in serious self-dealing transactions.

This evidence explains why Congress repeatedly has declined, and continues to decline, to enact legislation exempting bank pooled investment funds for Keogh plans and IRAs from the protections afforded by the federal securities laws.

Exhibits

EXHIBIT A

NEWARK STAR-LEDGER—June 20, 1978

"We're #1 nationally in investment performance."

In a recent Merrill Lynch survey of commingled equity funds managed by banks throughout the country, United Jersey Bank ranked:

First in the nation for the year ending March 1978.

In the top 7 percent in the nation for the three years ending March 1978.

In the top 6 percent in the nation for the five years ending March 1978.

During these same periods, United Jersey Bank significantly outperformed the Standard & Poors 500 Index—the benchmark against which virtually all investment managers are measured. In other words, superior relative and absolute performance... consistently.

So if you're responsible for the growth of your company's pension and profit sharing funds or interested in better growth for your personal investments, turn to the team with a winning track record. For your copy of the survey results and a head start in investment growth, call me, Harry S. Stotter, Senior Vice President, at (201) 646-5217.

INVESTMENT MANAGEMENT DIVISION

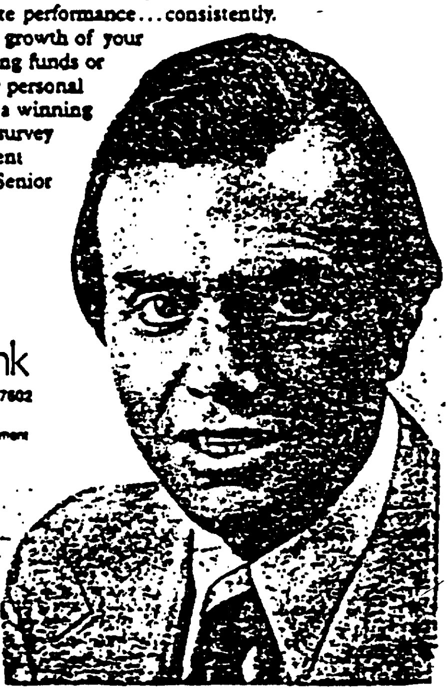
United Jersey Bank

210 Main Street, Hackensack, N.J. 07602

Regional Trust Facilities throughout New Jersey.

Executor • Trustee • Custodian • Investment Management

Total assets over $1.2 billion.

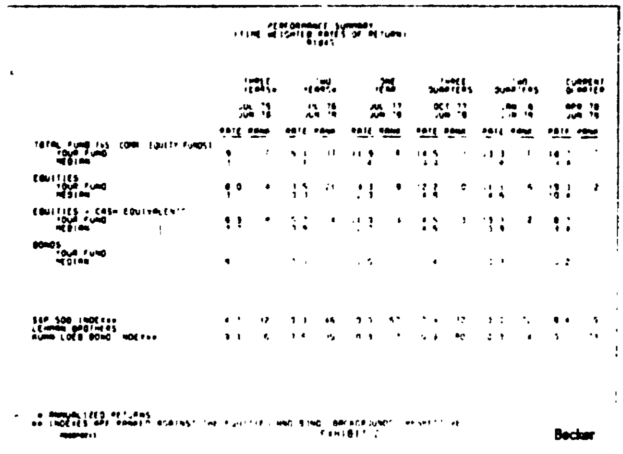


Harry S. Stotter
Senior Vice President

INSTITUTIONAL INVESTOR—August, 1978

PENSIONS & INVESTMENTS—September 25, 1978

When you manage money from 103rd Street you have to do better... and we have!



If you are searching for an equity manager that specializes in indexing, income, risk aversion ... call someone else. If your interest is in **performance**, we would like to be a part of your asset management team. Let us explain our investment philosophy.

SAL ALAIA
VICE PRESIDENT
881-2353

Beverly Bank

1357 W 103rd St.
Chicago, Illinois 60643
881-2200

PENSIONS & INVESTMENTS—January 1, 1979

Good performance is worth talking about

Superior performance is worth looking into

For five years our composite of 24 institutional accounts

- ****outperformed* 78%** of the funds in the Becker sample in *total fund*
- ****outperformed* 92%** of the funds in the Becker sample in *common stocks*
- ****outperformed* 75%** of the funds in the Becker sample in *bonds*
- ****outperformed* 86%** of the funds in the Becker sample in common stock common funds
- ****outperformed* 98%** of the funds in the Becker sample in fixed income common funds

We think you will want to look into our 5-year performance record because measurement people tell us that achieving a 1st Quartile Rank in all major measurement categories—total return, common stocks, bonds, common funds—is *superior!*

We'd like to show you our record. Send for our Performance pamphlet now. Or call (412) 355-3648 for Mr. Francis Devlin, Vice President, Institutional Accounts. He'll be glad to talk to you about how we can perform for you.

*Based on a national survey of more than 4,000 funds measured by A. G. Becker Funds Evaluation Service for five years ending December 31, 1977.

☐ Yes, I'd like to see your 5-year performance record for Institutional Accounts. Please send your free pamphlet.

Name ______

Title ______

Organization ______

Address ______

City ______ State ______ Zip Code ______

Mail to: Mr. Francis Devlin, Vice President
Institutional Accounts
Trust Division
Pittsburgh National Bank
Fifth Ave. & Wood St.
Pittsburgh, PA 15222

PITTSBURGH NATIONAL BANK

PENSIONS & INVESTMENTS—May 21, 1979

Retirement fund sponsors are judged by their performance.

So is the Trust Division of The Fifth Third Bank in Cincinnati.

We manage over a billion dollars in assets. Our performance has consistently placed us in the first quartile of the universe of investment advisors—ranked by the major investment measurement services. We are conservative, long-term investors who build balanced portfolios.

Our flexibility allows us to anticipate and react to the markets. Our size allows us to respond to the needs of our customers with personal service.

If you are responsible for decisions affecting retirement funds, you will be judged by their investment performance.

So are we.

Our record of performance is excellent. Yours will be, too, when you use the services of the Trust Division of The Fifth Third Bank in Cincinnati.

Contact Bob Mitchell, Trust Officer, for complete information on our services. (513) 579-5684.

FIFTH THIRD BANK

38 Fountain Square Plaza
Cincinnati, Ohio 45202

First Minneapolis excels in investment performance.

On November 24, 1975, "Pensions & Investments" published a survey of employee benefit commingled fixed income funds of major banks.

First National Bank of Minneapolis ranked
. . . FIRST for the five years ended September 30, 1975, with a compound annual return of 9.3%.

On December 8, 1975, "Pensions & Investments" published a survey of employee benefit commingled equity funds of major banks.

First National Bank of Minneapolis ranked
. . . THIRD for the five years ended September 30, 1975, with a compound annual return of 7%.

FIRST IN FIVE-YEAR FIXED INCOME PERFORMANCE. THIRD IN FIVE-YEAR EQUITY PERFORMANCE!

First Minneapolis
Trusts and Investment Management Group

Your fixed-income fund has got to deliver superior results.

Year. After year. After year.

We'll find a way.

It's a matter of record: According to *Pensions & Investments*, Nov. 20, 1978, out of 98 money management institutions, we were the only one in the top quartile for every reporting period.

This is no guarantee of future success. It's an indicator that sound investment strategies and decisions can deliver outstanding results.

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.

Put our fund to work for you. Or let us tailor an actively managed fixed-income portfolio to your individual goals and objectives.

Call Tom Patterson, Vice-President, at 312/828-7001. We'll find a way.

CONTINENTAL BANK
TRUST AND INVESTMENT SERVICES

Continental Illinois National Bank and Trust Company of Chicago, 231 South LaSalle Street, Chicago, Illinois 60693

PENSIONS & INVESTMENTS—April 11, 1979

HEADLINE:

"SMALL BANKS AND INSURANCE FIRMS HAD BEST PERFORMANCE IN 1976"

Results of "Pensions & Investments"
Survey indicates that in 1976 the best investment performance was found outside the large institutions.

1976 Results
Out of 128 banks reporting 1976 results: The First National Bank of Kenosha ranked first with 38.4% return.

1974-1976 Results
Out of 122 banks reporting 3 year annualized results: The First National Bank of Kenosha ranked first with 21.2% annualized return.

We have demonstrated our investment expertise. We are also capable of providing equally expert personal service. We are more concerned with where the investment dollars are exposed instead of how large a cash position we are maintaining.

To learn more about THE FIRST NATIONAL BANK OF KENOSHA and its management of employee benefit accounts, contact E. M. Miller, Vice President, The First National Bank of Kenosha, P. O. Box 280, Kenosha, WI 53141 or by phone (414) 658-2331.

FIRST
National Bank
of Kenosha

5622 6th Avenue Kenosha, Wisconsin 53140

Phone: (414) 658-2331 Member F.D.I.C.

Fort Worth National's among *Pensions & Investments'* top 25% of equity managers. Consistently.

Does Fort Worth National know how to manage equities successfully? Look at the record.

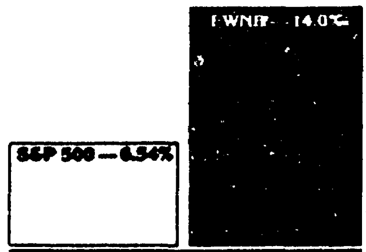
Over the past ten years, our annualized rate of return consistently has placed in *Pensions & Investments'* Performance Evaluation Report's top quartile of bank and insurance company equity pooled accounts. In Frank Russell's surveys, we've ranked even higher when compared to banks and insurance companies with funds larger than Fort Worth National's.

We also have outperformed *Standard & Poor's* 500. In 1978, for example, our equity fund return was 14.0% versus 6.54% for S&P's 500. The charts show how well we've done over the past five years.

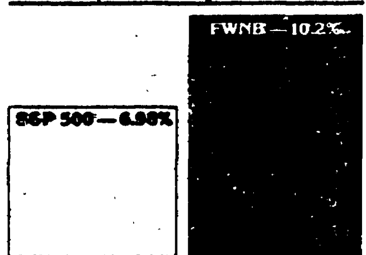
This is only part of the story. We'd like to tell you more about our investment philosophy, staff and comprehensive Plan Administrator Service. Contact Gary C. Nelson, Vice President-Trust Officer, at 817/338-8443. When you do, you'll find out why more and more plan sponsors say...

FORT WORTH NATIONAL ...that's my BANK

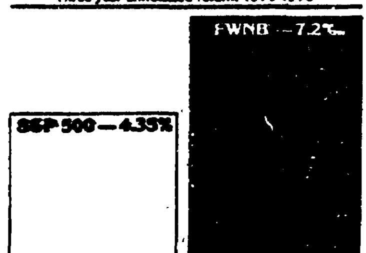
MEMBER TEXAS AMERICAN BANCSHARES INC.
500 Throckmorton Street Fort Worth, Texas 76101



One-year return ending, Dec. 31, 1978



Three-year annualized return, 1976-1978



Five-year annualized return, 1974-1978

Member FDIC

PENSIONS & INVESTMENTS—December 18, 1978

First Pennsylvania is "Most Consistent Manager" as seen in Pensions & Investments.

The best nine-year record.

Who, asked Pensions & Investments, are the managers with consistently good results, year in and year out? To find the answer, they compared the returns of 365 different bank and insurance company managers. The survey covered five different time periods—nine years, five years, three years, one year, and the latest quarter.

Consistency in both fixed-income and equity.

What they found: First Pennsylvania Bank was ". . . the most consistent manager in the survey in both equity and fixed-income. The First Pennsylvania Bank was in the first quartile of performers in four of the five time periods in fixed-income and in all five periods in its management of equities."

We outperformed both S&P and Salomon.

In 1977, the S&P 500 declined 7.2%; we achieved a positive rate of return of 3.4% on our pension equity fund.

In the same period, the Salomon Index gained just 1.7%; but our fixed-income fund gained 5.3%. Over the past five years, we have outperformed 82% of the equity funds and 89% of the bond funds surveyed by A. G. Becker.

If you'd like to learn more about First Pennsylvania's extraordinary record and how we can help you achieve your performance objectives, we'd be glad to discuss our approach to investment management with you. Just call H. Jerry Wolf at (215) 786-8706. Or write.

First Pennsylvania Bank
Trust & Investment Group
Philadelphia, Pa. 19101
©1978 First Pennsylvania Bank, Member FDIC

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Commingled Equity Funds

(Funds in top quartile over three or more time periods)

INSTITUTION	9 yrs	5 yrs	3 yrs	1 yr	3 mos
American Bank Pa	●	●	●	●	●
Bankers Life Ia	●	●	●	●	●
1st of Birm Al	●	●	●	●	●
FIRST PENNSYLVANIA	●	●	●	●	●
1st Variable Ar	●	●	●	●	●
Minnesota Mutual	●	●	●	●	●
Prov Natl Pa	●	●	●	●	●
Fifth Third Oh	●	●	●	●	
Liberty Natl Ok	●	●	●	●	
Pacific Natl Wa	●	●	●	●	
1st City Dallas	●	●	●		●
1st Albuquerque	●	●	●		●
Citz Chillicothe Mo		●	●	●	●
Citizens & So Ga	†	●	●	●	●
1st Natl Exch Va		●	●	●	●
1st Kenosha Wi	†	●	●	●	●
1st Wis Natl	†	●	●	●	●
Guardian Ins N Y	†	●	●	●	●
Hibernia Natl La	†	●	●	●	●
Mass Mutual		●	●	●	●
Natl Westchester N Y		●	●	●	●
Phoenix Mu Ct		●	●	●	●
United Jersey N J	†	●	●	●	●
U S Natl Or	†	●	●	●	●
U S Natl Galveston	†	●	●	●	●
Fort Worth Natl	●	●		●	
Old Natl Wa	●	●			●
Chicago Title	†	●	●	●	
1st Trust Corp Co		●	●	●	
Marine Midland N Y		●	●	●	
Commonwealth Natl Pa	†	●	●		●
Oregon Bank	†	●	●		●
First in Dallas		●		●	●
Cont Life Ont			●	●	●
Landmark Union Fl	†		●	●	●

Commingled Fixed-Income Funds

(Funds in top quartile over three or more time periods)

INSTITUTION	9 yrs	5 yrs	3 yrs	1 yr	3 mos
Continental Illinois	●	●	●	●	
Equit Trust Md	●	●	●	●	
FIRST PENNSYLVANIA	●	●	●	●	
1st Atlanta, Ga	†	●	●	●	●
1st Bartlesville, Ok	†	●	●	●	●
Hibernia Natl La	†	●	●	●	●
Lincoln Natl In	†	●	●	●	●
Liberty Natl Ok	●	●	●		
Morgan Guaranty, N Y	●	●	●		
Detroit Bank Trust	●	●		●	
1st of Minneapolis	●	●			●
Old Kent Mi	●	●			●
Bank of Oklahoma			●	●	●
Fourth Natl Ok			●	●	●
Mercantile of Dallas			●	●	●
Ohio Cit Trust			●	●	●
Sec Trust Rochester			●	●	●
Union Planters, Tn			●	●	●
U S Trust, N Y		●		●	●

†Indicates fund was not in existence for entire nine-year period

A bank at work:

producing positive investment results

The Philadelphia National Bank's commingled equity fund for employee benefit trusts has out-performed both the Dow-Jones Index and Standard & Poor's Index for the 5 years ended June 30, 1975, as follows:

	Total Rate of Return on a Cumulative Basis (income reinvested)	Compound average annual growth rate
PNB Philabank Stock Fund	+98.1%	+14.7%
Dow Jones Industrial Average	+57.8%	+ 9.6%
Standard & Poor's "500"	+55.8%	+ 9.3%

PNB offers a high level of experience and personalized service to meet the objectives of each fund. You'll find that PNB's investment management services are tailored to your needs and specific requirements. And we provide the specialized services of securities' and economic research, portfolio management and close personal account supervision. We are just the right size to do these things most efficiently and to make decisions with speed and flexibility.

To learn how these results were achieved, call Harry A. Dorian at (215) 629-4031.

PNB Philadelphia National Bank

PHILADELPHIA NATIONAL BANK, PHILADELPHIA • PHILADELPHIA INTERNATIONAL BANK, NEW YORK
Offices: Philadelphia • New York • Bangkok • Caracas • London • Luxembourg • Nassau • Panama • São Paulo • Sydney
Associates: Dublin • Hamburg • London • Managua • Panama • Paris • Rio de Janeiro • Vienna

DECEMBER 1975

PENSIONS & INVESTMENTS—May 21, 1979

Our Fixed Income Fund has shown top quartile performance with lowest quartile risk. Has yours?

Compare your fixed income fund with ours. For the period ending December 31, 1978, as measured by Frank Russell Co., Inc., the performance of our fixed income fund for employee benefit accounts was in the top quartile for one, two, three, five and eight years. At the same time, our fund was in the lowest quartile of volatility for all these periods.

In fact, for the three-year period ending December 31, 1978, only five managers of the 111 bank-pooled fixed income funds measured by Russell delivered a higher return at a lower risk. Interestingly, the size of the funds handled by these managers only ranged from $8 to $25 million. Our fund is $111,000,000 and averaged an 8.3 percent annual return, while maintaining lowest quartile volatility.

If your fund's performance doesn't measure up to ours, shouldn't you turn to Detroit Bank & Trust as your next manager? We already have over a billion dollars of employee benefit assets under management.

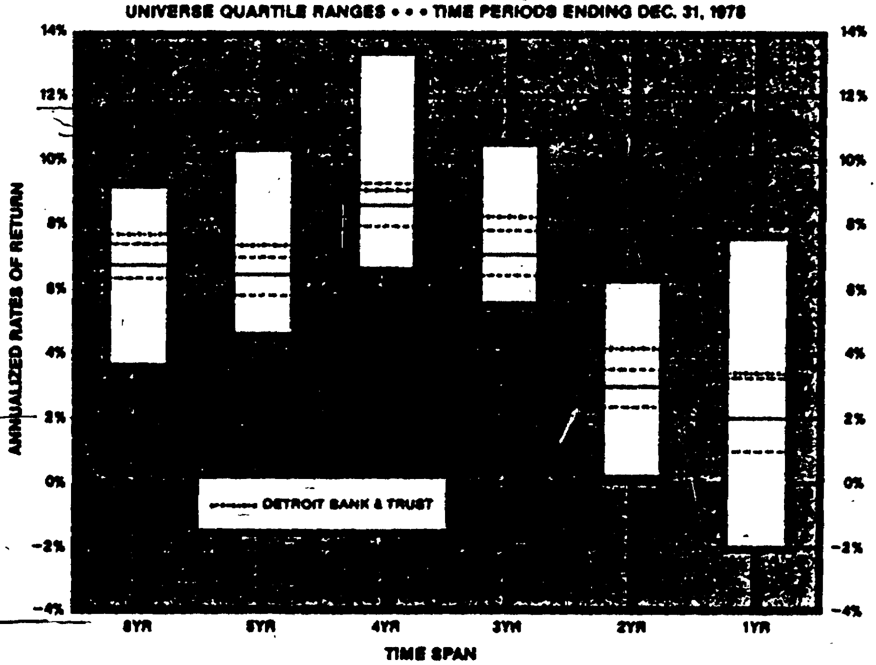
Call or write Terry Keating at (313) 222-3898, Detroit Bank & Trust, Box 59, Detroit, Michigan 48232.

you ought to know a DETROIT BANK-er better

DETROIT BANK & TRUST

BANK FIXED-INCOME POOLED ACCOUNTS

UNIVERSE QUARTILE RANGES • • • TIME PERIODS ENDING DEC. 31, 1978



130 years' experience, you can bank on it.

PENSIONS & INVESTMENTS—April 23, 1979

A lot of fund managers are happy to equal the S&P average. We start there.

Over the most recent 5-year period, Central National Bank achieved an average 6% return on its Commingled Equity Fund for Employee Benefit Plans. That's well above the S&P average for 500 stocks.

The same kind of above-average performance was recorded for the most-recent 3-year and 4-year periods, too.

Ranked fifth out of 72 equity pooled bank portfolios by the Frank Russell Co. Inc., we're proud to have out-performed some of the best known names in the country. In fact, our record of performance clearly makes us a "little-known big name."

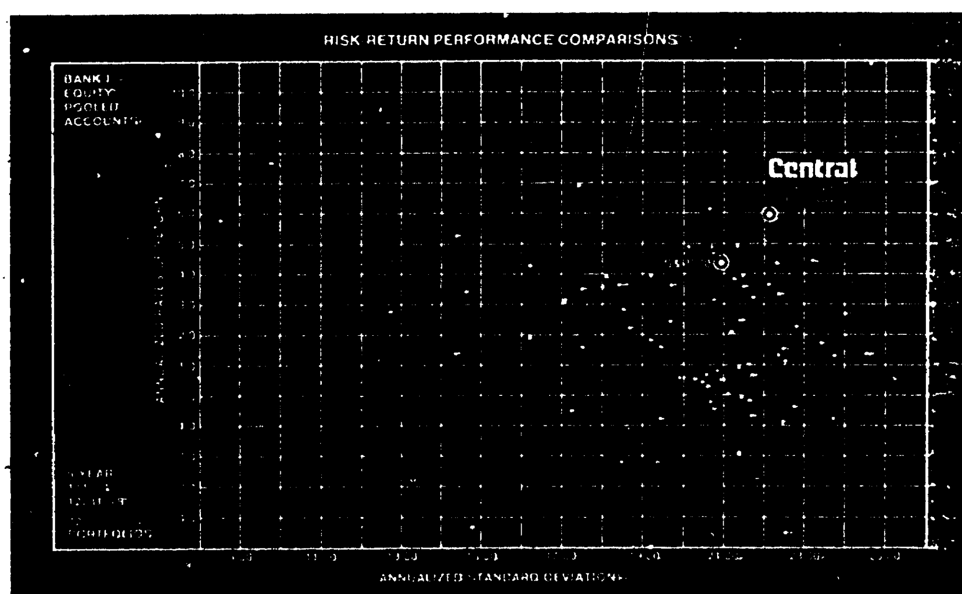
We employ multiple strategies. The unifying theme is a realistic appraisal of potential total return as related to risk, with an orientation toward quality growth companies.

You probably don't know us yet, but if you begin looking at who are the consistent performers, you'll want to talk to us.

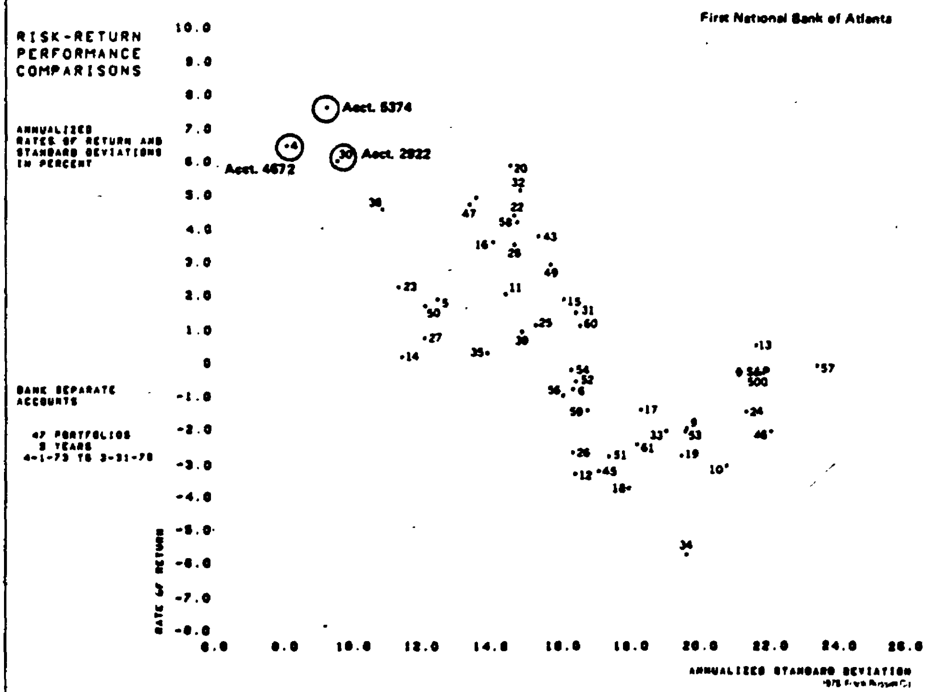
The person to start with is Chuck Meckes, Vice President, Trust Department. Call him at (216) 344-5023.

Central Bank

Central National Bank of Cleveland



Our past is more than just performance. It's a philosophy.



For the past five years The First National Bank of Atlanta has consistently out-performed the other banks in the Frank Russell Survey. How so?

Well, the way we figure it, if we're going to optimize our clients' return, then we're going to have to conservatively manage the risks. Which is why we demand of ourselves a consistently conservative investment posture. And as you can see by the chart this policy has served our clients well over the past five years.

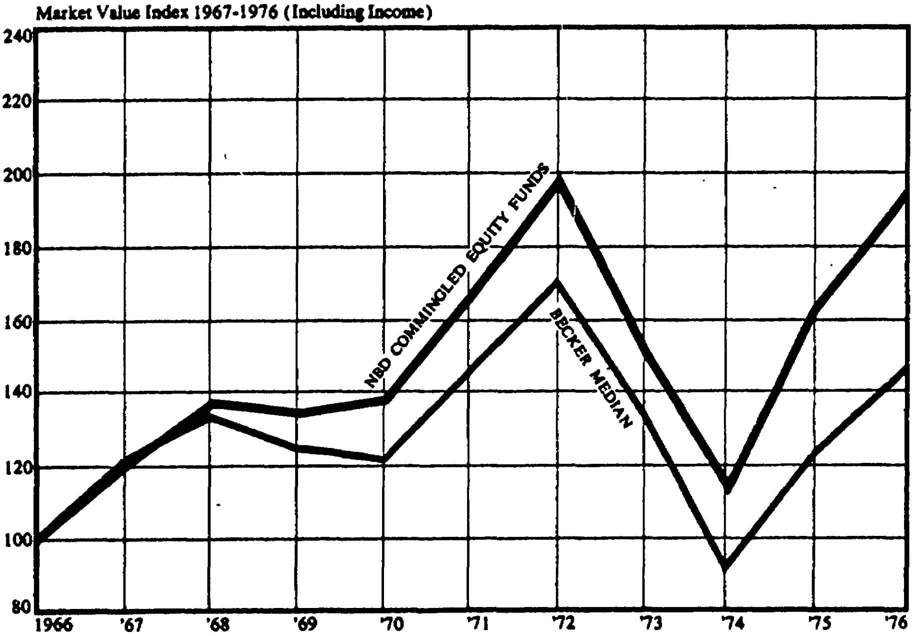
For more information on how we can help you in the future, there's no time like the present to contact Fred Betts 404/588-6817.

THE FIRST NATIONAL BANK OF ATLANTA

Trust & Investment Department, 2 Peachtree St., N.W. Atlanta, Georgia 30303

Read between the lines.

Market Value Index 1967-1976 (Including Income)



OVER THE LAST DECADE, THE NATIONAL BANK OF DETROIT COMMINGLED EQUITY FUNDS HAVE OUTPERFORMED 97% OF THE BECKER UNIVERSE.

THIS RECORD IS A RESULT OF:

- Consistently superior performance from peak to peak, trough to trough, and over full market cycles.
- A uniquely disciplined approach to investment research and portfolio construction, utilizing modern asset valuation technology.

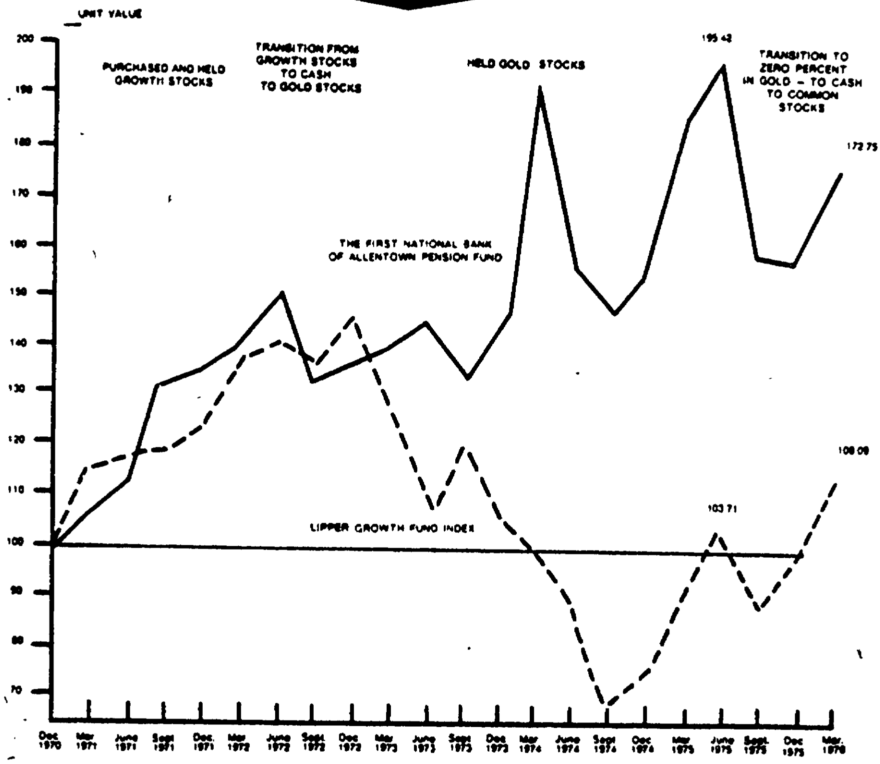
For some fascinating details on this process, and how it can benefit you, please contact RICHARD L. FOERSTERLING, Vice President, Trust Investment Department, National Bank of Detroit (313) 225-2820.

NBD

Trust Division
National Bank
of Detroit

PENSIONS & INVESTMENTS—May 10, 1976

Money management is where you find it, even in Allentown, Pennsylvania.

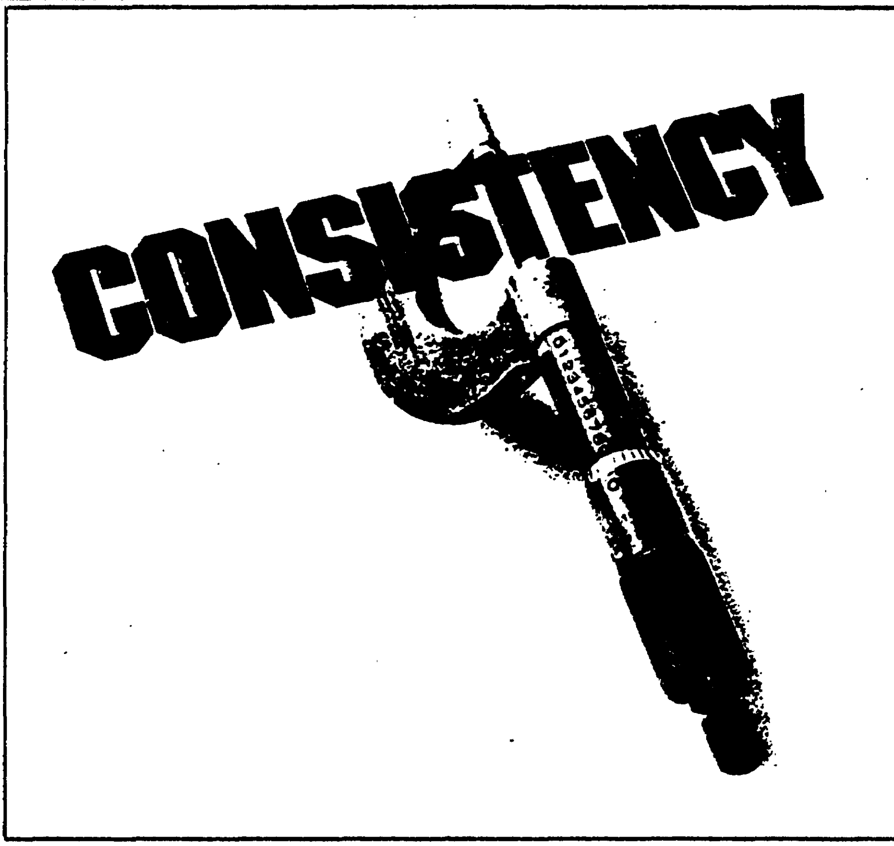


Wouldn't you agree?

For more information call Bill Snow
Investment Management Division
(215) 439-4360 or (215) 439-4209

Lipper Growth Fund Index Adjusted December 1970 = 100
The use of the Lipper Index does not imply endorsement, approval or analysis by the Lipper organization.

1st NATIONAL BANK
ALLENTOWN, PA.



To choose a money manager, first measure consistency.

No fund can afford extreme volatility in the performance of its money manager, nor run the risks that come with desperate efforts to foresee short-term swings in the market.

Consider a prudent alternative. Examine National Bank of Detroit's "equity percent" ranking in the Becker Securities, Inc. universe for periods ending 1972 through 1977.

NBD outperformed, on average, 86% of other money managers for the six latest ten-year periods, exceeding the Becker Median yearly by an average of 2.1 percentage points.

NBD outperformed, on average, 86% of other money managers for the six latest seven-year periods, exceeding the Becker Median by 2.5 percentage points.

NBD outperformed, on average, 80% of other money managers for the six latest four-year periods, exceeding the Becker Median by 2.8 percentage points.

Consistency of this caliber, under all market conditions, is the product of NBD's disciplined valuation system. This system reduces subjective bias and makes it possible to anticipate the value of securities without regard to type and to position your portfolio accordingly.

It will cost you nothing but a few minutes of your time to learn how these impressive results are achieved, and how we can put our capabilities to work for you. You begin with a telephone call to Richard Foersterling, Vice President at 313-225-2820.

NBD

Trust Division . National Bank of Detroit

107 INSTITUTIONAL INVESTOR

PENSIONS & INVESTMENTS—July 31, 1978

Compare your Fixed Income Fund with the one we manage.

You want your fixed income manager to earn a high rate of return, avoid high risk and deliver consistently good performance.

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.

The fund managed by Detroit Bank & Trust has maintained a rate of return well above the median for the six cumulative periods measured by Russell (8 years, 5, 4, 3, 2, and 1), and in the top quartile four times out of the six, including the longest (8 years) and the shortest (1 year).

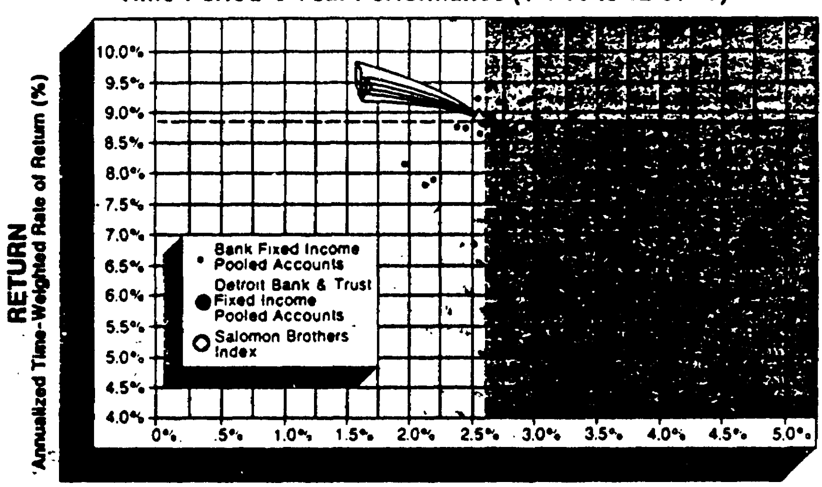
If your performance doesn't measure up to ours, shouldn't you turn to Detroit Bank & Trust as your next manager? We already have over a billion dollars of employee benefit assets under management.

Call or write Terry Keating at (313) 222-3898, Detroit Bank & Trust, Box 59, Detroit, Michigan 48231.

you ought to know a DETROIT BANK·er better

DETROIT BANK & TRUST

RISK VS. RETURN
Time-Period·8 Year Performance (1-1-70 to 12-31-77)



RISK
Quarterly Standard Deviation

The Indian head leads you to Detroit's first family of banks DETROITBANK Corporation.

NEWARK STAR-LEDGER—April 24, 1979

Take a longer look at investment performance...

In evaluating bank-pooled investment funds, the only true measure is to examine performance over a 3 to 5 year period. No bank in New Jersey surpasses First Jersey in performance over the current full economic cycle.

Here are the facts from a recent long-term independent survey by Computer Directions Advisors.

NEW JERSEY BANKS EQUITY FUND PERFORMANCE 12/29/78

	LATEST YEAR 12/77-12/78		LATEST 3 YEARS 12/75-12/78		LATEST 5 YEARS 12/73-12/78	
	RETURN	NAT. RANK	RETURN	NAT. RANK	RETURN	NAT. RANK
First Jersey National Bank	8.7	54	43.4	11	49.8	15
Fidelity Union Trust Company	9.1	46	N/A		N/A	
First National State Bank	8.1	64	31.9	33	18.0	92
Garden State National Bank	5.9	120	22.6	79	45.2	22
Midlantic National Bank	8.5	59	28.5	44	34.3	56
New Jersey National Bank #2	5.1	132	13.4	147	N/A	
Summit & Elizabeth Trust	8.1	66	.9	201	19.2	83
United Jersey Bank	7.3	[illegible]	33.8	26	39.1	29
No. of Funds Surveyed - National	215		206		188	
FJN's Percentile - National	25.1%		5.4%		8.0%	

NEW JERSEY BANKS FIXED-INCOME PERFORMANCE 12/29/78

	LATEST YEAR 12/77-12/78		LATEST 3 YEARS 12/75-12/78		LATEST 5 YEARS 12/73-12/78	
	RETURN	NAT. RANK	RETURN	NAT. RANK	RETURN	NAT. RANK
First Jersey National Bank	2.9	48	30.3	8	42.5	28
First National State Bank	(.4)	159	21.2	110	33.2	101
Garden State National Bank	2.5	62	29.7	12	40.2	33
Midlantic National Bank	1.6	92	28.1	17	36.7	66
New Jersey National Bank	1.7	89	28.8	36	N/A	
United Jersey Bank	.2	150	20.8	117	N/A	
No. of Funds Surveyed - National	162		153		140	
FJN's Percentile - National	29.6%		5.2%		17.9%	

And the First Jersey's commingled investment fund has grown equally dramatically in size — 140.8% in common stocks (to 10,101,560.86), and 130.4% in fixed income holdings (to 6,000,686.15) since the end of 1974.

John J. Saueracker
Sr. V.P. Investment Dept.

That is the kind of growth that can be achieved only by outstanding and consistent performance over the long haul. It's the kind of performance that puts the First Jersey National Bank in first place in New Jersey.

We invite you to participate in our success. A call to John J. Saueracker will introduce you to a concerned expert who will guide you to a plan that precisely fits your current needs and objectives for pension and profit-sharing fund investments. You can reach John at: (201) 547-7077.

FIRST JERSEY
SINCE 1864 NATIONAL BANK
Banking on a first name basis.

Headquarters —
2 Montgomery Street, Jersey City, N.J. 07303
27 offices in Hudson, Bergen, Essex, Union, Monmouth and Ocean counties.
Member FDIC and FEDERAL RESERVE SYSTEM

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.

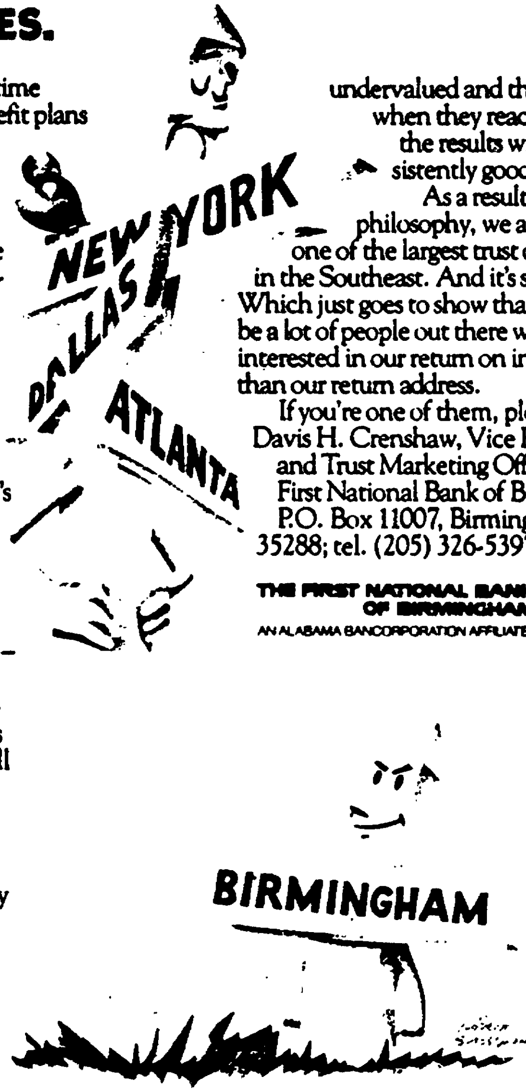
And we have a philosophy that would be just as sound no matter where we had our office. Which is simply that if you consistently buy stocks that are undervalued and then sell them when they reach full value, the results will be consistently good.

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

AN ALABAMA BANCORPORATION AFFILIATE MEMBER FDIC



INSTITUTIONAL INVESTOR—August, 1978

It takes a broad range of investment skills to match retirement fund objectives today.

Here's how the people of First Chicago, with investment responsibility for $8.8 billion, can provide diversification that's beyond the realm of other major money managers.

Mention diversification to most money managers and they'll tell you about their stocks and bonds. Mention it to First Chicago and we'll tell you a lot more.

We believe that extraordinary times call for extraordinary measures. To cope with today's erratic market behavior you need diversification that goes beyond conventional stocks and bonds, and beyond national boundaries. We've developed the skills to provide this full spectrum of diversification. And we have performance figures to prove its effectiveness. Here are a few examples.

Real estate to offset inflation.

A limited supply and increasing demand make choice income property an ideal investment for protecting assets from inflation. To provide easy access, First Chicago developed Real Estate Fund F, the oldest and by far the largest nationally diversified real estate fund, emphasizing outright ownership of properties, operated by any bank.

Properties are selected and managed by the Trust Department's own team of real estate specialists. As we invest only for funds we manage, we have no conflict as to allocation of choice properties. And investments are diversified both geographically and by property type: industrial buildings, office buildings, retail centers and garden apartments.

Fund F has provided an annualized return of 8.2% since its inception in 1973. And for the 12 months ending June 30, return was 9.1%.

Assistant Vice President David L. Greenlee, C.P.M. (left), inspects corporate headquarters building owned and leased by First Chicago's Real Estate Fund F.

International securities to reduce volatility.

Since the securities markets of other countries tend to peak and valley at different times than our own, adding equities of overseas companies to your portfolio can reduce volatility. Yet that avenue of investment remains foreign to most major money managers.

Not to First Chicago.

We were among the first to recognize the advantages of international diversification. In early 1973 our Trust Department established a London base staffed with a seasoned investment team. Today that team has management responsibility for over $110 million in equity and debt investments.

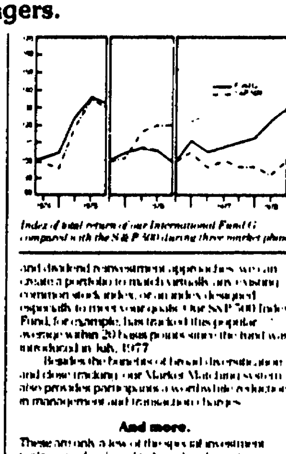
Investments are diversified by country, type, industry and company. And our common stock emphasis is on well-managed, high quality corporations, especially those in sound, relatively high-growth economies with solid currencies.

Recent equity performance has been particularly favorable, as reflected by International Fund G. Since Oct. '76, unit value has increased 31.1% while the S&P 500 was up only 11.8%.

A market matching system that really matches.

Modern Portfolio Theory suggests, and we agree, that part of your employee benefit assets should be under passive index management. And First Chicago has developed a technology for it that's unique.

Using one of three asset composition techniques, plus special trading strategies and dividend reinvestment approaches, we can create a portfolio to match virtually any existing common stock index, or an index designed especially to meet your goals. Our S&P 500 Index Fund, for example, has tracked this popular average within 20 basis points since the fund was introduced in July, 1977.



Index of total return of our International Fund G compared with the S&P 500 during three market phases.

Besides the benefits of broad diversification and close tracking, our Market Matching system also provides participants a worthwhile reduction in management and transaction charges.

And more.

These are only a few of the special investment tools we've developed to broaden diversification, improve performance and reduce overall portfolio volatility. Each is available as a special service, or as part of our complete retirement fund management program. If limited diversification isn't doing the job for you, why not look into the full spectrum at First Chicago? Write or call John P. Scott, Trust Officer, Trust Department, The First National Bank of Chicago (312) 732-1172. Member FDIC.

The First National Bank of Chicago
Trust Department

Active investing in the fixed-income market makes sense and money.

Becker

FUNDS EVALUATION SERVICE

INTERIM REPORT

NATIONAL CITY BANK • CLEVELAND, OHIO
NATIONAL CITY BANK INVESTMENT FUND FOR RETIREMENT TRUST – FIXED INCOME

TIME-WEIGHTED RATES OF RETURN AND RANKINGS
PERIODS ENDED JUNE 30, 1977

YOUR FUND W1298	12 MONTHS PERCENT		24 MONTHS PERCENT		36 MONTHS PERCENT	
FIXED INCOME	RATE	RANK	RATE	RANK	RATE	RANK
YOUR FUND	13.2	12	12.5	10	11.9	11
MEDIAN	10.4		9.8		9.7	

This rate of return was accomplished through efficient management of our $129 million Fixed Income Collective Fund for Retirement Trusts without impairing the quality of the portfolio. 98.45% of the market value is in Governments, Agencies and AAA Corporate Bonds. We feel this is the type of bond management you should be looking for. For further information or to arrange for a fact finding presentation, call (216) 861-4900 or write the Trust Group, New Business Division, National City Bank, 623 Euclid Avenue, Cleveland, Ohio 44114.

National City Bank
Cleveland • Ohio

WALL STREET JOURNAL—June 29, 1978

Vice President Howard Hudson, right, head of Morgan's fixed-income group, exchanges market information and viewpoints with the group's specialists.

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.

They are aggressive, active managers with well-defined goals – maximum return with minimum risk, consistency rather than volatility. Their strategy is to combine high credit quality, a carefully controlled maturity structure, and skillful timing.

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 fixed-income return on all employee benefit accounts compared with Salomon Brothers High Grade Corporate Bond Index since the Index was established. Reinvestment of income assumed.

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 Assistant Vice President John L. Griffith, Morgan Guaranty Trust Company, 9 West 57th Street, New York, N.Y. 10019.

The Morgan Bank

BUSINESS WEEK—April 2, 1979

How international diversification improves return and reduces volatility for Morgan's investment clients

Member FDIC

Morgan officers at this international investment strategy meeting in London are (from left) Robert Rex and Nicholas Potter, New York; Karl Van Horn and Pierre Devaux, London; Hideo Doi, Tokyo; Carl Hathaway, New York; Walter Zimmer, London.

Alert pension fund sponsors, foundations, and other institutions are discovering the advantages of investment diversification by country. Through actively managed international portfolios they're getting improved return and lower volatility.

Many of them are clients of The Morgan Bank, which manages more than half a billion dollars in overseas equity and fixed-income securities for U.S. employee benefit plans. The chart at right shows the five-year performance of our commingled pension fund devoted to international equities.

At Morgan our investment approach traditionally has been international. Even when U.S. regulations made new overseas buying impractical, we kept up our research and our contacts. Today our international investment team includes professionals based in London, Paris, Geneva, and Tokyo.

Geographic diversification that's actively managed and based on careful research broadens the range of investment options. It can smooth the cyclical bumps that are likely to jar a one-economy portfolio. It can turn inflation differentials and currency fluctuations into opportunities rather than hazards.

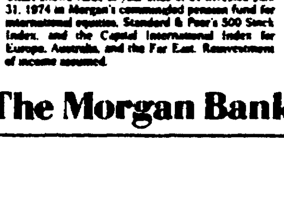


Chart shows value at year-ends of $1 invested Jan. 31, 1974 in Morgan's commingled pension fund for international equities, Standard & Poor's 500 Stock Index, and the Capital International Index for Europe, Australia, and the Far East. Reinvestment of income assumed.

But this kind of fund management takes special resources. Morgan's international investment managers draw on the knowledge of a multinational research team, the country-by-country analyses of the bank's international economists, and the currency judgments of its foreign exchange specialists in the world's money centers. Employing these strengths systematically, they build international portfolios that balance risk and return in accord with the client's specific objectives.

For more information on the advantages of international diversification, please write on your letterhead to Henry D. Cavanna, Vice President, Morgan Guaranty Trust Company, 9 West 57th Street, New York, N.Y. 10019.

The Morgan Bank

EVEN IF YOUR PENSION FUND HAD A GOOD YEAR,

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 Judith M. Trepanowski, Marine Midland Bank, 250 Park Avenue, N.Y., N.Y. 10017, telephone (212) 949-6649.

[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, Beirut, Bogotá, Buenos Aires, Caracas, Frankfurt, Hong Kong, Jakarta, London, Madrid, Manila, Mexico City, Nassau, Panama, Paris, Rio de Janeiro, Rome, São Paulo, Seoul, Singapore, Sydney, Tehran, Tokyo, Toronto.

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.

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PENSION WORLD/NOVEMBER 1977 17

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January 15, 1979

To: Investment Company Institute

From: Hill, Christopher and Phillips, P.C.

Subject: Analysis of Prospectuses and Annual Reports of Collective Investment Funds for Keogh Plans that have Registered Participations under the Securities Act of 1933.

Seven bank-sponsored collective investment funds for Keogh plans have registered participations under the Securities Act of 1933 ("1933 Act").1/ These funds are exempted from regulation under the Investment Company Act of 1940 ("1940 Act") by legislation enacted in 1970.2/ We have reviewed the operations of six of these funds as described in their most recent prospectuses on file with the Securities and Exchange Commission.3/

1/ The seven collective investment funds for Keogh Plans were established by American Security and Trust Company (Washington, D.C.), Commerce Bank of Kansas City, Continental Illinois National Bank (Chicago), The First National Bank of Boston, National Bank of Detroit, United Missouri Bank of Kansas City, N.A., and Wells Fargo Bank, N.A. (San Francisco).

2/ Investment Company Amendments Act of 1970, Pub. L. No.91-547, 84 Stat. 1413 (1970).

3/ The prospectuses and reports of Commerce Bank of Kansas City have not been available from the public files of the SEC.

Our review focused on ten areas of fundamental regulatory concern under the 1940 Act, as follows: (1) limitations on investment discretion; (2) calculation of advisory fees; (3) per share income and capital changes information; (4) valuation dates; (5) timely payment of distributions; (6) timely investment of portfolio cash; (7) valuation of debt securities; (8) purchases of certificates of deposit issued by fund affiliates; (9) allocation of brokerage commissions and, (10) reports to participants. Attached is a table prepared for each fund that quotes the fund's prospectus on each of the ten matters.

The study demonstrates that in many instances the bank managers of these unregulated funds arrogate to themselves completely unfettered discretion to change investment policies and advisory fees without the consent of investors. The banks are also able to obscure their advisory fees by excluding them from disclosed expense ratios. The absence of 1940 Act regulation also allows the banks to delay honoring investor redemption requests, to avoid reporting to shareholders, and to use the fund's brokerage commissions without regulatory restrictions.

Most important of all, the regulatory vacuum created by the exemption from 1940 Act regulation allows the banks to profit from self-dealing transactions with their funds. Thus, banks can maximize the funds' interest-free deposits with the banks by delaying investments of new deposits and by keeping the funds' portfolios in a "liquid position". They also invest fund assets in certificates of deposit issued by their own banks. Such self-dealing would be illegal if the funds were registered under the 1940 Act. Thus, the study makes clear, notwithstanding registration under the Securities Act of 1933, disclosure by itself, even disclosure administered by the SEC, is not sufficient. It is the strongest evidence that protection of participants in managed investment funds requires 1940 Act regulation.

The review of prospectuses and annual reports does not purport to be exhaustive. On the contrary, it reflects a number of limitations that result from inabilities to obtain full information. For example, the SEC Public Reference staff could not find any prospectus files for Commerce Bank of Kansas City or any annual report files for six of the funds.[4/] In addition, the current information on financial operations of each of the funds was only as of a single date, the end of their fiscal years. If any additional conflict of interest transactions occurred between a bank and its fund, they could easily have been eliminated before the reporting date. Thus

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4/ Annual report files were found only for National Bank of Detroit.

a complete study requires going beyond the limited information in SEC filings and examining the operations of the funds themselves.

1. Limitations on Investment Discretion

The 1940 Act requires investment companies to establish and adhere to definite investment policies. The Act also prohibits investment companies from changing their fundamental policies without shareholder approval. Thus, managers of registered investment companies have no power to unilaterally change the investment policies approved by the shareholders.

These requirements were mandated by Congress to provide investors with an adequate basis for their investment decisions, to assure them that material changes in investment policy will not be made without their consent, and to give them an opportunity to withdraw their investments if those policies are changed.

In contrast, the bank fund managers, in the absence of 1940 Act regulation, are not subject to any legal restrictions with respect to their freedom to change even the most fundamental investment policies. All but one of the bank fund prospectuses 5/ make clear that their fund managers have taken advantage of the regulatory vacuum by stating that

5/ The one exception is the National Bank of Detroit which does appear to subject itself to certain restrictions.

the banks have complete freedom of action to make any type of investment, in any amount, for any reason whatsoever. Thus, without approval or even notification to shareholders, the banks may change, in their unfettered discretion such fundamental investment policies as: the percentage of fund assets which may be invested in any one issuer; the percentage of outstanding voting securities of an issuer which may be purchased; the concentration of investments in a particular industry; or engaging in such speculative activities as margin, short-sale and commodities transactions.

As a result, employers and employees have a totally inadequate basis for making their investment decisions. They have no basis on which to distinguish one fund from another. They have no influence or residual control over a fund's investment policies once their contributions are invested in the fund. And they have no assurances that next year (or next week) the fund is going to resemble in any way the fund they chose this year or that they will have an opportunity to withdraw their investments before any policy change.

2. <u>Investment Advisory Fee</u>

Section 15(a) of the 1940 Act requires a registered investment company adviser to have a written contract with the investment company. This section also requires that the advisory fee be "precisely described" in the contract.

The fees charged to all six of the bank funds are not specifically stated in any agreement. Although the fees currently being charged are stated in the fund prospectuses, they are subject to change unilaterally by the banks. Thus, participants have no control over fees they pay. Their only recourse in the event a bank decides to change its fees is to hire a new trustee - an expensive and complicated task for an ERISA plan.

Investment advisory fees in the investment company industry typically are 0.5% or less. In addition, the fees are ordinarily reduced at certain breakpoints as the assets of an investment company increase. In contrast, only one of the six fees currently being charged the unregulated bank funds contains a breakpoint. None of the fees was less than 0.5%; one bank charged 0.75% and another charged 1.0%. In addition, only one of the banks states that it calculates its fee based on average assets.[6/] The remaining banks calculate their fees as of a specified date or dates. In two cases, the banks apparently calculate their fees of 1.0% and 0.75% as of December 31 of each year.[7/]

6/ That fund prospectus (United Missouri Bank), however, does not indicate whether an average of daily, monthly or quarterly asset values are used.

7/ American Security and Trust Company and Wells Fargo Bank, N.A.

This practice increases the costs to the funds and profits of the banks. Since most Keogh plan contributions traditionally have been made in December, the funds are charged a full fee for less than a month of portfolio management. For example, if a Keogh plan sent contributions to Wells Fargo of $1 million on December 26, 1978, a full fee of $10,000 would be deducted five days later. If that same Keogh plan requested a distribution of $1 million on December 26, 1979, Wells Fargo would not make a withdrawal until after another full fee of $10,000 was deducted on December 31, 1979.

This practice also gives the banks an unfair competitive advantage. Their prospectus statements appear to indicate that they charge fees comparable to registered investment companies. In fact, however, the way they calculate their fees produces substantially more revenue and is not comparable.

3. Per Share Income And Capital Changes Information

1940 Act regulation requires registered investment companies to include in their prospectuses a table showing per share income and capital changes for the past 10 years. One important item required to be included in the table is a ratio of expenses to investment income. The significance of this table, in the view of the SEC, is indicated by the requirement that it be placed within the first five pages of an investment company prospectus.

Four of the bank sponsored fund prospectuses do include per share income and capital changes tables ~~but~~ only two of these were prepared on a basis similar to that required under the 1940 Act. Thus, it is impossible for an investor to determine the investment and expense experience of four of the six funds. And it is impossible to compare their experience with that of other mutual funds.

Incredibly, two of the banks did not treat their fees as a fund expense for purposes of these tables or their statements of operations. None of the banks treated account charges as fund expenses. As a result, one of the funds reported an annual expense ratio of 0.01% while another fund with a similar cost structure reported an expense ratio of 0.8%. Mutual funds subject to the 1940 Act would, in similar situations, be required to report expense ratios of 1.0% to 1.5% or more. Thus, because the banks do not include these expenses, their financial statements purport to show a significantly less expensive operation than do mutual funds in similar situations.

4. Valuation Dates

The 1940 Act requires a registered mutual fund to credit investments and make redemptions on a daily basis. This requirement in effect mandates daily valuation of mutual fund assets. The 1940 Act imposes these requirements to assure that amounts paid by investors are invested and redeemed promptly at appropriate net asset values.

These requirements apply to all mutual funds registered with the SEC, even though their advisers do not have the same incentives to delay crediting investments and making withdrawals as do banks. Banks, of course, are in a classic conflict of interest situation with respect to contributions and withdrawals. They receive substantial direct benefits from any float they can generate as a result of delaying investment of contributions or payment of withdrawals.

Nevertheless, banks are not required to value the assets of their funds on a frequent basis. Thus, none of the six unregulated funds values on a daily basis. Three state they value their funds' portfolios on a monthly basis. One fund values its portfolio four times a year and another values five times a year. One of the banks states that it has only one regular Valuation Date; but indicates it may value more frequently.[8/]

Such infrequent Valuation Dates allow the banks to deposit contributions in the non-interest bearing accounts from the day of receipt until the next Valuation Date. They also may deposit withdrawals in one of their non-interest bearing accounts from a Valuation Date until the withdrawal

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8/ United Missouri Bank of Kansas City.

check clears. Thus, the valuation procedures of the banks apparently create significant additional interest free deposits and directly benefit the banks at the cost of lost interest to investors. Nevertheless, only one bank even referred to this conflict in its fund prospectus.[9/]

5. Payment on Redemptions

Section 22(e) of the 1940 Act requires registered mutual funds to make payment within seven calendar days of receipt of an order for redemption.

This requirement does not apply to the unregulated funds. Thus none of the six bank sponsored funds makes a withdrawal or distribution except on a Valuation Date. Only one of the banks even states in its fund prospectus a policy with respect to making payments within a specified time following a Valuation Date. That prospectus states that payments will be made within 10 days following a Valuation Date. The lack of any requirements in this area also permits the creation of a float to the benefit of the banks.

6. Investment of Fund Cash

An investment company adviser is under an obligation to keep assets as fully invested as possible consistent with the investment company's investment objectives and

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9/ The First National Bank of Boston.

policies. As a result, investment company advisers typically have procedures to assure that no cash is left on deposit in a non-interest bearing account unless it is absolutely necessary.

Unlike investment company advisers, banks obtain direct substantial benefit from deposits. Each of the fund prospectuses, however, indicates that banks may leave uninvested cash in non-interest bearing accounts without any responsibility for loss of interest. Thus the banks have established policies that permit serious conflict of interest transactions that benefit themselves at the expense of Keogh plan participants. Such practices also create an obvious bias in the formulation of investment decisions, e.g., whether economic conditions militate in favor of being fully invested.

The frequency and magnitude of these conflict of interest deposits are great. The bank regulators latest joint report Trust Assets of Insured Commercial Banks - 1977 10/ showed that as of December 31, 1977, $2.4 billion of trust department assets were held in demand deposits in the trustee bank. $526 million of that amount represented assets of employee benefit plans.

10/ Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, Trust Assets of Insured Commercial Banks - 1977, 5 (1978).

7. Valuation of Portfolio Securities

The SEC requires investment companies which hold a significant amount of short-term debt securities to value such securities with maturities over 60 days at market value rather than at amortized cost. As a result, mutual funds which wish to purchase such securities risk fluctuations in their net asset values per share that would place them at a competitive disadvantage against investment vehicles which need not value such securities at market.[11/] For this reason, a registered company can maintain a constant net asset value only by limiting the amount of portfolio securities with more than 60 days to maturity. Often, however, the longer term securities pay higher rates of interest.

The unregulated bank sponsored funds do not suffer from this restriction. Each of the fund prospectuses states that short-term securities are valued at cost rather than market. Thus these funds can purchase short-term debt securities without regard to possible consequence on net asset value of fluctuations in market price, thereby gaining a competitive advantage over registered funds.

8. Purchase of Certificates of Deposit

Anti-self dealing provisions of the 1940 Act prohibit an investment company from purchasing securities from its investment adviser. They also prohibit an investment

11/ Some mutual funds are attempting to persuade the SEC to permit valuation at amortized cost within certain specified limitations.

company from loaning money to or purchasing securities issued by its adviser.

The unregulated bank sponsored funds, however, are not inhibited by these proscriptions against self-dealing. Each of the fund prospectuses states that the bank is permitted to purchase for the fund's portfolio certificates of deposit issued by the bank. Since these are conflict of interest deposits, the funds may very well be receiving a lower rate of return than the rate they would receive if the banks were required to negotiate purchases of certificates of deposit from independent sources.

The frequency and magnitude of these conflict of interest deposits are significant. The bank regulators joint report on Trust Assets of Insured Commercial Banks - 1977 showed that, as of December 31, 1977, $8.6 billion of trust account assets were held in time deposits of the trustee banks. Nearly $2 billion of this amount represented employee benefit plan assets.[12]

9. Allocation of Brokerage Commissions

Some investment company advisers direct portfolio transactions to brokers on the basis of research services pro-

12/ Id. at footnote 10.

vided the investment company or its adviser. Any formal arrangements or understandings, however, are carefully limited so as to avoid serious issues as to whether the adviser has limited its freedom to obtain best execution.

The unregulated funds do not concern themselves with such issues. The five prospectuses with disclosure on this subject[13/] state that brokerage transactions are directed on the basis of best execution and also research received by the bank. Nevertheless, two banks have formal agreements with brokers to direct substantial amounts of brokerage commissions to them.[14/] In the case of Wells Fargo Bank, the amounts of commission subject to these agreements total over $2 million.

10. Reports to Participants

The 1940 Act requires registered investment companies to send their shareholders semi-annual and annual reports. The SEC has interpreted this provision to require that separate fund reports be furnished to each Keogh plan participant.

Only one of the bank sponsored fund prospectuses discloses that it sends reports to participants of plans. The other five banks state that they send annual reports only to employers.

13/ National Bank of Detroit did not close its policy on allocation of brokerage commissions.

14/ United Missouri Bank of Kansas City and Wells Fargo Bank, N.A.

American Security and Trust Company
Self-Employed Retirement Trust (SEC
File No. 2-51997; ID No. 47995)

Subject	Prospectus Disclosure (July 5, 1977)
1. Restrictions on Investment discretion	"Subject to this limitation (the prudent man rule), American Security is authorized to invest in every kind of property, real, personal and mixed, and every kind of investment."(p. 9)
2. Description of Investment Advisory Fee	"An annual fee of $50.00 per participating trust or 0.75% of the net value of such trust on December 31 of each year, whichever is the larger, will be charged by the Trustee. In addition, there are several other annual and incidental fees for specific functions, such as bookkeeping and distribution services. See "The Model Plan - Administration of Plans" for a description of fees."(p. 3)
3. Per Share Performance Data	None.
4. Valuation Date For Purchases	"American Security has established the last day of each calendar month as Valuation Dates."(p. 12)
5. Timely Payment of Distributions	"American Security has a reasonable period not to exceed ten business days following each Valuation Date to make the computations necessary to value the Units and to make payment for Units redeemed from a Fund."(p. 13)

Subject	Prospectus Disclosure
6. Investment of Cash	"American Security may ... retain in cash, without liability for interest, such portion of the assets as it deems reasonable, until such time as it selects investments of the type to which it expects to give principal considerations as suitable for purchase." (p. 10)
7. Valuation of Portfolio Securities	"Variable note commercial paper and United States Treasury securities are valued at cost." (p. 42)
8. Purchase of Certificates of Deposit	No policy disclosed.
9. Allocation of Brokerage Commissions	"Subject to obtaining the best price and execution, American Security may place a portion of both listed and over-the counter business with brokers who have provided statistical, wire, quote or research assistance to American Security. American Security has no agreement with any broker to allocate any such business." (p. 26)
10. Reports to Participants	No policy disclosed.

Continental Illinois National Bank
Self-Employed Retirement Plan and Trust
(SEC File No.2-54362; ID No.218570)

Subject	Prospectus Disclosure (May 31, 1978)
1. Restrictions on Investment Discretion	"Continental does not intend (i) to invest in securities for the purpose of obtaining control of management; (ii) to concentrate the investment of the assets of a Fund in securities of a single issuer (other than the United States Governement or its agencies and instrumentalities) or in securities of issuers in the same industry; (iii) to purchase for a Fund securities for which there is no established trading market; other than short-term securities, such as demand notes of major corporations; (iv) to purchase securities for a Fund on margin, except where necessary for the clearance of purchases and sales of securities; (v) to borrow money or pledge, mortgage or hypothecate any of the assets of a Fund; (vi) to underwrite securities of mutual funds; or (vii) to make short sales of securities on behalf of a Fund; (viii) to purchase the securities of mutual funds; or (ix) to purchase for a Fund commodities or commodities contracts. The Declaration of trust does not require Continental to observe these general investment policies and Continental may do any of the foregoing without amendment of the Declaration of Trust and without prior notice to Participants." (p. 15).
2. Description of Investment Advisory Fee	"Continental, as trustee of the CIRT, will charge against the assets of each Fund of the CIRT a fee, accrued and paid monthly, at the annual rate of one-half of one percent of its fair market value. In addition, each Fund will pay the expense of an annual audit of such Fund, and other expenses properly allocable to such Fund. The cost of such fee and expenses will be borne proportionately by each Unit issued by a Fund." (p. 4).

Subject	Prospectus Disclosure
3. Per Share Performance Data	Table similar to registered investment companies. (p.5)
4. Valuation Date For Purchases	"'Valuation Date' is a day as of which the CIRT is valued and coincides with the last day of each calendar month." (p. 8)
5. Timely Payment of Distributions	No Policy Disclosed.
6. Investment of Cash	Continental "has broad and exclusive powers ... to retain a reasonable portion of a Fund's assets in cash pending purchase of suitable investments or to provide necessary liquidity and to deposit such cash in any depository, including the banking department of Continental ...." (p.17)
7. Valuation of Portfolio Securities	"Short-term investments are stated at cost which approximates market."
8. Purchase of Certificates of Deposit	"Participants should be aware that applicable regulations require penalties on early redemption of certificates of deposit with a fixed term." (p.14)
9. Allocation of Brokerage Commissions	It will be the general practice of Continental to select brokers and dealers on the basis of their ability to provide the best execution on the purchase or sale of portfolio securities for a Fund of the CIRT. When executing securities transactions on which commissions are required to be paid to a broker or dealer, Continental may, in the allocation of such business, consider the brokerage and research services provided by competing brokers and dealers, but Continental has no agreement with any broker to allocate any such business. (p.16)
10. Reports to Participants	"Within 45 days of the close of each calendar quarter, the Trustee will mail to each Participant a statement of the number of Units in a Fund held for his Account, the fair market value of such Units, and the Participant's interest in savings accounts or certificates of deposit. Within 45 days after the close of each of the first three calendar quarters, the Trustee will also mail to

10. Reports to Participants Cont'd)	each Participant a quarterly unaudited financial report of the CIRT. Annually, within 90 days following the close of the calendar year, the Trustee will mail to each Participant annual audited financial statements of the CIRT together with a then current prospectus, if that prospectus contains material changes from the version last sent to the Participant." (p.13)

The First National Bank of Boston
Pooled Retirement Fund for H.R.
Plans (ID No. 327921 (Code 2))

Subject	Prospectus Disclosure (June 12, 1978)
1. Restrictions on Investment discretion	"The bank has broad discretion as to the manner in which the assets of the Trust Fund are invested, and is not specificall prohibited by the Declaration of Trust establishing the Trust Fund from concentrating Trust Fund assets in one issuer or one industry, purchasing securities on margin, making short sales, trading in commodities, purchasing the securities of new enterprises or engaging in various other investment practices set forth under "Investment of Trust Fund Assets". While utilization of such practices may involve a greater degree of investment risk, it is not anticipated that any of them will be engaged in to any significant extent. In investing the assets of the Trust Fund, the Bank is required by law to act prudently." (p. 3)
2. Description of Investment Advisory Fee	"The Bank is permitted to charge such reasonable fees for the performance of its duties as it may from time to time specify by advance notice to the Employer. Subject to its right to change the fee, the Bank at present imposes a trust charge at the rate of 1% per year on the first $5,000,000 of assets of the Trust Fund, .80 of 1% per year on the next $15,000,000 of assets of the Trust Fund, and .60 of 1% per year on any balance." (p. 15)
3. Per Share Performance Data	None.
4. Valuation Date For Purchases	"Funds contributed under the Plan will be held by the Bank in trust for the benefit of Participants, and will be placed in the Trust Fund on the next succeeding Valuation Date, which is a date not less frequent than quarterly selected by the Bank. Prior to investment in the Trust Fund, funds will not be invested or earn interest." (p. 3)

Subject	Prospectus Disclosure
5. Timely Payment of Distributions	No policy disclosed.
6. Investment of Cash	No policy disclosed.
7. Valuation of Portfolio Securities	"Variable demand notes and other money market obligations are carried at cost which approximates market value" (p. 26)
8. Purchase of Certificates of Deposit	No policy disclosed.
9. Allocation of Brokerage Commissions	"Where equally satisfactory execution at comparable commission rates at competitive levels can be obtained, transactions may be placed with brokers who have provided investment advice or investment assistance for the benefit of the entire Old Colony Trust Division of the bank." (p. 13)
10. Reports to Participants	"The Bank will provide quarterly reports to Administrators for distribution to Participants, showing the value of Participants' shares of the Trust Fund." (p. 16)

National Bank Of Detroit — NBD Retirement Plan For Self-Employed Individuals (SEC File No. 2-21954; ID No. 606689)

Subject	Prospectus Disclosure (May 1, 1978)
1. Restrictions on Investment Discretion	"The Trustee may invest and reinvest the Fixed Income Fund in bonds, notes, debentures, mortgages, preferred stocks (including bonds, debentures and preferred stocks convertible into common stock or other securities), lessors' interests in leases of either real or personal property, or both, contracts or other evidences of indebtedness, or other tangible or intangible property or interests in property, either real or personal, the income return from which is normally fixed or limited by the terms of the contract, document or instrument creating or evidencing such property or interests in property. The Trustee may invest and reinvest the Equity Fund in common stocks, and in rights, warrants, and options to acquire common stocks; provided, however, that obligations of the United States and short term obligations of corporate or other issuers may be purchased and held pending the selection and purchase of other suitable investments and reinvestments. However, the Trustee does not intend to invest the Equity Fund in options to acquire common stocks. The Equity Fund is invested in a selected group of stocks with the objective of maximizing total return through appreciation and income. The Trustee may invest and reinvest the Balanced Fund in assets which are suitable investments for the Fixed Income Fund and in assets which are suitable investments for the Equity Fund, in those proportions which the Trustee deems appropriate to achieve a balanced collective investment fund. The investment objective of the Balanced Fund is to provide a fixed return from Government and corporate bonds with a minimum of market fluctuation, together with dividend income and appreciation from stocks. At the present

Subject	Prospectus Disclosure
	time, it is anticipated that the Trustee will invest approximately 50% of the Balanced Fund in assets which are described above as suitable investments for the Equity Fund and approximately 50% in assets which are described above as suitable investments for the Fixed Income Fund, although the Trustee may at any time determine that the ratio of one type of asset to the other should be changed."(p. 8)
2. Description of Investment Advisory Fee	"The Declaration of Trust provides that the Trustee may charge to the Trust Fund the reasonable fees of the Trustee and the reasonable expenses of the Trustee, including the costs of services of agents, attorneys, appraisers, and auditors. Such charges shall be a lien upon the Trust Fund until paid. The Trustee is also permitted by the terms of the Declaration of Trust to charge additional sums by agreement with each Employing Unit to such Employing Unit. The present schedule of charges is as follows: A charge for management of the Trust Fund based upon 3/16 of 1 per cent of the market value of the Trust Fund as of each quarterly Valuation Date; the annual equivalent of this management charge is estimated to be approximately 3/4 of 1 per cent of the market value of the Trust Fund (based upon an average of the market value as of four Valuation Dates each year)."(p. 13)
3. Per Share Performance Data	"Similar to registered investment companies' tables"(p. 11)
4. Valuation Date For Purchases	"A "Valuation Date" is one of the dates upon which the Trust Fund is evaluated and the total value related to the number of units in the Trust Fund then in existance; under the Declaration of Trust, Valuation Dates occur on the last business days of March, June, September and December of each year and any other date selected by the Trustee.... The Trustee has determined that the last business day of April will be a Valuation Date until further notice."(p. 4)

Subject	Prospectus Disclosure
	"All income of a Pooled Fund shall be added to the principal of such Pooled Fund and invested and reinvested as a part thereof. Contributions delivered to the Trustee before a Valuation Date will be held in cash in a temporary suspense account until the next Valuation Date when they will be credited to the appropriate accounts in the Trust Fund for investment." (p. 30)
5. Timely Payment of Dis-butions	No policy disclosed.
6. Investment of Cash	"Pending the selection and purchase of suitable investments, and the payment of expenses or other anticipated distributions, the Trustee may retain in cash, without liability for interest, such portion of any Pooled Fund as it shall deem reasonable under the circumstances." (p. 9)
7. Valuation of Portfolio Securities	"Investments of the Balanced Fund are stated at market value determined by closing prices on national security changes, except for ... unlisted bonds and notes for which market value is determined by the Trustee on the basis of current telephone quotations from New York bond brokers." (p. 31)
8. Purchase of Certificates of Deposit	No policy disclosed.
9. Allocation of Brokerage Commissions	No policy disclosed.
10. Reports to Participants	"The Declaration of Trust requires the Trustee to render to each Employing Unit an annual written account of the Trustee's transactions relating to the Trust Fund." (p. 14)

United Missouri Bank Master Plan and Trust for Self-Employed Individuals. (SEC File No.2-54362; ID No.218570)

Subject	Prospectus Disclosure (Dec. 8, 1977)
1. Restrictions on Investment Discretion	"NOTWITHSTANDING THE RESPECTIVE INVESTMENT OBJECTIVES IN THE THREE SEPARATE FUNDS, UMB, AS TRUSTEE, HAS BROAD DISCRETION IN THE INVESTMENT OF THE ASSETS IN THE FUNDS, AND IS NOT PROHIBITED BY THE UNITED MISSOURI BANK MASTER PLAN AND TRUST FOR SELF-EMPLOYED INDIVIDUALS FROM CONCENTRATING THE ASSETS OF A FUND IN SECURITIES OF ONE ISSUER OR ONE INDUSTRY, PURCHASING SECURITIES ON MARGIN, MAKING SHORT SALES, TRADING IN COMMODITIES, PURCHASING THE SECURITIES OF NEW ENTERPRISES OR ENGAGING IN VARIOUS INVESTMENT PRACTICES WHICH ARE NOT SPECIFICALLY SET FORTH IN THIS PROSPECTUS." (p. 2)
2. Description of Investment Advisory Fee	"The plan provides that the following shal constitute charges under the Plan Trust and shall be paid by the Trustee out of the Plan Trust unless otherwise paid by the Employer: ... fees and other compensation of the Trustee for its services hereunder in amounts agreed upon from time to time by the Employer and the Trustee. *** At present, UMB charges an annual administrative fee of $65 per Plan plus an annual assets charge equal to .5 of 1% ($5 per $1,000) of the average fair market value of Plan Trust assets (cash values of insurance contracts are not considered assets for this purpose. All fees are subject to change. In the event the Trustee changes any of the fees, written notice of the effective date of any such change is given to the Employer prior to the effective date of such change Notice of fee changes is not given directl to each Participant." (p. 18)

Subject	Prospectus Disclosure
3. Sliding Scale Advisory Fee	None
3. Per Share Performance Data	Similar to tables of registered investment companies except only the audit fee is treated as an expense.
4. Valuation Date For Purchases	"The regular Valuation Date for each Plan is the last business day of the Plan year, which date corresponds to the last day of the sponsoring Employer's fiscal year. Additional Valuation Dates may occur throughout the Plan Year as necessary or desirable for administrative purposes, including the occurrence of a benefit distribution event and the allocation of voluntary contributions. Such additional Valuation Dates correspond to the last business day of a calendar month or of a fiscal quarter, depending upon the requirements of the particular Plan involved."
6. Timel[illegible] Payment on Distributions	No policy disclosed.
6. Investment [illegible] Cash	"The Plan gives the Bank "broad powers ... to maintain a portion of the assets of the Plan Trust in cash and unproductive income it may deem advisable or expedient...." (p. 23).
7. Valuation of Portfolio Securities	"Investments in United States Treasury Bills are valued at cost which approximates market" (p. 56)
8. Purchase of Certificates of Deposit	"The Plan may not purchase Certificates of Deposit issued by the Bank." (p. 21)
9. Allocation of Brokerage Commissions	"UMB may cause the Fund to pay a member of an exchange, broker or dealer an amount of commission for effecting a securities transaction in excess of the amount of commission another member of an exchange, broker or dealer would have charged for effecting that transaction, but only when UMB has determined in good faith that such amount of commission was reasonable in relation to the value of the brokerage and research services provided by such member, broker or dealer, viewed in terms either that particular transaction or UMB's overall responsibilities with respect to the accounts as to which it exercises investment discretion.

Subject	Prospectus Disclosure
	In addition to research services and information obtained in connection with specific brokerage transactions as described above, UMB currently has such commission agreements and/or understandings with Becker Securities Corporation in the annual amount of $19,500.00 in commissions, the Frank Russell Company in the annual amount of $10,000.00 in commissions, DeMarche Associates in the annual amount of $15,000.00 in commissions and Standard & Poor's Securities Corp. in the annual amount of $20,000.00 in commissions in consideration of providing statistical reports relative to the investment performance of various money managers and data on selected securities which are considered for purchase in these funds." (p. 20).
10. Reports to Participants	"Within sixty days after the close of each Plan Year the Trustee shall send to the Employer and to the Plan Administrator a written accounting of its administration of the Plan Trust for such Plan Year." (p. 27)

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Subject	Prospectus Disclosure (April 28, 1978)
1. Restrictions on Investment discretion	"The Declarations of Trust do not require Wells Fargo to observe the foregoing investment restrictions and Wells Fargo may do any of the foregoing without amendment of the Declarations of Trust and without prior notice to Participants except as prohibited by law or governmental regulation." (p. 18)
2. Description of Investment Advisory Fee	"Investment Management Fees. Wells Fargo charges each Investment Fund in which Keogh Plan contributions are invested a fee at the following annual rates and such rates may be increased without prior notice to Participants: Equity Securities Fund - 1% of fair market value of fund assets.* Fixed Income Fund - 1% of fair market value of fund assets.* Real Estate Equity Fund - 1.2% of appraised value of real estate assets and 1/2 of 1% of market value of securities.**" (p. 7)
3. Per Share Performance Data	Similar to tables of registered investment companies (pp. 10-12)
4. Valuation Date For Purchases	"The Regular Valuation Date for each Fund is the close of business on the last business day of each month and the investment date is the next succeeding business day. The Trustee may choose more frequent Valuation Dates in its discretion." (p. 13). "The Trustee has the use, interest-free, of contributions made each month prior to a regular Valuation Date." (p. 13) .

Subject	Prospectus Disclosure
5. Timely Payment of Distributions	No policy disclosed.
6. Investment of Cash	"Occasionally funds may be temporarily held uninvested awaiting investment or distribution."(p. 16 and p. 17).
7. Valuation of Portfolio Securities	"Short-term securities are valued at cost which is considered to be fair value under current market conditions."(p. 66)
8. Purchase of Certificates of Deposit	"There are individual certificates of deposit issued by Wells Fargo for the accounts of Participants who direct investment of their accounts or a portion thereof in certificates of deposit." (p. 6).
9. Allocation of Brokerage Commissions	"When executing securities transactions on which commissions are required to be paid to a broker, Wells Fargo may, in the allocation of such business, consider the research services provided by competing brokers. In 1977 Wells Fargo had agreements or understandings (mostly verbal) with 85 brokerage firms to allocate to them sufficient business from the Trust Division to generate approximately $2,413,000 of commissions annually in consideration of research and statistical reports. Similar arrangements are being entered into during 1978."(p. 15).
10. Reports to Participants	"Reports will be sent annually to Employers showing the value of the account of each Participant and the amount of contributions made on his behalf or by him."(p. 29)

Subject	Prospectus Disclosure
	In addition to research services and information obtained in connection with specific brokerage transactions as described above, UMB currently has such commission agreements and/or understandings with Becker Securities Corporation in the annual amount of $19,500.00 in commissions, the Frank Russell Company in the annual amount of $10,000.00 in commissions, DeMarche Associates in the annual amount of $15,000.00 in commissions and Standard & Poor's Securities Corp. in the annual amount of $20,000.00 in commissions in consideration of providing statistical reports relative to the investment performance of various money managers and data on selected securities which are considered for purchase in these funds." (p. 20).
10. Reports to Participants	"Within sixty days after the close of each Plan Year the Trustee shall send to the Employer and to the Plan Administrator a written accounting of its administration of the Plan Trust for such Plan Year." (p. 27)